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WORLD WIDE TAX NEWS

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INTERNATIONAL

BEPS MULTILATERAL INSTRUMENT

As described in our previous newsletters, the Base Erosion and Profit Shifting (BEPS) project of the Organisation for Economic Co-operation and Development (OECD) contains several different proposed actions to avoid aggressive tax planning and tax avoidance by multinational enterprises. Many of these actions could only be realised by amending existing bilateral tax treaties worldwide. However, it would be almost impossible to adjust each concluded bilateral tax treaty separately, in line with the BEPS recommendations.

Therefore, based on action point 15 of the BEPS project, a so called 'multilateral instrument' was introduced which allows countries to timely and efficiently amend their existing bilateral tax treaties in line with the tax treaty related BEPS recommendations.

In this matter, on 24 November 2016, the OECD released the text of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting. This Multilateral Instrument (MLI) has now been adopted by more than 100 countries.

EDITOR'S LETTER

Welcome to this issue of *BDO World Wide Tax News*. This newsletter summarises recent tax developments of international interest across the world. If you would like more information on any of the items featured, or would like to discuss their implications for you or your business, please contact the person named under the item(s). The material discussed in this newsletter is meant to provide general information only and should not be acted upon without first obtaining professional advice tailored to your particular needs. *BDO World Wide Tax News* is published quarterly by Brussels Worldwide Services BVBA. If you have any comments or suggestions concerning *BDO World Wide Tax News*, please contact the Editor via the BDO Global Office by e-mail at mireille.derouane@bdo.global or by telephone on +32 2 778 0130.

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The MLI intends to implement the BEPS measures swiftly, in a coordinated and consistent manner, into the various existing tax treaties, and it allows countries to implement minimum standards as outlined in the outcome of the BEPS package. The MLI covers the following BEPS measures:

- **Action 2 – hybrid mismatches**: Action 2 predominantly looks at hybrid financing arrangements, but it also examines transparent entities and dual resident entities. Specifically in relation to dual resident entities, the MLI establishes that a determination based on place of effective management should be replaced by a mechanism whereby it is up to the two tax authorities to agree where an entity is tax resident (the 'competent authority' basis).
- **Action 6 – treaty abuse**: Action 6 lays down requirements for the availability of treaties to be limited to situations where a 'principle purpose test' (PPT), based on the transactions or arrangements, is met. The PPT can be separately supplemented by a 'limitation on benefit's' (LOB) rule which limits treaty benefits to persons who meet certain conditions.
- **Action 7 – permanent establishment (PE) status**: Action 7 seeks changes to address the avoidance of a PE in a territory through the use of sales commissionaires and/or by virtue of the specific activity exemptions. The MLI permits jurisdictions to adopt the changes or to opt out of all or part of the recommendations (i.e. there is no minimum standard).
- **Action 14 – dispute resolution**: The MLI provides for a dispute resolution mechanism as envisaged in Action 14 where a taxpayer considers that they are being denied the provisions of a tax treaty. This is part of the minimum standard of the MLI, albeit with flexibility permitted in some areas of implementation.

The MLI will be applicable alongside the existing tax treaties. The countries concerned will still have some flexibility under the MLI – for example, they are allowed to specify the tax treaties to which the MLI applies.

Furthermore, the MLI also enables countries to include a so-called 'mandatory binding treaty arbitration' (MBTA) into their bilateral tax treaties. This part is only applicable between parties if they explicitly choose to apply it. Based on the MBTA, unresolved issues can be submitted to arbitration. The arbitration decision is final and cannot be changed, either by the competent authorities or by the arbitration panel, except in the following three situations:

- The affected taxpayer does not accept the mutual agreement implementing the arbitration decision, or does not withdraw any related legal or administrative proceedings within 60 days of being notified of the decision;
- The affected taxpayer proceeds to litigate on matters resolved by a mutual agreement implementing the decision;
- A court in one of the treaty countries rules that the decision is invalid.

Governments are currently preparing their lists of treaties which should be covered by the MLI and considering which options to select and reservations to make. Subsequently they will notify the OECD. The MLI will become effective after five countries have ratified this and will be applicable for a specific tax treaty after all parties to that tax treaty have ratified the MLI and a certain period has passed to ensure clarity and legal certainty. It is envisaged that the MLI will be formally signed by the different countries on 5 June 2017.

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AUSTRALIA

DIVERTED PROFITS TAX

Summary

The Australian Government recently released draft legislation to implement the proposed Diverted Profits Tax (DPT), which would make significant changes to the Australian transfer pricing landscape – in particular the proposed implementation of a 'pay now, argue later' approach to the proposed punitive 40% tax rate. This proposed DPT will overlap with existing Australian transfer pricing obligations, increasing the potential ramifications faced by taxpayers who do not properly analyse and document the 'economic substance' of their international related party transactions.

It is therefore now more critical than ever for taxpayers who fall within the ambit of the DPT to ensure that appropriate and contemporaneous transfer pricing documentation is in place to support the transfer pricing and BEPS-related aspects of any international related party transactions and conduct a DPT risk assessment and mitigation process.

The proposed DPT would impose a penalty tax rate of 40% on large multinational entities that are deemed to have artificially diverted profits from Australia. The legislation is expected to be introduced into Parliament in early 2017, and is proposed to be effective for years commencing on or after 1 July 2017, irrespective of when the arrangements were first entered into.

The proposed legislation is based broadly upon similar legislation introduced in the United Kingdom in 2015, but is wider than the UK DPT as it covers financing arrangements. This is another example of Australia introducing unilateral BEPS measures. Certain carve outs are also proposed, as detailed below.

Who will the DPT apply to?

The draft DPT legislation will only apply to taxpayers that are members of significant global entities (SGEs) with global group-wide revenue of AUD 1 billion or more, unless taxpayers can satisfy any of the exceptions below:

1. **Turnover test** – The turnover of the taxpayer and other Australian entities in the same global group does not exceed AUD 25 million;
2. **Foreign tax test** – The increase in the foreign tax liabilities from the arrangement is equal to, or exceeds, 80% of the corresponding reduction in the Australian tax liability (i.e. effectively a foreign tax rate of less than 24%); or
3. **Sufficient economic substance test** – The income derived as a result of the arrangement reasonably reflects the economic substance of the entity's activities in connection with the arrangement.

Principal purpose test

The Australian DPT will target profit-shifting arrangements entered into by SGEs where the 'principal purpose' or one of the principal purposes is to obtain either:

a) An Australian tax benefit; or

b) An Australian tax benefit and foreign tax savings.

This 'principal purpose' test has a lower threshold than the normal anti-avoidance test of 'sole or dominant purpose' but is consistent with the threshold applied in the anti-treaty abuse provisions of the Organisation for Economic Co-operation and Development's (OECD) Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS.

Implementation

The DPT rules will be contained within the general anti-avoidance rules in Part IVA of the Income Tax Assessment Act 1936 (Cth) (Part IVA of the ITAA 1936). By virtue of being contained in Part IVA of the ITAA 1936, any DPT assessed to be due and payable will not be subject to relief under double tax treaties – potentially resulting in double taxation for taxpayers. By comparison, transfer pricing adjustments made under the core Australian transfer pricing provisions can be subject to relief under any relevant double tax treaties. This demonstrates the purpose behind the DPT as an anti-avoidance law intended to 'persuade' multi-national groups to restructure their affairs to avoid its application.

Review and assessment process

The assessment and review process will consist of the following key steps:

1. **Administrative processes prior to issuing a DPT assessment**
   The Commissioner will advise the taxpayer of an intention to issue a DPT assessment.

   The taxpayer has 60 days to make representations in relation to the DPT before a DPT assessment is made. In this relatively limited timeframe, taxpayers will have to compile the transfer pricing and other documentation required to justify the economic substance of, and provide additional support for, the arrangements. Critically, what this means in practice is that robust transfer pricing documentation needs to be in existence rather than be created after being notified by the Commissioner.

2. **DPT assessment**
   If found to be within the scope of the DPT, the Commissioner will have up to seven years to issue an assessment for a DPT liability. The DPT assessment will also include an interest charge calculated from the due date for payment of the relevant income tax assessment.

3. **Payment of DPT liability**
   The taxpayer must pay the amount of the DPT liability set out in the assessment no later than 21 days after the notice of assessment without exception, i.e. it is a 'pay now and argue later' measure.

4. **Review period**
   The Commissioner must review the DPT assessment within a 12-month review period. During this time the taxpayer may provide additional information to the Commissioner. If the review is successful, the assessment will be reduced or reversed.

