



BDO International



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# Expatriate News

This Expatriate News includes the topic of how an expatriate employee can avoid becoming a permanent establishment of the employer in the country in which they are working, and starts by looking at the rules in Belgium. Recent events include important changes in Belgium and the USA, together with an update on the latest attitudes of the UK Revenue authorities in relation to expatriate employees.

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## EXPATRIATES & PERMANENT ESTABLISHMENTS:

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### General

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Many businesses initially explore the opportunities for new business by sending one or more employees on short visits to a new territory. However, in certain circumstances the host country may consider that a single employee has established a business presence there (with the result that the employer must potentially pay foreign tax on part of their profits). The rules in the host country often depend on the extent of the employee's authority to act on behalf of the employer and the type of accommodation from which the individual operates during their visits to the foreign location.

### Creating a Belgian establishment when seconding expatriates to Belgium

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When considering the position in Belgium, the position regarding permanent establishments which is set out in the OECD model tax treaty must be considered, in addition to the Belgian legislation for an establishment (or ICT).

In principle, based on the OECD double tax treaties concluded between Belgium and other States, a permanent establishment in Belgium occurs when a material or a personal establishment is present in Belgium. The



OECD model treaty states that a foreign company is deemed to have a (taxable) permanent establishment if there is a fixed place of business through which the foreign company engages in industrial or commercial activity (a material permanent establishment). The model treaty sets out in a non-exhaustive way examples of what is meant by the term 'fixed place of business' and it includes 'offices'. However, Article 5 of the treaty stipulates that a permanent establishment shall not include a fixed place of business, used for one or more of the following purposes:

- (a) the use of facilities exclusively for storing, displaying or delivering of goods or merchandise belonging to the foreign company;
- (b) the maintenance of a stock of goods or merchandise belonging to the foreign company for the sole purpose of storage, display or delivery;
- (c) the maintenance of a stock of goods or merchandise belonging to the foreign company for the sole purpose of processing by another company;
- (d) the maintenance of a fixed place of business for the sole purpose of purchasing goods or merchandise, or for collecting information, for the foreign company;
- (e) the maintenance of a fixed place of business for the sole purpose of performing activities that have a preparatory or auxiliary character for the foreign company only.

Regardless of these provisions, the model treaty confirms that a dependent agent (such as an employee) who acts on behalf of a foreign company in Belgium may create a personal permanent establishment of the foreign company in Belgium if they have, and habitually

exercise, the authority to conclude contracts in the name of the foreign company. However, even in this situation the foreign company will not be deemed to have a permanent establishment in Belgium if the relevant individual's activities are limited to one or more of the preparatory and auxiliary activities indicated at (a) to (e) above.

### **Belgian tax law**

The definition of a Belgian establishment in the domestic legislation is wider than the definition in the OECD model tax treaty. Based on the interpretation of this legislation, this can create an opportunity for a Belgian establishment without having a permanent establishment for the purposes of the relevant double tax treaty. Where the exceptions from a treaty establishment at (a) to (e) above apply, the effect is that the Belgian informal branch would not be liable to tax in Belgium. This can be useful when applying for the highly-favourable special tax status for foreign executives working in Belgium, because the expatriates should be assigned to a Belgian branch (even if there is no taxable permanent establishment in Belgium under the definitions in the relevant tax treaty).

Belgian domestic tax law provides that a Belgian establishment would be present where there is a personal and/or material presence in Belgium, without taking into account the negative situations in the OECD model double tax treaty (as set out at (a) to (e) above). As a consequence, when a foreign company sends a foreign employee on secondment to Belgium (for example, to undertake professional activities of a preparatory nature), the special tax status for foreign executives could be applied provided that at least a branch (for preparatory work) is set up in Belgium, which falls within the scope of the negative situations in the OECD model treaty.

## In summary, no Belgian corporate income taxes should be paid and the employee can be sent on secondment to a Belgian branch and will benefit from the special expatriate tax status.

