

**A Comparison of Key Aspects of the
International Tax Systems of Major OECD and
Developing Countries**

**Prepared for
Business Roundtable**

May 10, 2010

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Executive Summary

This report, prepared by PricewaterhouseCoopers LLP for Business Roundtable, examines significant features of the international tax systems of 10 member countries within the Organization for Economic Co-operation and Development (OECD) and of four large developing countries. The 14 countries are referred to as the "study countries" in this report.

The 10 OECD countries selected for inclusion in the report are Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Spain, Switzerland, and the United Kingdom. These countries have large domestic economies and are major headquarter locations for multinational corporations. The developing countries selected are Brazil, Russia, India, and China (the so-called "BRIC countries"). These countries have large domestic economies relative to other developing nations and are viewed with growing importance as part of the world economy. These 14 countries and the United States include the 10 largest countries in the world ranked by gross domestic product and outward foreign direct investment in 2008.

Based on our review of the tax laws in the 14 study countries as of 2009, the following conclusions can be drawn:

- Each of the 10 OECD study countries and one of the four BRIC countries (Russia) operate territorial systems that provide tax exemption (either whole or partial) for dividends received from foreign subsidiaries.
- Among the three countries that generally impose tax on foreign source dividends (Brazil, India, and China), a foreign tax credit is available for taxes paid directly by the parent on such income. China also provides a foreign tax credit on taxes paid indirectly with respect to foreign subsidiary dividends, and India allows a credit where provided under treaty. The indirect foreign tax credit for both China and India is not reduced by reference to low-tax foreign subsidiaries that do not remit income to the parent.
- No study country (other than Brazil) has specific rules that seek to limit the deductibility of expenses that indirectly relate to foreign source income nor requires such expenses to be allocated to foreign source income. In this respect, rules that seek to limit deductions equally apply in respect of domestically sourced income. Several countries that operate a foreign dividend exemption system (e.g., France and Germany) only provide for a 95% exemption.¹ The remaining 5% of the dividend is added back to taxable income as a proxy for denied deductions. However, in these cases, there are no criteria that require expenses to be allocated and in years where foreign source dividends are not paid, all expenses that are deductible under general domestic legislation remain deductible.²
- Study countries (except for Japan and China) allow a foreign subsidiary to generate at least some interest income from financing activities and royalty income from IP ownership without taxing such income on a current-year basis.³

¹ In the case of France, the exemption can exceed 95% as discussed later in the report.

² Apart from Brazil, there is no differentiation in the study countries between expenses incurred to generate foreign or domestic income. Expenses are either deductible or not regardless of whether they are incurred to generate domestic or foreign source income (including exempt foreign dividend income).

³ Japan includes such income under its CFC rules when it is taxed by the foreign country at a rate of less than 25% (some exceptions apply as discussed later in this report). Japan has proposed lowering the applicable foreign rate to 20% beginning in 2010.

- All countries examined (other than Germany) use tax-related incentives to encourage domestic research and development. Often a range of different incentive measures are provided.
- Several countries have adopted regimes that preferentially tax qualifying income from intellectual property.

1. Introduction and Scope

Business Roundtable engaged PricewaterhouseCoopers LLP to examine significant features of the international tax systems of 10 member countries within the Organization for Economic Co-operation and Development (OECD) and of four large developing countries. The 14 countries are referred to as the "study countries" in this report.

The 10 OECD countries selected for inclusion in the report are Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Spain, Switzerland, and the United Kingdom. These countries have large domestic economies and are major headquarter locations for multinational corporations. The developing countries selected are Brazil, Russia, India, and China (the so-called "BRIC countries"). These countries have large domestic economies relative to other developing nations and are viewed with growing importance as part of the world economy. These 14 countries and the United States include the 10 largest countries in the world ranked by gross domestic product and outward foreign direct investment in 2008.

This report examines the general application of each country's international tax rules, and tax incentives for research and development (R&D) as they apply in 2009.⁴ In particular, the report considers the following key aspects of the tax systems in the study countries:

- The tax treatment of dividend income received from foreign subsidiaries;
- The extent of restrictions (if any) on the deductibility of indirect costs associated with the generation of foreign source income and whether domestic expenses need to be allocated against foreign income;
- The existence and extent of any legislation designed to tax income generated by offshore subsidiaries owned by corporations resident in the study countries under so-called controlled foreign corporation (CFC) rules, which tax such income on a current basis;
- Any limitations on the ability to claim foreign tax credits on dividends received from foreign subsidiaries;
- The existence of any tax incentives aimed at encouraging R&D; and
- The existence of any "patent box" regime designed to encourage the development and holding of intellectual property through the provision of certain incentives (e.g., preferentially taxed royalty income).

⁴ As a general review, this report may not describe all conditions and exceptions to the general rules of each country. This report does not consider tax rules applicable to individuals or other investment vehicles such as partnerships or trusts. The application of the rules considered in this report may differ for non-corporate entities.

Throughout this report, the term "foreign subsidiary" refers to a company that has its tax residence in a country that is different from the residence country of some or all of its owners. The term "parent company" refers to a company that owns shares or some form of equity interest in another company, but not necessarily a controlling interest in that company.

2. Basic Concepts of Taxing Foreign Source Income

Foreign source income refers to income that is deemed to be generated from activities conducted in a foreign jurisdiction.