5. **Appeal Process**
   After the review period, the taxpayer has 30 days to lodge an appeal to the Federal Court of Australia against the DPT assessment. Any information not provided by the taxpayer during the review period will be inadmissible in this appeal process.

What does this mean in practice?

The DPT as a 'pay now, argue later' measure makes it more critical than ever for taxpayers to plan ahead and ensure that comprehensive and robust transfer pricing documentation is prepared at an early stage. This documentation will need to be of a very high standard, closely follow OECD principles, and focus on the economic substance of the arrangements including risk allocation and value creation within the group to ensure these are aligned with the relevant transfer pricing outcomes.

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HONG KONG

NEW CORPORATE TREASURY CENTRE REGIME

On 9 September 2016 the Hong Kong Inland Revenue Department (IRD) issued Departmental Interpretation and Practice Note No. 52 (DIPN 52) regarding the taxation of corporate treasury activity which expressed the IRD's view and assessing practice on the new corporate treasury centre (CTC) regime.

Historically, income earned by a group treasury company from its ordinary course of corporate treasury management and money lending activities carried out in Hong Kong is subject to profits tax at the tax rate applicable (currently 16.5%). However, any interest payment made by the group treasury company to its overseas group companies is not tax deductible because such interest is not chargeable to Hong Kong profits tax in the hands of the overseas recipients.

In order to attract multinational enterprises (MNEs) to establish CTCs in Hong Kong to perform treasury activities for their group companies, the Financial Secretary announced in his 2015/16 Budget Speech delivered in February 2015 the introduction of a CTC regime in Hong Kong. On 26 May 2016, the Legislative Council passed the 2016 Amendment (No. 2) Ordinance to implement the budget proposal.

Key features of the 2016 Amendment (No. 2) Ordinance

Half rate concession for qualifying CTCs (QCTCs)

A concessionary tax rate of 8.25% (i.e. current profits tax rate of 16.5% x 50%) will apply to qualifying profits of a QCTC in relation to its corporate treasury activities, including:

(i) Borrowing money from and lending money to non-Hong Kong associated corporations;

(ii) Qualifying corporate treasury services provided to non-Hong Kong associated corporations; and

(iii) Qualifying corporate treasury transactions undertaken on its own account and related to the business of non-Hong Kong associated corporations.

The half rate concession applies to a QCTC for a year of assessment only if:

a) In that year of assessment, the central management and control of the CTC is exercised in Hong Kong and the activities that produce the qualifying profits in that year are carried out in Hong Kong by the CTC, or arranged by the CTC to be carried out in Hong Kong; and

b) The CTC has made an election in writing, which is irrevocable, that the half rate concession applies to it.

There are safe harbour rules that allow CTCs having profits and assets not wholly for corporate treasury activities to be entitled to the concessionary 8.25% profits tax rate similar to qualifying profits:

– **1 year safe harbour** – For the year of assessment concerned, the percentages of a CTC's corporate treasury profits and corporate treasury assets are not lower than 75%;

– **Multiple-year safe harbour** – For the year of assessment and the preceding one or two years of assessment, the average percentages of a CTC's corporate treasury profits and corporate treasury assets are not lower than 75%.

Alternatively, a CTC could obtain a determination from the Commissioner of Inland Revenue that it is a QCTC.

For a CTC which also acts as a holding company, the IRD clarified in DIPN 52 that it is prepared to exclude equity investment in associated corporations and dividend income from the formula for the calculation of safe harbour, such that a CTC may also be regarded as a QCTC under the safe harbour rule.

Deduction on interest expense paid by CTCs to non-Hong Kong associated corporation

Section 16(2)(g) was added to the Inland Revenue Ordinance (IRO) to allow deduction of interest expenses paid by a CTC to associated corporations outside Hong Kong, provided that:

(i) The corresponding interest received by the lender is subject to tax of substantially the same nature of profits tax in a territory outside Hong Kong;

(ii) The tax has been/will be paid thereon at a rate not lower than the Hong Kong reference rate (i.e. the prevailing 16.5% or 8.25% as the case may be); and

(iii) The lender is the beneficial owner of the interest income.

Apart from the above criteria, the interest deduction is further subject to the following anti-avoidance measures:

– **Interest diversion test** – Interest deduction will be restricted if there is an arrangement under which interest will be paid, directly or through an interposed person, to a related person that is neither subject to Hong Kong profits tax nor any similar tax outside Hong Kong or subject to tax at a rate lower than the Hong Kong reference rate; or

– **Loss shifting test** – Interest deduction will be denied if the IRD is satisfied that the main purpose, or one of the main purposes, of the borrowing of money by a corporate from its non-Hong Kong associated corporation is to utilise a loss to avoid, postpone or reduce any liability to profits tax under the IRO.

It is worthwhile noting that the IRD mentioned in DIPN 52 that the interest diversion test was designed to combat profit shifting schemes involving disguised expense and to protect Hong Kong's tax base. Hence, it would apply to disallow an interest deduction even if the interest is paid to a related person in other forms, such as management fee or service fee under an arrangement.

Deeming interest and specified gains derived by CTCs to have a Hong Kong source

New deeming provisions, Sections 15(1)(ia) and (la), are added to make it clear that the interest income and specified disposal profits earned by a CTC in respect of the business of borrowing from and lending money to associated corporations in or outside Hong Kong are deemed trading receipts chargeable to profits tax.

The IRD clarified in DIPN 52 that sums are chargeable to profits tax only if they arise through or from the carrying on in Hong Kong by the corporation of its intra-group financing activities. The 'Provision of credit test' would continue to apply to simple inter-company loans not made in the ordinary course of an intra-group financing business.

The above new interest deduction rule and the concessionary tax rate applicable to CTCs will apply to sums payable, received or accrued on or after 1 April 2016, and the new deeming provisions will apply to sums received or accrued on or after the commencement date of the 2016 Amendment (No. 2) Ordinance, i.e. 3 June 2016.

Conclusion

The introduction of the CTC regime will help to remove the asymmetrical tax treatment that may arise from intergroup company money lending and borrowing transactions. However, the half-rate concessionary tax treatment is limited to certain loans and corporate treasury services provided by a QCTC to its overseas associated corporations, and certain qualifying corporate treasury transactions undertaken by a QCTC. In other words, a QCTC would still be subject to profits tax at the full rate of 16.5% in respect of its loan interest income and corporate treasury services income received from associated corporations in Hong Kong. MNEs should evaluate the effectiveness of this CTC regime to their corporate structure. If structured properly, Hong Kong may be a good location for MNEs, including Chinese state-owned enterprises, to operate their corporate treasury activities for outbound investments.

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INDIA

DECLARATION OF CYPRUS AS NOTIFIED JURISDICTIONAL AREA RESCINDED

Cyprus was declared a notified jurisdictional area by the Indian Government in November 2013, as Cyprus was not providing information requested by tax authorities under the exchange of information provisions of the tax treaty. As a result of such notification under a specific provision of the Income-tax Act, transfer pricing provisions applied to all the parties to a transaction of a taxpayer with a person in Cyprus. Furthermore, the sum/income/amount receivable by the person located in Cyprus was liable for withholding tax at the higher of Indian or tax treaty rates or 30%.

Following the revision of the tax treaty between India and Cyprus (including updated provisions for exchange of information), the above notification of November 2013 has now been rescinded from the date of its issue. However, this is subject to exceptions in respect of acts or omissions before the rescission.

[Notification No. 114/2016 dated 14 December 2016 and Notification No. 119/2016 dated 16 December 2016]

CLARIFICATIONS OF GENERAL ANTI-AVOIDANCE RULES (GAAR)

GAAR provisions were introduced in 2013, applicable from fiscal year 2015-16. However, in view of the severe tax consequences and limited clarity, implementation was postponed to April 2017. As an anti-abuse and anti-avoidance measure, the GAAR provisions seek to deny tax benefits to unallowable arrangements that lack commercial substance. In January 2017 the Central Board of Direct Taxes (administrative body of Ministry of Finance) issued clarifications regarding implementation of the GAAR provisions. The key points are summarised below:

1. The GAAR and Specific Anti-avoidance Rules (SAAR) can co-exist and are applicable, as necessary, in the facts and circumstances of each case.
2. If a case of avoidance is sufficiently addressed by the provisions in the tax treaty relating to Limitation of Benefits (LoB), GAAR will not be invoked. The Circular explains that adoption of anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies, which are required to be tackled through domestic anti-avoidance rules.
3. If the location/residence of a foreign portfolio investor (FPI) is based on non-tax commercial considerations and a main purpose of the arrangement is not to obtain a tax benefit, the GAAR will not apply.
4. Grandfathering rules provide that the GAAR provisions will not apply to income from transfers of investments made before 1 April 2017. The Circular clarifies that grandfathering will be available to:
   - Investments made before 1 April 2017 in respect of instruments compulsorily convertible from one form to another, at terms finalised at the time of issue of such instruments;
   - Shares coming into existence by way of split or consolidation of holdings or bonus in respect of shares acquired prior to 1 April 2017 in the hands of the same investor.
5. GAAR would not apply to arrangement sanctioned by courts that explicitly and adequately considered the tax implications.
6. The proposal to declare an arrangement as unallowable will have a two-stage vetting process – firstly at Principal Commissioner/Commissioner level and secondly at Approving Panel headed by a High Court Judge. Adequate safeguards have been put in place to ensure that the GAAR is invoked only in warranted cases.