This principle would imply that, where an expatriate employee only performs activities for the foreign company that have a preparatory or auxiliary character, no permanent establishment would occur under the strict interpretation of the double tax treaty, although a permanent establishment would be present under the definition of permanent establishment in the domestic Belgian tax law.

Although the effect of the various double tax treaties would be that Belgium would not have the authority to levy taxes in these 'negative cases', the Belgian branch of the foreign company has to fulfill certain formalities in order to be able to apply for the special expatriate tax status for its foreign executives. One of these is the filing of a nil corporate non-resident income tax return in Belgium with an enclosure detailing the costs relating to the employment of each expatriate in Belgium (for example, salary, housing allowance and car costs). Another formality relates to the operation of a Belgian payroll for the purposes of paying the Belgian professional income withholding taxes (which are ultimately offset against the final Belgian taxes of the relevant expatriate employee).

In summary, no Belgian corporate income taxes should be paid and the employee can be sent on secondment to a Belgian branch and will benefit from the special expatriate tax status. An example would be where an Indian employee was sent on secondment by his Indian company to Belgium, to perform professional activities

of a preparatory nature in Belgium. The Indian employee only has Indian nationality (not Belgian nationality) and can be considered to be a non-resident of Belgium for income tax purposes. According to the double tax treaty concluded between Belgium and India, no permanent establishment of the Indian company would occur where the Indian employee only performs activities that have a preparatory or auxiliary character on behalf of his foreign employer.

The Belgian domestic tax law would indicate that the Indian company would have a Belgian establishment, but because of the operation of the India/Belgium tax treaty the Belgian activities would not be liable to Belgian corporate income tax. However, it should be noted that there is a low risk of the Belgian tax authorities arguing that there is a taxable presence in Belgium and that Belgian corporate income taxes should be paid by the Indian company. Furthermore, as long as there is only a Belgian establishment, the Indian branch would need to fulfil the formalities outlined above.

### Conclusion

The fact that the definition of a permanent establishment in the Belgian tax law is wider than the definition in the various double tax treaties with Belgium means that a foreign company can commence its activities in Belgium through an expatriate employee who can benefit from the special tax status for foreign executives, and no corporate income taxes need to be paid in Belgium.

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## BELGIUM:

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### LIMOSA declarations

The LIMOSA reporting requirements were outlined in BDO Expatriate News earlier this year. The requirements have been revised by Royal Decree 31/8/2007, which was published in the Belgian State Gazette of 13 September 2007.

LIMOSA reporting came into force on 1 April 2007 for non-Belgian employers who have temporary or partial Belgian assignments, or who engage employees and trainees in Belgium. The reporting also applies to non-Belgian self-employed persons who perform their services on a temporary or partial basis in Belgium.

Previously, a foreign employer or self-employed person was exempt from filing a LIMOSA declaration if they went to Belgium to attend a scientific conference, on the condition that this trip did not exceed 5 days per calendar month. As this rule seemed to dissuade foreigners from attending and organising scientific congresses in Belgium, the Belgian government decided that the limitation to 5 days per calendar month would no longer apply to participants in scientific conferences.

The original regulations also indicated that there was also no obligation to file a LIMOSA declaration in respect of business meetings attended in limited numbers, provided that the individuals' stay in Belgium did not exceed 5 days per month. It has now been decided that there is no obligation to file a LIMOSA declaration where these meetings do not exceed 60 days per calen-

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dar year, with a maximum of 20 days for each meeting. Any private travel days which the individual spends as a tourist in Belgium, either before or after the meeting, will not be counted for this purpose.

These new rules apply with effect from 1 April 2007.

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## EUROPE:

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### Luxembourg

The European Court of Justice (ECJ) has considered the application of the personal tax legislation in Luxembourg to a German-resident couple in the case of *Etat du Grand-Duché de Luxembourg v Lakebrink and Another* (Case C-182/06).