2.1 *Worldwide versus territorial taxation systems*

Since foreign income is generally taxed under local laws in the foreign country in which the income arises, the home country of a multinational corporation generally seeks to avoid double taxation of the foreign income by either providing a tax credit for foreign income taxes paid or exempting such income from home country taxation.

Countries frequently are described as having either a worldwide or territorial system with respect to foreign income of their resident companies. Under a worldwide approach, a country taxes resident corporations on all their income whether generated from domestic sources or from overseas activities. Under a territorial system, a country taxes its resident corporations only on income generated from activities within the country, and income generated by foreign subsidiaries generally is not taxed in the parent company's jurisdiction of residence whether or not repatriated.

Generally, worldwide taxing jurisdictions provide tax credits for foreign income taxes, while territorial countries providing an exemption for foreign source dividends will not provide a foreign tax credit on such income.

Most countries do not follow "pure" worldwide or territorial approaches to taxing foreign income. The United States, for example, is considered to follow a worldwide approach, but generally does not tax income of foreign subsidiaries until repatriated. This is referred to as a "deferral" regime, under which tax is deferred until the income is repatriated to the parent company's jurisdiction.

As described in section 3, many countries with worldwide or territorial systems have versions of CFC rules that generally seek to tax the parent corporation on a current basis in relation to passive income earned by foreign subsidiaries. These CFC rules are designed to protect the tax base of the parent corporation's country while not interfering with offshore investment in active business activities. Members of the European Union generally do not seek to apply their CFC rules to foreign subsidiaries located in another European Union country.

Even though most countries do not adopt a pure worldwide or pure territorial approach, countries can be classified as having an approach that is either more territorial or more worldwide in nature. For the purposes of this report, we have sought to classify as territorial those countries that have as a feature of their domestic law an exemption (of at least 95%) for dividends paid from foreign subsidiaries (subject to certain criteria discussed below).⁵ As outlined below, all OECD study countries have systems that are more territorial in nature. Among the BRIC countries, Russia follows a territorial approach; Brazil, India and China follow a worldwide approach.

⁵ Countries classified as territorial in this report may tax foreign branch income and certain foreign income other than dividends.

2.2 Overview of foreign source income

Corporations generate income from a range of activities and sources. Broadly, income can be classified as *active* or *passive*.

Active income normally arises from the primary business activity of the company and involves more than investing in an asset that generates a return. It often involves a continuous process of designing, producing and selling a good or service to ultimate customers, whether related or unrelated to the company.

Passive income normally is generated by the corporation through acquiring and holding the asset with no additional activity, again regardless of whether the income is received from a related or unrelated party. While the precise definition of passive income differs between countries, interest income, royalty payments from owning intellectual property, dividends from holding shares, and rental income often are classified as passive income.⁶ Capital gains realized from the sale of assets that generate passive income (e.g., shares, loans, intellectual property, or buildings) may be considered passive income.

3. Study Country Tax Comparisons

3.1 Taxation of dividends from foreign subsidiaries and the deductibility of expenses to generate that income

3.1.1 Tax treatment of dividend income received from foreign subsidiaries

Foreign source income may arise when profits from the activities of a foreign subsidiary are repatriated to the parent through the payment of a dividend. Several key issues arise in relation to the receipt of such dividends:

- Are such dividends taxed in the hands of the parent corporation by its country of residence?
- If there is an exemption, is it a complete or partial exemption?
- What criteria must be met to qualify for the exemption?
- Are the parent's domestic expenses deductible in the parent company's home country when they indirectly relate to foreign subsidiary income?

A summary of these issues is outlined in **Table 1**, below, for each of the study countries.

OECD countries

Each OECD study country offers a total or near total exemption from tax for dividends received from foreign subsidiaries. Five of the OECD study countries -- Canada, the Netherlands, Spain, Switzerland, and the United Kingdom -- allow a 100% exemption for foreign source dividends provided certain criteria, discussed below, are satisfied. The other five OECD study countries -- Belgium,

⁶ A determination of the existence of passive income may depend on the business activities of a particular corporation. For example, rental income for a company that builds, owns, and operates shopping centers normally would not be passive income. Furthermore, interest income generated by a bank would not be considered passive as such entities are in the business of borrowing and lending money.

France,⁷ Germany, Italy, and Japan -- provide an exemption for effectively 95% of the dividend. In this latter group, this exemption takes the form of either (1) an actual 95% exemption or (2) a 100% exemption but with 5% of the dividend being added back as a proxy for non-deductible expenses.

Both the United Kingdom and Japan shifted in 2009 from regimes that taxed foreign source dividends to territorial systems that provide for such dividends to be exempt (subject to certain criteria).