[CBDT Circular 7 of 2017 dated 27 January 2017]

DEMONETISATION – THE TAX IMPACT

With an objective of curbing 'black money', the Indian Prime Minister announced the demonetisation of INR 500 and INR 1000 currency notes on 8 November 2016.

Parallel to the above announcement, the Government introduced a disclosure scheme giving taxpayers an opportunity to declare undisclosed income in the form of cash or deposits with banks/post office. The important provisions of the scheme, operational from 17 December 2016 until 31 March 2017, are as follows:

- A declaration can be made in respect of income (in the form of cash or a deposit), chargeable to tax for years prior to fiscal year 2016-17;
- Tax, surcharge and a penalty totalling 49.9% of such declared income is payable;
- 25% of the undisclosed income must be deposited (non-interest bearing) under a specified scheme, with a lock-in-period of 4 years. The payment of taxes and the deposit must be made before filing a declaration;
- No deduction of expenditure or set-off of losses is allowed against the income;
- The undisclosed income declared under the scheme will not constitute taxable income under the Income-tax Act;
- The contents of a declaration will not be admissible as evidence against the declarant under any laws (with the exception of the Black Money Act, Penal Code, etc.).

A further amendment to the tax provisions provides that if the taxpayer's reported taxable income includes any income in the nature of an unexplained credit, unexplained investments, etc. or is determined by a tax officer during a revenue audit, such income will be subject to tax at a rate of 60%. In addition to tax, a 10% penalty will also be payable in certain circumstances.

[The Taxation Laws (Second Amendment) Act, 2016 dated 15 December 2016]

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SINGAPORE

NEW PROTOCOL TO SINGAPORE-INDIA TAX TREATY

On 30 December 2016, Singapore and India signed a Protocol to amend their bilateral Avoidance of Double Taxation Agreement (DTA) in New Delhi.

Background to taxation of capital gains and details of new amendment

Prior to this, the DTA between Singapore and India provided for residence based taxation on gains arising from the alienation of shares. In other words, gains derived by a resident of Singapore from the alienation of shares in an Indian company would only be taxable in Singapore. India therefore had no right to impose any tax on the gains derived, though the asset in question was shares in an Indian company. Simultaneously, with no capital gains tax in Singapore, the alienator virtually received tax-free income if certain prescribed conditions were satisfied.

However, the position is now amended through a third protocol to the DTA which introduced a source-based taxation on gains arising from alienation of shares. Under this protocol, the erstwhile capital gains tax exemption (on gains from the alienation of shares in an Indian company) will only be available to shares acquired before 1 April 2017. Gains from the alienation of shares acquired on or after 1 April 2017 will now be taxable in India under the source-based taxation regime.

In addition, a transitional provision is provided for gains arising during a window period of 1 April 2017 to 31 March 2019 for shares acquired on or after 1 April 2017. Such gains arising during that period will be subjected to tax at 50% of the domestic tax rates applicable in India. Hence, capital gains on shares acquired after 1 April 2017 but sold by or before 31 March 2019 can use these transitional rules, subject to a Limitation of Benefits (LoB) Article, which seeks to avoid misuse of the DTA by shell companies.

The LoB clause provides the following cumulative tests for a taxpayer to be eligible to claim the transitional period benefits:

- **Primary purpose test** – Transitional period benefit not available where the affairs of the taxpayer are arranged with the primary purpose of taking advantage of the Protocol without bona fide business activities;
- **Activity test** – Transitional period benefit will not be available to a shell or conduit company. A company would not be considered as a shell or conduit company if it is listed on a recognised stock exchange, or expenditure on operations is at least SGD 200,000 in Singapore or INR 5,000,000 in India for each of the 12 month periods in the immediately preceding period of 24 months from the date on which the capital gains arise. However, in respect of investments acquired after 1 April 2017 and sold before 31 March 2019, the expenditure test needs to be met for the 12 month period immediately preceding the date of transfer.

Other amendments

- The 2016 Protocol has introduced Article 9(2) in the DTA which includes provisions to facilitate the relieving of economic double taxation (taxation of two different persons with respect to the same income) in transfer pricing cases. Availability of corresponding tax adjustments would ensure that the same income is not doubly taxed due to transfer pricing disputes. This amendment will facilitate the resolution of transfer pricing disputes in transactions between India and Singapore through the Mutual Agreement Procedure or Bilateral Advance Pricing Agreement route, and is in line with the OECD's recommendations under its Base Erosion and Profit Shifting project;
- **Anti-avoidance measures** – The 2016 Protocol has introduced a new article which provides that the DTA will not prevent either of the countries from applying its domestic laws and measures concerning the prevention of tax avoidance or tax evasion.

Key points

Singapore was the largest foreign direct investor into India for the period April 2015 – March 2016 and one of the largest portfolio investors in Indian markets. The capital gains tax exemption regime must have been one of the contributing factors. The impact of the change on the Singapore and India's economy should be closely watched. It is with much anticipation that some new initiatives on joint promotion of bilateral investments will soon be available. For now, businesses will have to revisit their existing investment structures in India and ensure that taxes and underlying currency fluctuations do not outweigh expected gains.

Please contact us for further information on this change.

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SRI LANKA

2017 FISCAL BUDGET PRONOUNCEMENTS

In November 2016, the Minister of Finance presented the Government Budget for the year 2017. Presenting the Budget under the broad theme 'Accelerating Growth with Social Inclusion' the Hon Minister emphasised that reducing the Budget deficit was a priority while special attention would be given to reduce government debt.

The Budget focuses on developing the country, and contains broad policies of national importance that will assist the achievement of the far-reaching reforms to propel Sri Lanka to be a strong high income economy in the Asian region. The medium-term strategy of the government is focused on generating one million employment opportunities, enhancing income levels, developing rural economies, and ensuring ownership of land to the rural and estate sector working class, middle class and public sector employees, thus creating a strongly vibrant much wider middle class.

In that context the Budget has focused on key areas such as sustainability, eco-friendly green initiatives, agriculture, tourism, exports, investment promotion, skill development and productivity, education, health and the SME sector, including accessibility for financial resources. The Budget also focuses heavily on technology-based development such as the digital economy, commercial agriculture, and accelerating the process of industrialisation.

The Budget has critically addressed the aspect of tax revenue, where there is decline in tax revenues as a share of GDP. Tax efficiency in the country is low relative to its peer countries. Tax administration is negatively impacted by the complex tax structure and the large number of exemptions and tax holidays, leading to a narrow tax base. In this context several measures have been proposed to improve government revenue.

We summarise the Budget proposals below, classified under the broad elements in the Budget framework.

Government revenue

Corporate tax

- Three tier income tax rates have been introduced with rates of 14%, 28% and 40%.
- Tax on interest and dividends to be increased to 14%.
- Re-introduction of withholding tax on specified fees.
- Removal of exemptions currently applicable on income from investments in listed securities, Dividends, Unit Trusts and other instruments.

Personal income tax

- Earnings in excess of a tax free threshold of LKR 1.2 million will be taxed at the progressive rate structure which will be 4%-24%, with equal slabs of LKR 600,000 per annum at each level.
- Withholding tax on interest income will increase to 5%, with no exemptions other than for senior citizens who will be entitled to tax-free interest income of LKR 1.5 million per annum.
- Secondary employment income up to LKR 50,000 per month will be liable for PAYE at 10%, and if the amount exceeds LKRv50,000 it will be liable for PAYE at 20%.

Capital gain tax

Capital gain tax on immovable properties will be introduced with effect from 1 April 2017, at a rate of 10%.