The claimants were German nationals resident in Germany, who were both employed exclusively in Luxembourg and who had no taxable income in Germany for the year in question. They applied for loss relief to be taken into account in assessing the tax rate applicable to them in Luxembourg for two houses which they owned in Germany. They did not occupy the houses, which were leased out. Their claim was refused on the grounds that, under Luxembourg tax law, the tax rate for non-resident taxpayers only takes into account foreign earned income. The ECJ was asked for a preliminary ruling on whether the refusal to take negative rental income in another Member State into account in determining the applicable tax rate constituted indirect discrimination (as prohibited by Article 39 of the European Constitution, which indicates that 'freedom of movement for workers shall be secured within the Community').

The ECJ decided that the treatment of non-resident workers in the Luxembourg legislation was less favourable than the legislation for resident workers. Although the Luxembourg legislation took no account of non-residents' foreign unearned income (which gave them a tax regime which was favourable overall, when com-

pared to the position of residents), an unfavourable tax treatment which was contrary to a fundamental Community freedom could not be justified by the existence of other tax advantages.

The Court decided that the resulting tax disadvantage was capable of amounting to indirect discrimination which was contrary to EC Article 39. Discrimination was indicated to normally arise by the application of different rules to comparable situations, so that not granting to a non-resident taxpayer the tax advantages granted to resident taxpayers was not generally discriminatory (because the two categories of taxpayer were not in a comparable situation). However, the situation was different where the non-resident received most of their income in their state of employment and no significant income in their state of residence. This was because the state of residence was not in a position to grant the taxpayer any advantages resulting from their personal and family circumstances, and those advantages could also not be granted in the state of employment.

On these grounds, the ECJ ruled that EC Article 39 precludes national legislation which prevents a European Community national who is not resident in the EC Member State in which they receive the major part of their taxable income from taking into account their rental losses in another State in determining the tax rate applicable.

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## MALTA:

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### Stock options

The Maltese fringe benefit rules in the Income Tax Act have recently been revised in relation to stock options by the Fringe Benefits (Amendment No 2) Rules 2007 (LN 147/07) with effect for the tax year 2007 and later years.

The new rules provide that when an employee exercises an option to acquire shares in the company in which they are employed, the taxable value of this benefit is calculated as 42.85 per cent of the excess, if any, of the

market value of the shares on the date of the exercise of the option over the option price of those shares.

The effect of this amendment to the legislation is that with effect from the 2007 year of assessment, the maximum rate of tax which applies to share option gains has effectively been reduced from 35 per cent to 15 per cent.

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## UK:

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### Modified PAYE

The UK Revenue authorities (HMRC) operate a number of special Pay As You Earn (PAYE) arrangements which simplify the normal statutory requirement for the employer of expatriate employees to withhold income tax at source from their UK-taxable earnings. One of these arrangements is Modified PAYE, under which the employer (or more commonly, the employer's agent) calculates tax-equalised expatriates' income tax liabilities on a best estimate basis and which also provides extended filing deadlines (in particular, for reporting non-cash benefits). The Modified PAYE arrangement must be agreed by HMRC before it is operated by the employer and the detailed rules are set out in the HMRC Employment Procedures Manual (EPM) at Appendix 6.

HMRC has been asked whether a Modified PAYE arrangement can apply if all of the detailed rules in Appendix 6 are not met. In reply, HMRC confirmed that they cannot allow employers to write their own rules for a Modified arrangement, but small differences may not preclude one. HMRC provided the example of the use of an employer PAYE Settlement Agreement (PSA) to cover the income tax on small items of earnings which are not tax equalised, which should not prevent the rest of the employee's tax-equalised earnings from being included in a Modified PAYE agreement.

It is anticipated that additional guidance on Modified PAYE arrangements may be issued by HMRC in due course, which should include all of the answers to the Frequently Asked Questions (FAQs) that have been issued by HMRC on this topic.

## Accountancy fees

There has been a longstanding open issue for many years in the UK regarding the accountancy fees which are paid by employers (and the in-house department costs) in respect of the work relating to expatriate employees. This work normally covers the UK tax return preparation, completion of UK arrival and departure forms P86 and P85 (and related employee briefings), planning advice and - if the individual is unlucky enough to have HMRC raise questions regarding their UK tax return - the costs associated with a TMA 1970 s 9A enquiry.