Many OECD study countries require certain criteria to be satisfied in order for foreign source dividends to qualify for exemption. While a detailed description of the differing requirements for an exemption in each jurisdiction is beyond the scope of this report, three principal criteria are used by most OECD study countries:⁸

- The parent company must hold a minimum ownership in the shares of the foreign subsidiary paying the dividend (usually between 5% and 25%),⁹ but not necessarily a controlling interest.
- The parent company must hold its ownership interest in the foreign subsidiary for a minimum period of time, generally between six months (e.g., Japan) and 12 months (e.g., Spain).¹⁰ Some countries, such as Spain and Belgium, allow a dividend received before the expiration of the holding period to still be eligible for the exemption, provided that the remaining portion of the holding period is satisfied after the dividend is paid.¹¹
- The foreign subsidiary paying the dividend either must not be in a jurisdiction that is considered a "tax haven" under the domestic laws of the parent country or else must be subject to an effective tax rate at least equal to a specified level. Italy, Belgium,¹² and Spain require that the dividend not be paid from a tax haven (treaty countries as well as other countries that have systems of corporate taxation generally are not considered tax havens for this purpose); Italy and Belgium allow an exception if a tax ruling is obtained. The Netherlands requires the paying subsidiary to be taxed at least at the rate of 10% on its income or that at least 50% of the subsidiary's assets consist of active assets or non-portfolio investments. Canada requires that the active business income giving rise to the dividend be earned in either a treaty country or a country with which Canada has a tax information exchange agreement.¹³

Of these three criteria outlined above, the last one appears to be the least often required by the 10 OECD study countries and generally has a relatively narrow application.

⁷ The French tax system provides for a greater than 95% exemption for foreign source dividends of certain qualifying holding companies. However, in all cases, the dividend exemption should, from a practical perspective, amount to less than 100%.

⁸ The exception to these general criteria is the United Kingdom. Generally, foreign source dividend will be exempt from tax in the United Kingdom where it is paid in respect of non-redeemable shares regardless of ownership proportions.

⁹ Most countries appear to have a lower threshold such as 5% (e.g., Netherlands, Spain) or 15% (e.g., Germany for trade tax purposes; for corporate tax purposes Germany has no ownership requirement).

¹⁰ France is a notable outlier requiring a 24-month holding period.

¹¹ The OECD study countries that are members of the European Union also allow a dividend to be paid before the qualification period has elapsed provided the remaining portion of the period is satisfied after the dividend is paid where the subsidiary paying the dividend is another European Union country.

¹² Belgium usually considers a foreign subsidiary with an effective tax rate of 15% or more to be acceptable; as noted above for European Union countries, activities conducted in any European Union subsidiary are also generally satisfactory regardless of the effective tax rate.

¹³ France is currently considering legislation that, if enacted, would modify the French dividend exemption and French CFC rules in relation to non-cooperative countries (i.e., certain tax havens).

In general, foreign dividends sourced from active or passive income are not treated differently for purposes of qualifying for exemption (Canada is the only country to require the dividend be sourced from active income of the paying subsidiary). Germany requires the dividend be paid from active income for the dividend to be exempt from German trade tax but not for exemption from federal corporate tax. The general extension of tax exemption for dividends paid from passive income may be indirectly limited in several of the OECD countries with CFC rules (discussed further below) that tax certain types or quantities of passive income on a current-year basis.

Non-OECD countries

Of the four major developing countries examined, Russia provides a 100% dividend exemption, applying criteria similar to rules discussed above for the OECD study countries.¹⁴

Brazil, India and China tax dividends received from foreign subsidiaries, with a foreign tax credit available. The foreign tax credit rules in Brazil, India and China are described in more detail in section 3.3.

3.1.2 *The extent of restrictions (if any) on the deductibility of costs indirectly associated with foreign source dividend income and whether domestic expenses need to be allocated against foreign income.*

This section examines how the study countries treat costs such as interest, stewardship and R&D indirectly associated with foreign source income (including exempt foreign dividend income).¹⁵

The U.S. tax system requires that indirect costs such as interest, stewardship costs, and R&D be apportioned between domestic source and foreign source income.¹⁶

All study countries (other than Brazil) generally allow a domestic tax deduction for expenses that indirectly are associated with foreign source dividend income. Brazil may deny a deduction for such expenses where they generate income for a foreign subsidiary.

No OECD study country requires its resident companies to allocate or defer indirect expenses incurred to generate foreign dividend income. Five of the OECD study countries -- Belgium, France, Germany, Italy, and Japan -- provide an exemption for effectively 95% of the dividend rather than 100%.¹⁷ The 5% of the dividend that is not exempt is either treated as not exempt or added back as a proxy for non-

¹⁴ In order to qualify for the dividend exemption in Russia the following criteria must be met: a 50% minimum ownership, RUB 500 million acquisition cost of the investment, 1-year holding period, and the dividend cannot be paid from a tax haven.

¹⁵ Each study country (and all countries that levy income tax) has rules that identify if an expense is tax deductible, the timing of the deduction, and whether there are any limits on a deduction. Many countries also have transfer pricing rules that, broadly, limit the deductibility of costs charged by a related party to those that would be charged by an unrelated party acting on arm's length terms. These limitations on deductibility apply to costs incurred to generate domestic as well as foreign source income, and hence are not the focus of this section. For example, while the Netherlands does not permit costs incurred in acquiring or disposing of shares in a company to be deducted for tax purposes, this limitation applies to the acquisition of both foreign and domestic shares. Similarly, rules in Switzerland that allocate interest expense against dividends qualifying for the participation exemption apply to both domestic and foreign source income.

¹⁶ The U.S. tax system (and some other tax systems) requires that direct costs incurred in providing services to a foreign subsidiary be charged out to the foreign subsidiary.