Economic Service Charge (ESC)

The ESC threshold will be reduced to LKR 12.5 million per quarter, and the ESC will be charged at the point of customs on the importation of motor vehicles.

Value added tax

- The SVAT scheme will be removed.
- Certain exemptions will be removed.

Nation building tax

The current system will continue, with the removal of some exemptions applicable to certain articles and services.

Financial transaction levy

A new tax will be introduced at the rate of 0.05% on the total cash transactions including easy cash by banks and other financial institutions.

Telecommunications levy

- The telecommunications levy on internet services will be increased to 25%.
- A SIM Card Activation Levy (SCAL) of LKR 200 per SIM will be introduced.
- The Annual Spectrum License Fee (ASLF) is increased by 25% with effect from 1 January 2017.

Other taxes and levies

- The computation of certain taxes on liquor will be revised and certain additional levies will be introduced.
- A new carbon tax for all carbon fuel run motor vehicles will be introduced.
- The excise duty on electric cars with motor power less than 100 KW will be reduced.
- The age limit for importing lorries and refrigerated trucks of capacity over 5 MT will be extended to 10 years. In addition, several duty revisions to correct anomalies in the duty structure will also be made.
- The embarkation levy is increased to USD 50 per passenger.

Other key proposals

- Foreigners will be allowed to buy condominiums with a loan up to 40% of the value.
- A new Securities Act will be introduced with separate board at CSE for SMEs for low cost capital.
- Repeal of Exchange Control Act.
- In a bid to better the ranking in ease of doing business, it has been proposed to have the Registrar of Companies open for operations seven days a week (except public holidays), and strengthen the Inland Revenue Department and the Labour Department related activities such that the time taken to start a business could be reduced to as low as four days.
- The establishment of the Office of the National Business Registry which mandates all businesses to be registered, while the appointment of a National Trade Prosecutor will ensure that the trade and the commercial agreements that the country enters into are enacted properly.

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ALGERIA

FINANCIAL LAW FOR 2017 – MAIN TAX MEASURES

Law No. 16-14 of 28 December 2016, published on the 29 December 2016, in relation to the financial law of 2017, contains several new fiscal and budget measures, including some for FY 2018 and 2019.

Key fiscal measures:

New VAT rates

From 1 January 2017 the standard rate of VAT increased from 17% to 19%, and the reduced rate increased from 7% to 9%.

This rate change 'has no direct impact' on the prices of several necessary products such as bread, meal, bread flour, milk, medicine, sugar, soya-based oil, fruit and vegetables excluding imported ones and distributed by eligible VAT payers (retailers and small traders are not considered as eligible VAT payers).

In addition, the provision of internet access (previously subject to the reduced rate) will be subject to the 19% standard rate from 1 January 2017, although fixed internet access (such as via ADSL) remains exempt from VAT until 31 December 2020.

From 1 January 2017, BUPRO (PROpane BUtane blend, previously exempt from VAT), is subject to the reduced VAT rate of 9%.

Goods and services exempted from VAT (including combine harvesters manufactured in Algeria, paper intended exclusively for the manufacture and printing of books, life insurance contracts and bank loans granted to households for the acquisition or construction of individual dwellings) will not be affected by the increase in prices due to the tax increase.

Entry in force of new rates

The new rates apply to transactions for which the chargeable event takes place from 1 January 2017 (for sales of goods, by legal or physical delivery, and for the provision of services, by full or part payment).

Thus, when physical goods are delivered before 1 January 2017 and invoiced after that date, the rate is 17% or 7%. If this is not the case, the new 19% rate applies.

For services, the new VAT rate is applicable when the payment is made after 1 January 2017, even if the service was supplied and invoiced before that date.

However, contracts which started before 1 January 2017 and which continued in force after that date must be amended to take into account the new VAT rates.

Advertising and broadcasting levies

From 1 January 2017, contracts relating to the production or distribution of advertising on any product not manufactured locally are subject to a specific tax of 10% based on the overall value of the contract.

From 1 January 2017, broadcasting undertakings (audio-visual undertakings, the press, specialist broadcasting undertakings, displays) are subject to a 10% levy on turnover on broadcasting contracts relating to non-manufactured products locally.

Property tax

From 1 January 2017, capital gains on the sale or transfer of commercial and residential land and buildings become subject to income tax at a rate of 5%.

The taxable gain constitutes the positive difference between the sale price of the asset and the acquisition price or the creation value by the transferor.

This tax is not due on capital gains realised on:

- The sale of a property by way of succession, for the liquidation of estate ownership;
- The sale of a building by the lessee or the lessor in a leasing agreement;
- All transfers of land or buildings held for more than ten years.

Income (such as rental income) from both built and unfurnished properties is also subject to tax.

Rescheduling of tax debts of firms in difficulty

To assist companies in financial difficulty, the new law proposes the rescheduling of their tax debt over a period not exceeding 36 months.

In order to encourage these companies to participate in this scheme, it is planned to grant, after the total settlement of their tax debts, a remission of the penalties for delay charged to them.

Transfer pricing

The new law also introduces measures aimed at strengthening transfer pricing controls.

It also obliges foreign companies established in Algeria with a large number of transactions with entities established outside Algeria to keep analytic accounting records.

The amount of the fine for a lack of production or the incomplete production of documentation justifying the transfer prices applied has increased from DZD 500,000 to DZD 2,000,000.

The purpose of this provision is to compel the entities concerned to disclose the methods used to calculate transfer prices and to demonstrate that they are determined at arm's length, and to inform the tax authorities of the legal nature of the relationship between those entities and those with which the transactions are made.

Customs duty and VAT

The law provides for a five-year exemption from customs duties and VAT for components and raw materials imported or acquired locally by subcontractors in the course of their production activities, assemblies and sub-assemblies for the products, and equipment of the branch of mechanical, electronic and electrical industries.

This measure aims to encourage subcontractors approved by the producers concerned, relaunching this sector.

Extension of the Voluntary Tax Compliance Program

The law also extends the Voluntary Tax Compliance Program until 31 December 2017, instead of 31 December 2016 initially, enabling taxpayers to comply with domestic tax regulation voluntary, without paying related penalties (for undeclared activities or revenues).

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AZERBAIJAN

SIGNIFICANT AMENDMENTS TO TAX LEGISLATION

As part of the steps taken by Azerbaijani authorities in an attempt to increase tax inflows to the state budget amid unstable oil prices, a new law introducing numerous amendments to the Tax Code of the Republic of Azerbaijan ('Tax Code') was enacted on 23 December 2016. Most of the amendments entered into force on 1 January 2017. We describe below those having an impact from an international perspective.

Transfer pricing

Transfer pricing comes as a novelty to Azerbaijani law. Under recent amendments to the Tax Code, the tax authorities are entitled to apply transfer pricing rules to transactions between:

(i) Azerbaijani residents and non-residents provided they are related parties;

(ii) A permanent establishment (PE) of a non-resident in Azerbaijan and the said non-resident or its divisions outside Azerbaijan; and

(iii) Azerbaijani residents or PEs of a non-resident in Azerbaijan and entities incorporated in jurisdictions with preferential tax treatment (i.e. jurisdictions which have a tax burden at least twice as preferential as that of Azerbaijan, and laws ensuring secrecy of financial information or information on actual owners and beneficiaries of assets).

The Tax Code lists the following transfer pricing methods:

(i) Resale price method;

(ii) Cost plus method;

(iii) Net margin method using information on similar transactions between comparable unrelated parties; and

(iv) Profit split method using information on similar transactions between comparable unrelated parties.

These methods will be further elaborated by specific transfer pricing rules to be adopted by the Ministry of Taxes, which was instructed by the President of Azerbaijan to introduce such rules no later than January 2017.

Advance tax rulings

Among other novelties to the Tax Code is the advance tax ruling, which previously was only implicit through scattered provisions of the Tax Code. Under the amendments, a tax ruling can be obtained for a particular transaction with a minimum value of at least AZN 10,000,000. The tax authority must issue the ruling within 30 business days from the date the relevant application is filed. The tax ruling will only be effective in respect of the transaction under which it was issued and will be valid for a period of 3 years.

Withholding tax on payments to residents of tax havens

Under recent amendments, all amounts paid to entities registered in jurisdictions with preferential tax treatment are considered as income derived from an Azerbaijani source. Accordingly, all direct or indirect payments from Azerbaijani residents and PEs of non-residents will be subject to a 10% withholding tax. This levy is irrespective of the type of income derived from the Azerbaijani source, and strives to cover payments that cannot be classified as payments for services, royalties, interests, dividends and other outbound payments that are already subject to withholding tax.