The stances taken by HMRC and employers (and the employers' advisers) on this subject continue to be diametrically opposed, even in the case of tax-equalised expatriates. HMRC asserts that there is always a taxable benefit from this work (in particular, because the tax return is the individual's responsibility), whereas the employers and advisers cannot see that there is a benefit (because this work is required to implement the employer's tax equalisation policy). Indeed, HMRC's stance appears illogical bearing in mind the fact that HMRC insists that the expatriates' tax returns are prepared by a professional where the employee is covered by an HMRC Modified PAYE arrangement (see above).

HMRC has, however, confirmed that their Expatriate Teams have been instructed (when considering the amount of the accountancy benefit) to take into account the commercial realities, especially in relation to 'bundled' accountancy fees for a number of services to a company. HMRC accepts that the fees paid for expatriate tax work may not increase year-on-year,

indeed they may fall. However, they still wish to pick up the specific fees charged for, or the costs relating to, any formal tax return enquiries as a separate benefit in kind.

Various alternative approaches have been proposed by employers and professional advisers, including a fixed benefit in kind where the adviser is paid a flat fee for all of the expatriates of a particular employer, irrespective of the work involved. A table of fixed accountancy benefits that would apply to all expatriates has also been suggested, which would apply irrespective of the actual accountancy costs.

**HMRC's stance appears illogical bearing in mind the fact that HMRC insists that the expatriates' tax returns are prepared by a professional where the employee is covered by an HMRC Modified PAYE arrangement**

This issue is likely to be unresolved until a tax case is taken before the HMRC Tax Commissioners, which should at least establish in principle whether there is a benefit in kind, if not the amount of the benefit in every situation.

### Equalised expatriates' cash bonuses

HMRC have, for many years, operated a practice under which the cash bonuses of tax-equalised expatriates can be both assessed and taxed by reference to the UK tax year in which they are received (rather than under the correct legal basis of assessment by reference to the year(s) for they are earned and taxation in the year of receipt).

Where it is adopted, this receipts basis must be operated consistently (year-in, year-out). This is to prevent any manipulation of the tax charge (in particular, by using the earnings basis to avoid UK tax on a pre-UK arrival bonus and then using the receipts basis to avoid tax on bonuses earned in the UK which are paid after departure). The practice is also not appropriate in all situations, as the resulting lack of symmetry and timing differences can cause difficulty where the employee is also subject to foreign tax on their bonus.

HMRC has confirmed that they are reviewing this practice to ensure that it does not exceed their powers. If this is the case, it appears likely that it will be ended.

### Social security contributions gross-up

Some employers equalise their expatriate employees on the social security contributions which are payable on their earnings, in addition to equalising them on their income tax. Where an employee is liable to UK social security contributions (national insurance contributions or NICs), these contributions will be payable on the employee's earnings, as grossed-up for income tax. In the past, employees paid a maximum amount of NICs each year, based on an earnings ceiling (currently £34,840 for 2007/08). However, in 2003 an additional 1 per cent employee NICs charge was introduced on earnings in excess of the earnings ceiling.

HMRC has recently raised the question of the gross-up of the additional employee 1 per cent NICs charge, where this is paid by the employer under the company equalisation policy. It appears that many employers have not included the 'NICs on NICs' element when calculating the liabilities on their employees' grossed-up income.

There is no specific NICs legislation to charge NICs on the employee NICs which are paid by the employer in this way. However, these NICs may be said to be earnings for NICs purposes, following the 'money's worth' charge set out the UK tax legislation and which is applied to NICs.

HMRC has recognised the fact that certain independently-published gross-up calculations exclude the 'NICs on NICs' element. HMRC has confirmed that they will, for the moment, accept this alternative approach where it is used in the employer's or adviser's calculations (and that no interest or penalties will arise in this situation). However, HMRC may require the NICs gross-up to be included when re-calculating an equalised expatriate's liability as part of a formal tax return enquiry.