¹⁷ Switzerland may also reduce the effective participation exemption by up to 5% as a proxy for general and administrative expenses.

deductible expense. In this respect, the "add back" may operate as a substitute for denying deductibility of domestic expenses incurred to generate exempt foreign dividend income. However, there is no specific limitation (other than the normal rules that apply to domestic expenses) on the deductibility of actual individual indirect costs incurred by the parent in generating the income.¹⁸ Further, in a year when no dividend is paid, there is no add back in these countries and the parent is permitted to deduct all indirect costs incurred in relation to their foreign subsidiaries without limitation.

In France, the 5% added back as a proxy for non-deductible costs cannot exceed, as a matter of law for each taxable period, the total amount of actual costs incurred by the French parent. This can lead to a potentially higher proportion of the dividend being exempt from tax although it cannot as a practical matter lead to 100% of the dividend being exempt.

As the tax law in Russia is continuing to develop in this area, no clear guidance is available on the deductibility of indirect expenses incurred to generate exempt or foreign source income. However, no specific or broad denial of deductibility of costs appears to currently exist.

India and China, which tax foreign income on a worldwide basis, allow such costs to be deductible like any other domestic expense incurred by the company. Such expenses are deductible subject to generally applicable domestic laws in China and India, and neither country allocates the expenses to the foreign source dividend or defers a deduction for the expense until the foreign income is repatriated.

3.2 CFC and other "anti-avoidance rules"

Many countries have implemented rules aimed at taxing a parent company on a current-year basis where the foreign subsidiary generates profits from certain activities (normally, passive activities). These rules seek to tax the parent company without regard to whether the income of the foreign subsidiary is repatriated back to the parent company. The most commonly implemented form of this rule is referred to as "CFC" rules.¹⁹

3.2.1 Which countries operate a CFC regime?

In general, CFC rules apply if the parent company has a specified level of control over the foreign subsidiary. Control normally is defined as a substantial portion of the shares in the foreign subsidiary, not necessarily a majority stake in the foreign subsidiary in its own right (i.e., a 50.1% interest may not be necessary for a CFC to exist).²⁰

Some jurisdictions apply their CFC rules only if the foreign subsidiary is located in a country considered to be a tax haven or is in a foreign country where the tax rate is below a specified threshold. Members of the European Union generally do not seek to apply their CFC rules to foreign subsidiaries located in

¹⁸ For example, the Swiss participation exemption applies in the same manner to domestic and foreign holdings. In both cases, financing costs may reduce the effective participation exemption.

¹⁹ Several countries also have attribution rules that apply to foreign investments that do not constitute CFCs due to a lack of control. Consideration of these rules is outside the scope of this report.

²⁰ Some jurisdictions apply CFC rules dependent on whether a certain number of resident taxpayers (even unrelated taxpayers) hold a sufficient combined interest in the foreign company so as to be in control of the company (e.g., Canada considers whether five unrelated Canadian taxpayers control the foreign subsidiary).

another European Union country. This is because such an application would violate the European Union principles of freedom of establishment and movement of capital.²¹

The study countries that apply their CFC rules when the tax rate is below a specified threshold include France (where the tax is at least 50% lower than the French tax otherwise payable), Germany (less than 25% tax rate), Japan (25% or less tax rate),²² the Netherlands (less than 10% tax rate), Spain (where the tax is less than 75% of the Spanish tax otherwise payable), and the United Kingdom (where the tax is less than 75% of the U.K. tax otherwise payable). However, even where the effective tax rate thresholds are not reached, most of these countries seek to tax on a current-year basis only specific types of income generated by foreign subsidiaries (discussed below). As outlined in **Table 2** below, of the 14 study countries, four (Belgium, Switzerland, Russia, and India) do not have CFC rules. Parent companies in those four countries are not subject to tax on an annual basis on unremitted income earned by their foreign subsidiaries. Additionally, in the case of Belgium, Switzerland, and Russia, this income generally will not be subject to tax when repatriated due to the existence of the dividend exemption provided certain criteria for the exemption are satisfied as discussed above.²³

Italy has recently revised its CFC rules and will seek to apply them where the following conditions are met: (1) the foreign company is actually subject to taxation that is less than 50% of the tax that would have been paid if the company was a resident of Italy; and (2) more than 50% of the income of the foreign company consists of passive income.²⁴

While not classified as CFC rules under domestic law, the "mark-to-market" regime in the Netherlands may have an effect similar to the CFC regimes of other countries. A Dutch parent is taxed on its income or loss as a result of the compulsory revaluation of the foreign subsidiary to fair market value if the subsidiary is subject to an effective tax rate of less than 10% (calculated based on Dutch tax law principles), the subsidiary's assets are 90% or more passive holdings,²⁵ the Dutch parent owns at least 25% of the subsidiary, and the holding does not qualify as a real estate investment.

3.2.2 Do countries with CFC rules prevent all offshore financing or IP activities?

As indicated in **Table 2**, below, nine of the 10 study countries (all but Japan) that have CFC regimes allow a foreign subsidiary to generate at least some interest income from financing activities and royalty income from intellectual property (IP) ownership without triggering CFC rules.²⁶ This is not to suggest that a company in each OECD study country could establish a foreign subsidiary generating financing or IP related income in any foreign country. However, it is possible to establish a foreign subsidiary generating financing or IP related income in at least a few foreign jurisdictions without having a current year income inclusion in the jurisdiction in which the parent company resides.

As noted in the prior section, broad exceptions in many cases permit offshore finance and IP activities. Specifically, all European Union study countries allow for financing subsidiaries and IP companies to

²¹ CFC provisions may apply to a foreign subsidiary in another European Union country if there is a substantial lack of substance in that country.