The exhaustive list of jurisdictions that are considered to have preferential tax treatment will be approved annually.

Application of VAT and withholding tax in international e-commerce

A new withholding tax at the rate of 10% has been established on transfers from Azerbaijani residents to accounts created at electronic wallets of non-residents. The tax will be withheld and paid to the state budget by local banks/post offices effecting the transfer.

On the other hand, any online purchases from non-residents are now subject to VAT at the rate of 18%. The obligation to charge VAT from transferors and pay it to the state budget has been imposed on banks effecting the transfer. Online purchases of air tickets and hotel services are excluded from this rule.

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EUROPEAN UNION

COMMON (CONSOLIDATED) CORPORATE TAX BASE – RELAUNCHED PROPOSALS

Introduction

On 25 October 2016 the European Commission (EC) relaunched legislative proposals for the Common (Consolidated) Corporate Tax Base (CCCTB) initiative. The original plan, launched in March 2011, was not sufficiently supported by the EU Member States for adopting the CCCTB proposal into a European Directive.

The relaunched proposals introduce a two-step Directive approach: the first Directive would introduce a Common Corporate Tax Base (CCTB), while the second Directive would introduce a consolidation requirement (CCCTB).

In this newsletter, we discuss two aspects of the proposals in more depth:

1. A notional interest deduction (under the name of an Allowance for Growth and Investment (AGI)); and
2. Temporary cross border tax relief.

Allowance for Growth and Investment

The AGI would, according to the EC, tackle the asymmetry whereby interest paid out on loans is deductible (subject to some limits and anti-abuse laws) from the taxpayers' common base, whilst this is not the case for profit distributions. The outcome of this asymmetry is a definitive advantage in favour of financing through debt as opposed to equity.

The AGI addresses the current debt-bias in taxation which allows companies deducting interest payments on their debts from their taxable base (preferably in a high taxed jurisdiction) but does not allow companies deducting the costs of equity from their taxable base. By introducing the AGI in the CCTB, the costs for debts and equity would be treated equally, neutralising the current framework that discourages equity financing. This proposal aims to reward companies for strengthening their finance structure with equity, which should make them less vulnerable to economic shocks.

Under the AGI, taxpayers would be granted a tax deduction when choosing to increase equity for financing (by issuing shares or retaining profits) rather than obtaining debts (e.g. a loan). The deduction would be calculated by multiplying the change in equity by a fixed rate, which is composed of a risk-free interest rate and a risk premium. Under current market conditions, the rate would be 2.7%. Companies would generally be allowed to continue deductions for 10 years. A decrease in equity results in a corresponding addition to the tax base.

Temporary cross-border tax relief

Under the EC proposals, losses incurred by a resident taxpayer or a permanent establishment (PE) of a non-resident taxpayer may be carried forward and deducted in subsequent tax years.

Additionally, in these proposals a cross-border loss relief is introduced. Under this facility, after the deduction of its own tax losses, a resident taxpayer in a Member State is allowed to temporarily utilise the tax losses of its immediate subsidiary or PE in another Member State in proportion to its shareholding.

The EC is of the opinion that in order to facilitate the cash-flow capacity of businesses and encourage cross-border expansion within the European Union, taxpayers should be entitled to temporarily take into account losses incurred by their immediate subsidiaries and PEs situated in other Member States.

This relief for cross-border losses would only provide a temporary advantage, since the parent company should normally add any subsequent profits made by its immediate subsidiaries or PEs back to its tax base at a later date, taking into account the amount of tax losses previously deducted.

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Example

A company starts using the common tax base in January 2020. In the same year it issues EUR 10 million worth of new shares to invest in new premises. The AGI rate for the year 2020 is 3% (the rate will change from year-to-year).

In the year 2020, the company can deduct an AGI allowance for an amount of EUR 300,000 (equity increase of EUR 10 million x 3%) from its taxable profits. The company will also get additional allowances for the following 9 years after issuing this equity.

The exact amounts of the AGI will depend on how the equity value develops. The tax value of participations in related companies will be excluded from the AGI base.

The AGI is an important element of the CCCBT; it will put equity and debt financing on a similar footing for tax purposes.

FRANCE

PROGRESSIVE CORPORATE INCOME TAX RATE REDUCTION

The French standard corporate income tax of 33.1/3% is high compared to the other EU Member States. This rate is about 30.18% in Germany (Federal corporate income tax of 15% increased by a solidarity tax and a corporate local tax), 20% in the United Kingdom and 23.2% for the 27 EU members (unweighted average).

To date, the corporate income tax is a key element of the corporate investment decision and its high level could therefore make the French territory less attractive.

As a result, Article 11 of the French Finance Act for 2017 n° 2016-1917 dated 29 December 2016 aims at gradually reducing the French corporate income tax to 28% by 2020 for all profits of all companies.

Four anticipated steps to gradually reduce the French corporate income tax by 2020

– **For 2017**, the 28% rate would be applicable for SMEs, within the meaning of EU law, up to EUR 75,000 of taxable profit. The 15% rate will remain applicable for the portion up to EUR 38,120 for companies which comply with the conditions of Article 219, I b, of the French Tax Code [i.e. (i) turnover under EUR 7,63 million, (ii) fully paid-up capital and (iii) held at least 75% by individuals or by a company which complies with these three conditions].

– **For 2018**, the 28% rate would be applicable for all companies, up to EUR 500,000 of taxable profits.

– **For 2019**, the 28% rate would be applicable to the whole taxable profit for companies having a turnover below EUR 1 billion and up to EUR 500,000 of taxable profit for companies having a turnover above this EUR 1 billion threshold.

– **For 2020**, the 28% rate would be applicable to all companies.

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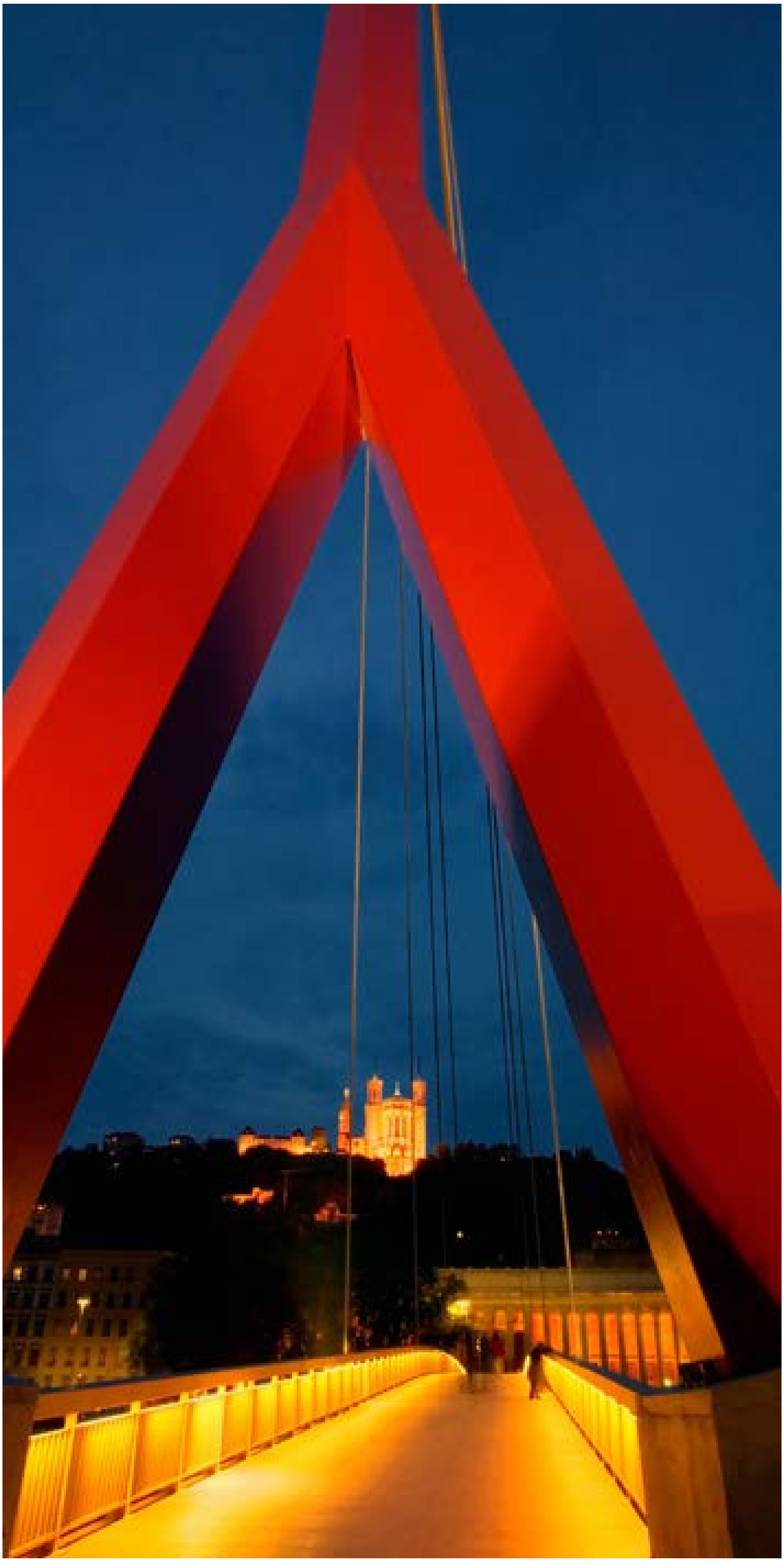