HMRC has not yet made a decision regarding the formal adoption of a specific gross-up formula from a specific date. Any further news on this topic will be included Expatriate News in due course.

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## USA:

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### Foreign housing costs

The US Internal Revenue Service (IRS) has now determined the housing costs amounts which are eligible for exclusion or deduction under Section 911 of the US Tax Code for 2007. An updated list has been issued of the specific locations for which a greater amount than the statutory limit for the Section 911 foreign housing expense exclusion will be allowed (due to the high cost of living in those areas). The housing costs adjustments are made on the basis of the geographical differences in foreign housing costs, by comparison to housing costs in the USA. The updated amounts apply for the 2007 tax year and later years.

### Background

Section 911(a) of the US Internal Revenue Code allows a qualified individual to elect to exclude a foreign earned income and housing cost amount from their gross income. The maximum foreign earned income exclusion for the tax year 2007 is \$85,700 (the exclusion for 2006 was \$82,400). Prior to 2006, foreign-based US employees could exclude their 'reasonable' housing costs in excess of a minimum amount and there was no specific ceiling on the amount that could be claimed.

The Tax Increase Prevention and Reconciliation Act of May 2006 changed the rules, so that the maximum housing exclusion which could be claimed was \$24,720. Although the new legislation generally reduced the housing deductions available to US employees working abroad, it also gave the IRS the authority to waive the limit in areas with high housing costs. These exceptions were set out in a list of the 2006 limits for various geographical locations.

### 2007 housing limits

The 2007 list has not only revised the dollar limits for some of the areas, but has also expanded the list of cities which are eligible for the higher housing exclusion. The largest increases in the previous housing limits apply to Calgary in Canada, to Malaysia and to Singapore. Countries appearing for the first time on the adjusted limits listing are Australia, the Philippines, and South Africa. The locations with the most expensive housing have been established as Hong Kong (with a 2007 limit of \$114,300, unchanged from 2006) and Moscow (with a new 2007 limit of \$90,900).

It should be noted that the tax savings which result from these increases are not always significant, because whenever an exclusion claim is increased, additional foreign tax credit relief is given up. This is because both an exclusion and foreign tax credits cannot be claimed in respect of the same income (so that double dipping is prohibited).

The new table showing the adjusted housing expense limits was published on 10 September 2007 in IRS Notice 2007-77, Determination of Housing Cost Amounts Eligible for Exclusion or Deduction for 2007, and is in IRS Bulletin 2007-40 of 1 October 2007. The Notice can also be found at the website of the US Department of Treasury at: <http://www.treas.gov/offices/tax-policy/library/N-07-77.pdf>

### **US Exit Tax**

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In July 2007 the US House of Representatives introduced the Tax Collection Responsibility Act of 2007, which included a proposed exit or 'mark-to-market' tax for individuals who expatriate from the USA.

### **Individuals subject to the tax**

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The proposed legislation would apply both to US citizens who relinquish their citizenship, and to long-term residents who terminate their US permanent residence status. An individual is a long-term resident for this purpose if they were a lawful permanent resident

## **The proposed legislation would apply both to US citizens who relinquish their citizenship, and to long-term residents who terminate their US permanent residence status**

('Green Card' holder) in at least eight out of the fifteen taxable years ending with the year in which the residence termination occurs.

The tax would apply to any US citizen who relinquishes their citizenship and to any long-term resident who terminates US residency, where that individual:

1. Has an average annual net income tax liability for the five tax years which end before the date of expatriation that exceeds \$136,000 (this is the 2007 amount, to be adjusted annually for inflation); or
2. Has a net worth of \$2 million or more on the date of expatriation; or
3. Fails to certify that they have complied with all their US federal tax obligations for the five years preceding expatriation, or fails to submit such evidence of compliance as may be required.

Certain exceptions would apply to individuals born with dual citizenship, and to individuals who relinquish their US citizenship prior to age 18.5 (provided certain requirements are met).