²² Japan has proposed lowering the rate of foreign tax for these purposes from 25% to 20% effective in 2010.

²³ While Russia does not have CFC rules at the time of preparation of this report, the Russian government is considering implementing such rules.

²⁴ Even if these criteria are satisfied, an Italian parent company can avoid a current-year income inclusion where it is established (by way of a ruling with the tax authorities) that the foreign subsidiary was not established for an artificial purpose aimed at achieving tax advantages.

²⁵ Passive holdings are defined as "free portfolio investments," which include foreign subsidiaries primarily engaged in cash holdings, inter-group receivables, or leasing to related parties.

²⁶ See potential exceptions for Japan described below.

operate in other European Union countries without their respective CFC rules applying provided that the structure is not a wholly artificial arrangement and the foreign subsidiary has the requisite level of substance.²⁷

Other criteria that allow such foreign financing or royalty income not to be taxed under the CFC rules vary between countries. As noted in the prior section, some jurisdictions exempt such income if the CFC's effective tax rate is above a certain threshold. Other countries provide that such income is not taxable if it does not represent more than a certain percentage of the foreign subsidiary's total income (e.g., France allows a combined total of 20% passive income such as interest and royalty income). Another case in which CFC rules exempt such income is where the CFC generates interest or royalty income through transactions primarily with unrelated parties. The United Kingdom and Germany, for example, use a combination of some of these exemption criteria. Germany excludes interest and royalty income from its CFC regime if (1) in the case of interest income, the capital has been derived from foreign capital markets and is lent to businesses with active income and, in the case of royalties, the IP has been self created without support of an affiliated company or (2) the interest or royalty income is taxed at a specified minimum rate in the foreign country (25%).

Japan treats a foreign subsidiary's interest and royalty income as subject to its CFC regime, unless the foreign subsidiary is subject to an income tax rate of 25% on such income,²⁸ or if the foreign subsidiary satisfies one of the active business exceptions from the CFC rules (e.g., the foreign subsidiary operates a wholesale, banking, securities, insurance, ship or aircraft business in which more than 50% of the operating revenue is generated from activities with unrelated parties). However, these active business criteria often make it practically difficult to have substantive financing or IP activities carried on in foreign subsidiaries of Japanese parent companies.

As noted, the four remaining study countries in the report -- Belgium, Switzerland, Russia, and India -- do not apply CFC rules.

3.2.3 Do countries operating a CFC regime seek to tax dividends, interests or royalties paid to the foreign subsidiary from "active" business income of a related party?

Table 2 reports whether CFC regimes apply to interest, dividends, and royalties paid from active income of a related foreign entity. Among the countries with CFC regimes, Canada, Spain, and Brazil do not tax any portion of dividends, interests, or royalties paid from active income of a foreign subsidiary and Germany does not tax dividend income paid from active income of a related party.

The remaining study countries that have CFC rules -- France, Italy, Japan, the Netherlands (in reference to the mark-to market regime), the United Kingdom, and China -- do not provide a general exemption for passive income received by a CFC paid from active business income of a related entity. However, this lack of a general exemption does not necessarily mean that such income is taxable in the parent company's hands on an annual basis. Such income must still satisfy the criteria for attribution under the relevant CFC rules discussed above. In particular, some countries will not tax such income provided that it does not exceed more than a certain proportion of total income of the CFC.

²⁷ This is due to the existence of the European Union fundamental freedom of establishment and movement of capital that, broadly, is designed to eliminate detrimental tax treatment between the country of a parent company and the county of a subsidiary company where both reside in the European Union.

²⁸ Japan has proposed lowering the rate of foreign tax for these purposes from 25% to 20% effective in 2010.

3.3 Limitations on the ability to claim foreign tax credits on dividends received from foreign subsidiaries

As discussed above, all of the OECD study countries and Russia provide some form of exemption from tax for certain qualifying foreign source dividends. If an exemption applies, no foreign tax credit generally is allowed. Dividends that do not satisfy the criteria to qualify for an exemption from tax usually may benefit from a foreign tax credit, subject to certain conditions.

Brazil, India and China, which tax foreign source dividends, generally provide a foreign tax credit on taxes paid directly with respect to a dividend from a foreign subsidiary. China also provides a foreign tax credit on taxes paid indirectly with respect to foreign subsidiary dividends, and India allows a credit where provided under treaty. Brazil generally does not allow a foreign tax credit on taxes paid indirectly with respect to a dividend from a foreign subsidiary.

Brazil, India and China limit the foreign tax credit to the lesser of foreign tax paid or local tax payable. For India and China, this limitation is generally calculated on a per country basis, while Brazil applies the limit on the specific dividend. The indirect foreign tax credit for both China and India is not reduced by reference to low-tax foreign subsidiaries that do not remit income to the parent. Any unused foreign tax credit may be carried forward for five years in China. Foreign tax credits may not be carried forward or back in India. The foreign tax credit for direct taxes may be carried forward indefinitely in Brazil.

3.4 The existence of any tax incentives aimed at encouraging R&D

As outlined in **Table 3**, below, while the type of tax incentive to encourage R&D varies among countries, there are some common themes.