ISRAEL

CLARIFICATION OF REQUIREMENT TO REPORT THE ADOPTION OF A POSITION THAT CONTRADICTS THE TAX AUTHORITIES' POSITION

Further to our update in WWTN issue 41 regarding the requirement to report the adoption of certain positions which contradict the tax authorities' position, where this would entitle the assessee to a tax advantage of ILS 5 million of a specific tax year or ILS 10 million for the previous 4 tax years, the tax authorities have issued a formal list of certain situations on which they have taken a position. The law has now come into effect and will apply from tax year 2016 onwards. The tax authorities have also stated that in future years they may add other positions to the existing list.

The following are some of the positions from an international tax perspective that the tax authorities have published which, if contradicted, will require specific reporting of the assessee's position in its annual tax report:

- Exit tax in respect of an individual who has ceased to be an Israeli resident: the position of the tax authorities is that the exit tax stipulated in the Israeli Tax Ordinance does not contradict any tax treaty Israel has entered into.
- Offsetting of losses from entities classified differently in other jurisdictions: an Israeli resident that holds a foreign entity which for Israeli tax purposes is deemed a non-transparent entity, while being deemed a transparent entity in the other jurisdiction (i.e. hybrid entities), will not be allowed to offset any losses incurred in the foreign jurisdiction against its taxable income.
- The calculation of taxable income of a permanent establishment or foreign resident where the home jurisdiction has not concluded a tax treaty with Israel will be carried out in accordance with Israeli domestic tax law.
- Further positions taken by the tax authorities included various transfer pricing issues.
- Trusts:
  - To the extent that a trust deed determines that a certain individual will not be a beneficiary for as long as he/she is deemed an Israeli resident, the tax authorities' position is that the trust will be treated as if that individual is a beneficiary, and as such, deemed a trust with an Israeli resident beneficiary.
  - Furthermore, to the extent that the trust's deed states that an Israeli resident will not be a beneficiary until certain conditions are met (i.e. the beneficiary must be a certain age, family status (married, single, etc.)) the tax authorities' position is that the trust will be treated as if that individual is a beneficiary and, as such, deemed a trust with an Israeli resident beneficiary.
- Further positions relate to Israeli controlled foreign company (CFC) provisions, inter alia, calculation of the taxable income of a CFC.

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LATVIA

TAX SYSTEM REFORM

At the start of 2016 the World Bank signed an agreement with the Ministry of Finance of the Republic of Latvia to review the equity and efficiency of the Latvian Tax system[1]. At the end of 2016 the first taxpayers' forum was held by the Ministry of Finance, and the World Bank experts presented the research results. The Ministry of Finance intends to use the results in developing future tax policy in Latvia. Experts from the OECD also participated in the forum with research on pro-growth and inclusive tax reform in Latvia. We discuss the World Bank and OECD research results in more detail below.

World Bank

Senior World Bank economists presented a Latvian tax policy review. It was indicated that tax revenue as a share of output in Latvia is relatively low compared to peer countries, so to increase tax revenues in Latvia it is necessary to broaden the tax base, raise tax rates and increase enforcement (reduce evasion).

Under personal income tax (PIT) the main issues are a high tax rate for low-income workers (33.5% for all incomes above the minimum income) and the amount of envelope wages (larger among high-income employees). Latvia therefore needs to introduce a non-linear tax schedule and reduce the tax burden on low income workers. The planned changes for PIT could be revenue-generating or revenue-neutral.

The main capital income tax issues in Latvia are as follow:

- The aggregate burden of capital taxes is low;
- Taxing capital income at very low or zero rates is not socially desirable;
- The tax treatment of capital income is not uniform; and
- Non-uniform tax treatment of capital income is inefficient.

The necessary changes for capital income tax are to raise the share of capital taxes in total tax revenue, introduce uniform tax treatment of all capital income and increase the tax take from assets over time.

An analysis of the VAT regime in Latvia reveals that a significant amount of VAT revenue is lost due to tax evasion and avoidance. Reduced rates and VAT exemptions are costly in terms of public revenue, and differentiated VAT rates should be used for reducing labour market distortions or redistributing income. The priority actions for VAT are improvement of tax compliance, the possibility of phasing out certain exemptions to have one unified rate, and removing lower rate regimes.

Finally, Latvia's corporate income tax (CIT) regime contains many of the ingredients that are required for a well-functioning system of CIT, but at the same time CIT revenue is low compared to that in the EU and other countries. The complexity of Latvia's taxation of business income creates distortions and inequalities, and the asymmetric tax treatment of debt and equity offers an incentive for corporations to use debt rather than equity financing. Therefore the World Bank recommends broadening the tax base, re-focusing tax allowances, and providing measures to counter base erosion and profit shifting (BEPS), including effective implementation of the EU Council Directive on CIT avoidance. When reforming the CIT system, Latvia should focus not just on revenue generation, but on the impact on economic activity, including investment and employment.

OECD

According to the OECD, the average tax wedge on labour income is relatively high amongst the OECD countries, but the PIT is not very progressive. At the same time, the tax wedge consists of high employee and (especially) employer social security contributions (SSC), but the marginal tax wedges at average earnings are at the average. Therefore Latvia needs to reform the PIT and its progressivity, to integrate the solidarity tax within the PIT and to address the excessive SSC burden on low incomes.

Evaluating CIT, the OECD indicated that the statutory CIT is very low, but Latvia has a very narrow corporate income tax base, which leads to very low effective corporate tax rates. Also, the micro enterprise tax needs urgent reform. Therefore the fundamental required reforms of CIT are:

- Broadening the CIT base;
- Implementing the new international tax BEPS minimum standards and best practices;
- Reforming/ increasing taxes on capital income at the individual level;
- Aligning the 'top' tax burden on labour and capital income to prevent tax-induced incorporation incentives;
- Strengthening the tax administration, tax enforcement and tax compliance (within all major taxes);
- Strengthening environmentally related taxes;
- Increasing recurrent taxes on immovable property.

The key principles for tax reform in Latvia should be: coherence of the tax system, the design of the tax system – strengthening the international tax system principles, the overall progressivity of the tax system and evaluation of tax expenditures on a regular basis.

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[1] According to the World Bank group research Doing Business 2017, Latvia ranks in 15th place in paying taxes (necessary tax payments per year are 7; time spent per year – 168.5 hours, total tax rate of profit – 35.9% and the efficiency of post-filing processes – 98.11%).

LUXEMBOURG

NEW RULES FOR INTRA-GROUP FINANCING

On 27 December 2016 the Luxembourg tax authorities published a new circular on the tax treatment applicable to a company that carries out an intra-group financing activity. Starting with fiscal year 2017, the new circular replaces the previous guidance that has been in place since January 2011. The new circular is related to new article 56bis of the Luxembourg Income Tax Law, which is closely aligned with chapters I to III of the OECD Transfer Pricing Guidelines also applying from fiscal year 2017.

The most important change is the abolition of the 1% equity at risk requirement (with a cap of EUR 2 million), which was an essential element for demonstrating the substance required in order to be considered as the beneficial owner of the interest payments on intra-group loans. Under the new circular, there is no such standardised equity requirement, but the equity required has to be determined on the basis of a comparability analysis in line with the OECD Transfer Pricing Guidelines. In addition, the Luxembourg tax authorities expect risk management to physically take place in Luxembourg.