### **Date of expatriation**

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The legislation sets out the rules for establishing the date of expatriation. In most cases, this will either be the date on which the individual swears or affirms their oath of renunciation in front of a consular officer and witnesses, or the date on which Form I-407 is filed to terminate their permanent residence status. Long-term residents would also be treated as expatriating when they utilise the residence 'tie-breaker' provisions in a double tax treaty in order to be treated as non-resident aliens in the USA, despite their permanent residence status.

It should be noted that the current rule which provides that an individual continues to be taxed as a US citizen or long-term resident for US federal tax purposes until Form 8854 is filed, would be repealed under the proposals.

## **Mark-to-market tax**

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The proposal would tax expatriating individuals on the net unrealised gains on their property, as if that property was sold for its market value on the day before the expatriation date. Any gain on the deemed sale would be taxed without regard to any other provisions in the US Tax Code, but any loss on the deemed sale would generally be taken into account to the extent otherwise provided in the Code. The value of property held when an individual first became a US resident would be taken into account for the purposes of calculating the gain, unless the individual made an irrevocable election for the general US tax principles to apply.

Any net gain on the deemed sale is taxable to the extent it exceeds \$600,000 (\$1.2 million for married individuals filing a joint return, both of whom relinquish their citizenship or terminate their residence). This amount would be increased by a cost of living adjustment factor for the calendar years 2008 onwards.

## **Deemed sale of property**

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The deemed sale rule would generally apply to all the property interests held by the individual on the date of expatriation. Special rules would apply to property held in a trust. The legislation would not in general apply to US-sited real property interests, which would continue to be subject to US tax where owned by a non-resident who is not a US citizen.

The proposals indicate that certain deferred earnings would not be subject to the mark-to-market treatment on expatriation. In general, stock option rights, restricted stock units, multi-year long-term performance awards and pension rights (approved or unapproved)

would be regarded as deferred earnings for this purpose. Where this treatment applies, the individual would remain subject to US taxation on their US-source income at the time that the earnings are realised or are otherwise taxable under general US tax principles, provided that:

1. The expatriating individual notifies the payer of the deferred earnings of their expatriate status; and
2. they irrevocably waive any right to claim any reduction in the tax withholding on such earnings under a treaty with the USA.

In this situation, the payer must withhold US tax at 30 per cent from any taxable payment of eligible deferred compensation. Where the payer is not a US person, they must elect to be treated as a US person for the purposes of the withholding requirement, and must also meet any other requirements which ensure that the withholding will be effected. In cases where the withholding tax does not apply, the current value of the expatriate's accrued earnings is treated as received by the expatriate on the day before the date of their expatriation in the form of a distribution under the deferred compensation plan (although no early distribution tax will apply at that time). However, any deferred compensation which is attributable to services performed outside the US while the expatriate was not a citizen or resident of the USA would not be taken into account for the purposes of the provisions.

It is important to note that although US-sited real property would not be subject to the exit tax, it would apply to all property situated outside the USA. This could

include the individual's private residence, a vacation home, or a rental property located in the individual's home country. The individual's worldwide investment assets would also be taken into account.

### Gift tax

The proposals include a tax on certain gifts or bequests which are received by a US citizen or a US resident from an individual who is within the legislation. This gift tax would be calculated at the greater of the highest estate tax rate or the highest gift tax rate that apply.

### Tax payment

The mark-to-market tax would be due for payment 90 days after expatriation. However, an expatriating individual would be permitted to make an irrevocable election to defer payment of the mark-to-market tax

on a property-by-property basis. An interest charge would apply during the deferral period and the individual would normally be required to provide a bond in order to make this election.

### Effective date

The legislation would take effect on the date that it became law and the exit tax would apply to individuals who expatriated on or after that date. The gift tax provisions would apply to all gifts and bequests received from relevant expatriating individuals on or after the date that the exit tax became law, regardless of the individual's expatriation date. Any individuals who expatriate themselves before the new rules became law would continue to be covered by the current expatriation rules.

### More information

For more information, please contact your local expatriate contact or one of the Expatriate Services Centre of Excellence contacts below.

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