OECD Countries

A tax credit (sometimes refundable) is provided in Belgium, Canada, France, Italy, Japan, and Spain. Depending in part on the type of R&D being undertaken, the amount of the credit ranges from 5% in Japan to 42% in Spain. Spain, Canada, France, and Italy all offer credits in excess of 20%.

Some countries, including Canada, France, Japan, Spain and the United Kingdom, have an accelerated depreciation deduction for assets used in undertaking R&D. Canada and the United Kingdom allow a write-off in the year the equipment for R&D is acquired.²⁹

Incentives offered in other jurisdictions include exemptions from remitting withholding taxes (e.g., Belgium); special tax treatment for temporary researchers; special tax deductions for wages paid to research staff (e.g., Japan and Spain), reduced wage tax and social security contributions with respect to R&D employees (e.g., the Netherlands), reduced tax rates or tax holidays (e.g., Switzerland); cash tax refunds from the government where R&D tax losses are forgone by election (e.g., the United Kingdom); or deductions that represent more than the costs incurred in undertaking the R&D (e.g., the United Kingdom offers a deduction between 130% and 175% of costs incurred to undertake R&D). Japan and Italy each have special incentives aimed at encouraging R&D undertaken through joint ventures and small and medium sized companies.

While expenses incurred for R&D in Germany generally are deductible for tax purposes, no specific rules or incentive regime exists.

²⁹ In Canada's case, the equipment must also be utilized in the R&D activity in that year, and the deduction may also be taken in a future tax year.

Belgium, Canada, France, Italy, Japan, Spain, and the United Kingdom each have multiple R&D incentives.

Non-OECD Countries

As outlined in **Table 4**, below, none of the developing countries examined offer credits for qualified R&D activities. However, various other tax incentives are offered, and each of the four countries has multiple incentive provisions.

Brazil, Russia, and China offer an accelerated depreciation deduction for assets used in undertaking R&D. Other incentives provided include exemptions from certain import and withholding taxes on payments to foreign licensors (e.g., Brazil); special tax deductions for wages paid to staff (e.g., Brazil); reduced tax rates or possible tax holidays (e.g., China); or deductions for payments to universities (e.g., India allows a 125% deduction for payments to specific universities).

Russia, India, and China offer deductions representing more than the costs incurred in undertaking certain expenditures for R&D.

3.5 Special tax rules to encourage the development and holding of intellectual property through incentives (e.g., preferentially taxed royalty income)

As outlined in **Table 5**, below, study countries effectively have special regimes for the taxation of royalty income (often referred to as "patent box" regimes) -- Belgium, France, the Netherlands, Spain, Switzerland, and China. In essence, these regimes seek to tax certain qualified income at a preferential tax rate. Table 5 includes the patent box regimes of Ireland and Luxembourg for comparative purposes. It should be noted that some of the countries (e.g., Ireland, the Netherlands, and Spain) have caps on the amount of royalty income from a specific item of IP that can qualify for the patent box regime. The Netherlands cap will be eliminated beginning January 1, 2010.

Of the countries listed in the table with preferential regimes, Ireland applies a zero rate of tax (subject to the income cap discussed above with other amounts of IP income being subject to a 12.5% tax rate) and Switzerland applies rates between zero and 12% depending on what is negotiated as part of the tax ruling process. The remaining countries apply varying tax rates (generally below 10%), with France and Spain applying the highest rate of 15%.

While the types of IP that qualify for preferential tax treatment vary, patents are consistently treated as qualifying IP in the countries examined. Ireland, Luxembourg, Spain, and Switzerland have expanded lists of qualifying IP, including designs, copyrights, models, and certain types of information. China's regime also extends beyond patents to include certain forms of commercial "know-how."

Of the countries listed in the table, only the Netherlands and Spain limit their patent box regimes to qualifying IP developed by the corporation. Subject to conditions in some countries, the remaining jurisdictions allow royalty income from acquired IP also to qualify for lower rates of tax.

Except for Belgium, the preferential IP regimes of the countries generally allow most expenses to reduce the amount of taxable royalty income received by a corporation that is tax resident in their respective jurisdiction. The Belgian regime prevents license fees and amortization of costs related to acquired IP from being used to further reduce the amount of qualifying royalty income subject to the reduced tax rate. However, these costs continue to be allowed as deductions to reduce other income of the Belgium subsidiary from Belgian corporate tax.

Most patent box regimes have been adopted only recently. With the exception of Ireland, which adopted its first patent box regime in 1973, the remaining jurisdictions implemented their rules in either

2007 or 2008. While Ireland has had a regime for many years, the rules were recently updated in 2009 to remain competitive with the recent regime introductions in other European countries.

A final point to note is that the U.K. government announced on December 9, 2009 its intention to introduce a patent box regime effective in 2013.

Table 1: Tax treatment of Foreign Source Dividends, 2009

Foreign Affiliate Dividends			
	Are dividends received from foreign affiliates exempt?¹	Percentage of exemption	Are indirect domestic expenses related to foreign income (including exempt foreign dividend income) deductible?²
Belgium	Yes	95%	Yes
Canada	Yes	100%	Yes
France	Yes	At least 95% ³	Yes
Germany	Yes	95%	Yes
Italy	Yes	95%	Yes
Japan	Yes	95%	Yes
Netherlands	Yes	100%	Yes
Spain	Yes	100%	Yes
Switzerland	Yes	100% ⁴	Yes
United Kingdom	Yes	100%	Yes
Brazil⁵	No	N/A	Generally no
Russia	Yes	100%	Yes
India	No	N/A	Yes
China	No	N/A	Yes

Note: N/A indicates not applicable because no exemption applies.