In a case where the requirements under the new circular are not met, the Luxembourg tax authorities might consider that the intra-group financing company is not the beneficial owner of interest payments and spontaneously exchange information with the tax authorities of the source country. This might be problematic if the Luxembourg company benefitted from a reduced withholding tax rate on the interest payments.

Besides the question of beneficial ownership, the foreseeable increase of the equity required in many cases will also affect the remuneration that Luxembourg intra-group financing companies need to earn in order to comply with the arm's length principle. The circular provides guidance on the return on equity that would be regarded as arm's length in certain situations, but this does not entirely replace the need to carry out a transfer pricing analysis to validate the arm's length terms and conditions in intra-group transactions.

The Luxembourg tax authorities will give taxpayers time to adapt to the new rules, but will expect an intra-group financing company with insufficient equity to have increased this to the required level at the end of the year 2017. Checks of the level of equity will then take place on basis of the 2017 tax returns, probably in 2018 or 2019.

The European Commission has been consulted in developing the new circular and has approved it prior to publication by the Luxembourg tax administration.

Affected groups will need to review existing arrangements in the coming months and consider making any required modifications.

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THE NETHERLANDS

CORPORATE INCOME TAX RATES FOR FORTHCOMING YEARS

The corporate income tax rates for year 2017 remain unchanged (20% for taxable amounts up to EUR 200,000 and 25% for the excess).

The rates for future years as proposed in the 2017 Dutch Budget Plan are shown in the following table:

Tax year	Taxable amount	Corporate income tax rate
2018-2019	Up to EUR 250,000	20%
	Over EUR 250,000	25%
2020	Up to EUR 300,000	20%
	Over EUR 300,000	25%
2021	Up to EUR 350,000	20%
	Over EUR 350,000	25%

SUPREME COURT PARTICIPATION EXEMPTION RULING

A holding of shares in a company may be subject to a so-called 'change of control' clause requiring the shareholder to offer its shares to another shareholder in the event of an (intended) indirect sale of those shares. If a shareholder sells its shares, but refuses to offer them to another shareholder, a court may well order it to make a settlement payment for infringing the change of control clause.

The Dutch Supreme Court recently considered whether such a settlement payment can be considered as a benefit arising to the recipient from a participation to which the participation exemption applies for Dutch corporation tax purposes.

On 23 September 2016, in case 15/02428, the Supreme Court decides as follows: a shareholding – that a taxpayer wishes to acquire – would only qualify as a participation for the participation exemption if an agreement has been concluded which obliges one party to deliver the shares and the other party to do something in return for acquiring the shares.

This ruling implies that a shareholding could not qualify as a participation for the participation exemption in the pre-contractual stage of its intended acquisition. As a consequence, a settlement payment resulting from terminating this pre-contractual stage by the seller would not be subject to the participation exemption at the level of the intended buyer. No participation would exist at the level of the intended buyer for the participation exemption at this stage to which the settlement payment could be attributed.

In summary, if no agreement is in place which obliges a shareholder in a company to deliver its shares to another shareholder who is obliged to do something in return for acquiring those shares, the shares do not qualify as a participation for the participation exemption. Consequently, the settlement payment cannot be considered as a benefit arising to the recipient from a participation to which the participation exemption applies.

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ROMANIA

CORPORATE TAX RELIEF FOR COMPANIES' RESEARCH AND DEVELOPMENT ACTIVITIES

Under the new provisions of the Romanian Fiscal Code (Law 227/2015), companies which carry out exclusively **innovation**, **research** and **development** activities (R&D) are exempt from payment of corporate income tax in the first 10 years of activity.

The Fiscal Code provides another main facility for companies paying corporate profit tax that develop R&D activities: such companies can benefit from a supplementary deduction of 50% from the expenses incurred in R&D. Also, they can opt to apply certain more favourable methods of amortisation for the equipment used. A condition for benefitting from this facility is that the R&D activities eligible for awarding the supplementary deduction must be from the category of activities developed by the taxpayer.

Where the R&D activities are carried out by more taxpayers through an association/ collaboration, the fiscal incentives are awarded to each of the participants after analysing the expenses incurred.

In summary, the expenses eligible for the supplementary deduction are:

- Expenses with amortisation or rent of equipment (tangible/intangible assets);
- Operational expenses such as consumables, services contracted, materials, and other experimental products for carrying out R&D activities;
- Expenses of personnel involved in R&D activities;
- Maintenance expenses for tangible/intangible assets.

The deductions awarded are not recalculated if the taxpayer does not realise the objectives of the R&D project.

The definitions of research and development activities within the meaning of the Romanian legislation.

Under the provisions of Ordinance 57/2002 regarding scientific research and technological development, **research** means 'experimental or theoretical activities developed to acquire new knowledge related to fundamental phenomena, and noticeable facts, without pursuing the immediate use or application', while experimental **development** is 'systematic activity, starting from knowledge resulted from research, which pursues the production of new materials, products or devices, setting up new processes, systems and services, or substantial improvement of the existent ones'.

Innovation represents 'implementing a product, service or new process or a substantially improved or new marketing method or new business in practical activity, organisation of the working place or external relations'.

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SPAIN

TAX MEASURES FOR 2017

Increase in Corporate Income Tax (CIT) and other taxes

On 3 December 2016, Royal decree-Law 3/2016, implementing tax measures (the Decree), was published in the official Gazette. The Decree introduces several measures in order to comply with the European Union Recommendations (21 June 2016). The most important measures are the following:

- The limit on the offsetting of tax losses is modified. For fiscal years starting on or after 1 January 2016 tax losses of previous years can be offset up to 60% (70% for fiscal year 2017 and onwards) of the taxable base, except 'large Enterprises', for which the limit is 50% (if turnover between EUR 20 million and EUR 60 million) or 25% (if turnover higher than EUR 60 million);
- For fiscal years starting on or after 1 January 2016, equity impairments losses that were deducted from the taxable base in fiscal years prior to 2013 must be annually reversed on a straight line basis over a five-year period;
- Starting from 1 January 2017, losses arising on transfer of participations whose capital gains and dividends qualify for the participation exception regime will no longer be deductible for CIT purposes. The same regime is applicable to permanent establishments outside Spain, whose losses arising on their transfer will not be tax deductible from fiscal year 2017 onwards;
- Starting from 1 January 2017, all types of losses generated by participations held in entities resident in tax havens or low-tax jurisdictions must be excluded from the taxable base.

VAT immediate delivery of information

From 1 July 2017, there will be a new system for providing the information needed to complete VAT ledgers through the website of the Spanish tax Authorities. This new system will be compulsory to all taxpayers that submit VAT returns on a monthly basis (companies with a turnover higher than EUR 6 million, VAT Groups, and taxpayers registered into the VAT monthly refund scheme – mainly exporters). The remaining companies can opt for the regime.

There is a very tight deadline (four calendar days) for sending the content of the invoices received / issued, through the Tax Authority's website, using a web service or an electronic form.

This new system of information will let the Tax Authorities have live data of companies' VAT inputs and outputs.

Model Country-by-Country (CbC) reporting

On 30 December 2016, model 231 of Country-by-Country reporting was published in the official Gazette. The Spanish corporate income tax regulations provide that any entity or entities resident in Spain forming part of a group with a turnover of at least EUR 750 million must submit CbC reports to the Tax Authorities.

The CbC report must be filed no later than 12 months after the end of the tax year (i.e. for year-end 31 December 2016 the CbC report must be submitted before 31 December 2017).

The content of the CbC is basically as follows (for any jurisdiction where entities are resident): entities that comprise the Group, fiscal jurisdiction, turnover, transactions between related parties, profit/loss before CIT, CIT quota, net capital, number of employees and assets.

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SWITZERLAND

SWISS WITHHOLDING TAX – INTEREST CHARGE FOR LATE NOTIFICATIONS OF DECLARATIONS

The Swiss withholding tax law allows the withholding tax requirement on dividend distributions to Swiss or foreign parent companies to be met by 'declaring' (i.e. notifying) the payment to the Swiss Federal Tax Authority (FTA), instead of the tax actually being paid to the FTA and refunded to the parent company. The current law requires an application for the notification procedure to be filed within 30 days after the due date of the dividend. No consequences are explicitly stipulated where the notification is submitted after this deadline and, based on the practice until 2011, the deadline was treated as purely administrative. Therefore, a delay in filing the notification was typically not sanctioned, or if at all, then only with a small fine.