Source: PricewaterhouseCoopers analysis.

¹ Each jurisdiction that provides an exemption for dividends from foreign affiliates specifies its criteria that must be met in order to exempt the dividend.

² Five of the OECD study countries -- Belgium, France, Germany, Italy, and Japan -- provide an exemption for effectively 95% of the dividend. The 5% of the dividend that is not exempt is either treated as not exempt or added back as a proxy for non-deductible expense. In this respect, the 5% may operate as a substitute for denying deductibility of domestic expenses incurred to generate exempt foreign dividend income. However, there is no specific limitation (other than the normal rules that apply to domestic expenses) on the deductibility of actual individual indirect costs incurred by the parent in generating the income (see discussion in the report above).

³ In France, the 5% added back as a proxy for non-deductible costs (including tax credits) cannot exceed, as a matter of law for each taxable period, the total amount of actual costs incurred by the French parent. This can lead to a potentially higher proportion of the dividend being exempt from tax although it cannot as a practical matter lead to 100% of the dividend being exempt.

⁴ Switzerland also may reduce the effective participation exemption by up to 5% as a proxy for general and administrative expenses.

⁵ General treatment shown is for dividends from Brazil treaty countries.

Table 2: Summary of Controlled Foreign Company Rules, 2009

	Does the country have a CFC regime?	Does the CFC regime apply to all offshore financing companies? ¹	Does the CFC regime apply to all offshore IP holding companies? ¹	Does the CFC regime apply to interest, dividends, and royalties paid from active income of a related foreign entity?
Belgium	No	No	No	No
Canada	Yes	No	No	No
France	Yes	No	No	Yes, some exceptions
Germany	Yes	No	No	Interest and royalties
Italy	Yes	No	No	Yes
Japan	Yes	Effectively Yes	Effectively Yes	Yes
Netherlands	Effectively ²	No	No	Yes
Spain	Yes	No	No	No, some exceptions
Switzerland	No	No	No	No
United Kingdom	Yes	No	No	Yes
Brazil³	Yes	No	No	No
Russia	No	No	No	No
India	No	No	No	No
China	Yes	Yes	Yes	Yes

Source: PricewaterhouseCoopers analysis.

¹ Offshore financing companies or IP holding companies that are not taxed under CFC regimes generally require that a specific set of requirements must be met, which may not be satisfied in all foreign locations. Study countries in the European Union may generally establish a financing or IP company in another European Union country due to rules that allow for the freedom of establishment and the movement of capital between European Union members provided those foreign subsidiaries have sufficient substance. For the purpose of this table, countries that do not have CFC regimes are listed as "No" because foreign financing and IP subsidiaries are not taxable on a current-year basis.

² The "mark-to-market" regime in the Netherlands may have an effect similar to the CFC regimes of other countries. A Dutch parent is taxed on its income or loss as a result of the compulsory revaluation of the foreign subsidiary to fair market value if the subsidiary is subject to an effective tax rate of less than 10% (calculated based on Dutch tax law principles), the subsidiary's assets are 90% or more passive holdings, the Dutch parent owns at least 25% of the subsidiary, and the holding does not qualify as a real estate investment.

³ CFC profits from certain tax treaty countries are exempt.

Table 3: Treatment of R&D Expenses for OECD Countries, 2009

Research and Development Expenses				
	R&D incentives?	Credit for qualified R&D expense?	Special capital cost recovery rules for equipment used for R&D?¹	Other R&D tax incentives?
Belgium	Yes	Special investment deduction of 15.5% or a refundable credit of equal tax value	No	<ul style="list-style-type: none"> • Payroll withholding tax remittance exemption • Special treatment for temporary researchers
Canada	Yes	20% - 35% credit, generally non-refundable but some exceptions	Fully deductible in the year acquired and 90% or more utilized for R&D purposes	No
France	Yes	30% credit ²	Potentially accelerated depreciation	No
Germany	No	No	No	<ul style="list-style-type: none"> • Qualifying R&D expenses generally deductible
Italy	Yes	10% - 40% credit ³	No	<ul style="list-style-type: none"> • Incentives available for small and middle market companies
Japan	Yes	5% - 12% credit	Accelerated depreciation	<ul style="list-style-type: none"> • Specific R&D credits available for joint ventures and small corporations
Netherlands	Yes	No	No	<ul style="list-style-type: none"> • Deduction of wage taxes and social security contributions for R&D employees • Immediate amortization of the R&D costs in the year of development
Spain	Yes	25% - 42% credit	Accelerated depreciation	<ul style="list-style-type: none"> • 17% credit on R&D wages • 8% credit on acquisition of certain R&D assets
Switzerland	Effectively yes ⁴	No	No	<ul style="list-style-type: none"> • Possible tax rates between 8% - 12%,⁵ or tax holiday
United Kingdom	Yes	No	Fully depreciable within year of acquisition	<ul style="list-style-type: none"> • 130% - 175% deduction of qualified R&D expenses

Source: PricewaterhouseCoopers analysis.

¹ Some jurisdictions that provide a special capital cost recovery may require specific criteria that must be met in order to qualify.

² France allows a 30% tax credit for the first EUR 100 million of qualified expenses incurred during the calendar year. Amounts in excess of EUR 100 million receive a 5% credit. First-time users may receive increased tax credit rates during the first two years.

³ Qualifying R&D expenses are capped at EUR 50 million per year.

⁴ Switzerland does not have a R&D incentives program as such; however, depending on the facts and circumstances, many different Swiss tax regimes might be beneficial for R&D activities.

⁵ The tax rate does not take income account amortization of IP. Including amortization of IP, a 0% rate might be possible for several years.

Table 4: Treatment of R&D Expenses for Key Developing Countries, 2009

Research and Development Expenses				
	R&D incentives?	Credit for qualified R&D expense?	Special capital cost recovery rules for equipment used for R&D?¹	Other R&D tax incentives?
Brazil	Yes	No	Expensed in year of acquisition	<ul style="list-style-type: none"> • Tax deductibility of R&D expenditures • 50% reduction of excise tax on purchase of R&D equipment • Accelerated amortization of intangibles applied to R&D • Withholding tax credits on royalties and technical service fees paid to providers outside Brazil • 0% withholding tax on payments made to beneficiaries outside Brazil on patents/trademarks • Subsidies for the remuneration of researchers
Russia²	Yes	No	Accelerated depreciation	<ul style="list-style-type: none"> • 150% deduction of qualified R&D expenses • R&D expenses in special economic zones may be deducted as incurred
India	Yes	No	No	<ul style="list-style-type: none"> • Manufacturing businesses are allowed a 150% deduction of expenditures on approved R&D facilities • 125% deduction for contributions to specific universities, companies, research institutes, etc.
China	Yes	No	Accelerated depreciation	<ul style="list-style-type: none"> • 150% deduction of qualified R&D expenses • Reduced tax rate or possible tax holiday if Hi-tech Enterprise or Hi-tech Service Enterprise • 5% tax exemption on revenue from technology transfer, technology development, and related consulting • Exemption on customs duty when importing R&D equipment

Source: PricewaterhouseCoopers analysis.

¹ Some of the jurisdictions that provide for a special capital cost recovery may require specific criteria that must be met in order to qualify.

² This analysis incorporates incentives under the Russian Corporate tax only. Additional incentives are provided under the Value Added Tax and Unified Social Tax.

Table 5: Treatment of Royalty Income from the Ownership of Intellectual Property, 2009

Intellectual Property and Patent Income (e.g., "Patent Box")						
	Special regime for patent income?	Applicable tax rate?	What types of IP qualify?	Does acquired IP qualify?	What expenses reduce qualified income?	Year regime enacted?
Belgium	Yes	Maximum 6.8% ¹	Patents and supplementary protection certificates	Yes, under specific conditions	Expenses except license fees and amortization of acquired patents	2008
France	Yes	15% ²	Patents and extended patent certificates	Yes, under specific conditions	Includes management expenses related to licensing IP	2005
Ireland	Yes ²	0% ³ /12.5% ⁴	Most IP	Yes	For capital expenditure incurred after May 7, 2009 ⁵	1973 ⁶
Luxembourg	Yes ¹	5.9%	Software, copyrights, patents, trademarks, designs, or models	Yes	Most expenses	2008
Netherlands	Yes	10% ⁷	Patents or IP from qualifying and approved R&D activities	No	Most expenses	2007
Spain	Yes	15% ⁸	Most IP	No	None	2008
Switzerland	Effectively yes ⁹	0% - 12%	Most IP	Yes	Most expenses	N/A
China	Yes	0% - 12.5% ¹⁰	Registered patents and know-how	Yes	Most expenses	2008

Source: PricewaterhouseCoopers analysis

¹ Under Belgium's regime 80% of qualifying gross patent income is allowed as a deduction, resulting in a maximum effective tax rate of 6.8%. Luxembourg has a similar system giving rise to an effective rate of 5.9%.

² Additional social tax contributions may apply.

³ Exemption from tax subject to a EUR 5 million cap per annum on income arising from European Economic Area (i.e., the EU plus Iceland, Liechtenstein, and Norway).

⁴ If an active trade is carried on (but taxable base may be reduced by amortization of acquisition costs).

⁵ The tax deduction can either match the amortization charge in the accounts or alternatively, the taxpayer may elect to claim a deduction over 15 years. The level of deduction in any year is limited to 80% of the IP trading profits with excess deductions carried forward to future years (subject to the same 80% limitation).

⁶ While Ireland has had a patent box regime since 1973, the system was the subject of major reform in 2009. The old regime will continue to operate by election for pre-existing arrangements relating to know how and acquired patents but after 2011 all taxpayers will be within the new regime.

⁷ The Dutch regime includes a ceiling of four times development cost and a specific maximum of EUR 400,000 for income related to R&D assets. The Dutch have proposed reducing the tax rate for qualifying income to 5%.

⁸ Spain exempts 50% of the qualified income; therefore, the effective tax rate on this income is 15%. Exemption ceases to be applicable in the tax year following the year where the qualifying IP income exceeds 6 times its costs of development.

⁹ Switzerland does not have an IP regime as such; however, depending on the facts and circumstances many different Swiss tax regimes are available for IP tax structures.

¹⁰ China provides an exemption on qualified income below RMB 5 million and amounts in excess of RMB 5 million are taxed at half the corporate income tax rate.