However, in January 2011, the Swiss Supreme Court ruled that this deadline was a fixed deadline, and that the taxpayer loses the opportunity to apply for the notification procedure if he does not file the relevant forms within 30 days. With reference to this Supreme Court decision, the FTA started in 2011 to refuse late submissions, even though the legal preconditions for the notification procedure were fulfilled. In addition, the taxpayer had to pay the withholding tax in cash, and the beneficiary needed to reclaim the withholding tax. The FTA also charged 5% interest for the delayed payment of a tax which was never actually due.

In its autumn session, the Swiss parliament voted for a retroactive correction of the practice regarding the notification procedure for withholding taxes. This correction includes reimbursing approx. CHF 600 million of interest for late payments pursuant to filing the notification declaration. New regulations and the possibility of reclaiming previously paid interest became effective on 1 February 2017. However, companies that have been affected by the stricter practice of the FTA since 2011 are allowed to accrue this benefit in their 2016 Financial Statements.

Under the new rules, a delayed filing of the notification procedure no longer forfeits the right to apply for the notification procedure in cases where the conditions are fulfilled. Consequently, interest for late payment cannot be charged, because the withholding tax itself does not need to be paid in cash. However, in cases where the deadline is missed, the FTA has the right to penalise the taxpayer with a fine of up to CHF 5,000. This new rule has a retroactive effect and therefore it becomes possible from the 2011 tax year onwards to reclaim paid interest for late filing of the notification procedure. This is of course only applicable if the taxpayer was entitled to the notification procedure at the time of the dividend payment. The FTA will not pay any interest on the repayment.

The interest for late payment will not be repaid automatically but the FTA has already announced a simple and non-time-consuming procedure to reclaim the withholding tax. From 15 February 2017 until 31 January 2018, the interest can be reclaimed by filing Form 1 RVZ. The FTA will not accept any other format of the claim (e.g. by letter). The FTA has already announced that they will review each claim in detail, in order to avoid interest from cases which do not fall in the narrow scope of this new rule being reclaimed.

If the interest has not yet been paid by the taxpayer, the FTA will automatically cancel its claim. The taxpayer concerned will be informed directly and should receive a confirmation about the cancellation from the FTA.

As far as pending cases before the courts are concerned, the FTA highly recommends filing the Form 1 RVZ in order to meet the filing deadline. However, the repayment will not be granted before the final decision is taken.

In any case, taxpayers have no right to claim interest on the amount they receive back from the FTA. We are more than happy to assist with such cases and the reclaim procedure.

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UNITED KINGDOM

PROPOSED CORPORATION TAX CHANGES

Relaxation of group tax-free reorganisation rules

The draft Finance Bill 2017 contains a number of proposed amendments to the Substantial Shareholdings Exemption (SSE) which enables groups to dispose of group companies free of corporation tax on the gain. The proposals, designed to make it simpler to operate the SSE and ensure that the UK remains fully competitive with other holding company jurisdictions, reflect changes to the domestic and international tax landscape since the SSE was introduced in 2002. The main proposed improvements are:

1. **Removal of the investor company trading condition**
   Currently, to qualify for the exemption from corporation tax on gains of disposals of group companies, both the investor group and the investee company or subgroup must meet a trading status requirement. The proposal is that the exemption will be reformed to remove the test for the investor group. From 1 April 2017 it will be the trading status of the investee company (and, if relevant, its subgroup) that counts, and the investing company will no longer have to be a sole trading company or a member of a trading group at any time before or after the disposal.

   This will be particularly helpful for reorganising UK subgroups of a foreign owned group, as obtaining information about the foreign parent's wider group activities has proved onerous. The change will mean that the UK company should itself have ready access to the required information. It should also enable property groups to benefit from the SSE when selling off development activities, including helping groups with a combination of trading and investment activities, e.g. so that a mixed property group can access the exemption when selling a development subsidiary.

2. **Broader exemption for companies owned by qualifying institutional investors**
   The trading condition for investee companies owned by investor companies which are themselves owned by qualifying institutional investors (QIIs), such as pension funds, sovereign wealth funds, charities and certain UK investment funds, will also be removed from 1 April 2017.

   The full exemption is available where at least 80% of the investor company is owned by QIIs, with a proportional exemption where the QII holding percentage is between 25%-80%. Furthermore, the exemption is extended to cover disposals where the UK investor company owns a sub-10% stake in the investee company which cost more than GBP 50 million.

   The fact that gains realised by such investors are currently taxable when investing through a UK company, but would be tax exempt when investing directly, has caused some to invest through offshore holding companies, which will no longer be necessary in future. This should help to achieve the Government's aim of improving the SSE in order to increase the UK's competitiveness as a holding company location for global investors. This change will also open up the relief to property investment for the first time.

Corporation tax loss relief reforms

The draft 2017 Finance Bill contains clauses implementing the proposed new regime for carry forward of tax losses, effective from 1 April 2017.

The draft legislation contains a number of amendments to the current regime, including:

- All post-April 2017 losses carried forward (whether trading or non-trading) can be used against total profits (rather than having to be streamed as now), or against profits of other group companies. However, the amount of taxable profits that can be fully offset by brought forward losses will be restricted to GBP 5 million, with a 50% restriction applying to the excess over GBP 5 million.
- Post-April 2017 losses can be used in priority to pre-April 2017 losses. The latter will still have to be streamed, unless a company elects to forgo them.
- Companies will be able to make a claim to decide whether to defer use of pre-April 2017 trading losses in favour of other loss reliefs (e.g. in-year group relief or post-April 2017 loss transfers).
- A simplified calculation will be allowed for companies who have no pre-2017 carried forward losses (or elect to forgo them). They will no longer have to apportion profits between trading and non-trading for loss offset. However, they cannot use a simplified calculation simply because they believe they would fall within the GBP 5 million annual allowance.
- The legislation confirms that losses and profits of a period straddling 1 April 2017 are to be split on a time apportionment basis, subject to a 'just and reasonable' override.
- The GBP 5 million annual allowance for a 'group' will be based on the existing group relief definition, but amended to minimise scope for avoidance. In particular, the decision not to use the IFRS 10 consolidation test as the basis will be welcomed by private equity-backed groups who could otherwise have found themselves aggregated. The fixed GBP 5 million allowance will be allocable at a group's discretion – so for example a company with GBP 7 million of post-April 2017 trading profit may be able to set off GBP 6 million of its pre-April 2017 trading loss.
- Terminal loss relief will be extended to permit a company's carried forward trading losses to be used to offset its profits of the 36 months prior to cessation (but not profits before 1 April 2017) without applying the 50% restriction.

Various anti-avoidance provisions are being introduced into the new rules, including:

- Groups buying a loss-making company cannot access its pre-acquisition losses for a period of 5 years;
- The change in ownership rules will be extended to catch changes made in the 5 years after acquisition;
- Where a company's trade or business becomes 'small or negligible', its carry forward losses will be streamed and this will also apply for the first time to non-trade debits which will henceforth expire on cessation of the company's investment business;
- When a company has disposed of all its income-producing assets, it can no longer surrender its carry forward losses;
- The 'transfer of deductions' provisions (which target latent losses) will be extended to catch loss carry forwards;
- The loss refresh provisions will be extended to encompass all losses;
- New targeted anti-avoidance rule, e.g. targeting fragmentation of a 'group' for the GBP 5 million allowance and artificial inflation of profits to frustrate the 50% restriction.

Groups should model the impact of the transition to the new loss regime and in particular the interaction with the new rules limiting interest deductibility which will also apply from 1 April 2017. For example, paying off deferred interest before April 2017 may mitigate an interest limitation, but result in a loss carry forward limitation.

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BRAZIL

TAX REGULARISATION PROGRAMME (PRT)

On 5 January 2017, the Brazilian Government issued Provisional Measure (MP) no. 766/2017 which allows individuals and legal entities to regularise tax debts due by 30 November 2016. Within this programme, taxpayers will also be allowed to include debts under discussion with the Tax Authorities, both in the administrative and judicial courts.

Taxpayers can elect for PRT within 120 days from the issue of the regulation by the Brazilian Tax Authorities (RFB) and Federal Attorney (PGFN), expected to be in February 2017.

Consequences of PRT

Participation in the PRT involves:

- An irrevocable and irreversible acknowledgement of the debts;
- An obligation to regularly pay instalments under the Program and also overdue debts after 30 November 2016;
- The inability to include the debts that are part of PRT in any other subsequent financing program;
- Commitment with the FGTS (Severance Pay Fund) obligations.

PRT payment alternatives

There are various options for regularising the debts, and other differences, depending on who manages the debts – RFB or PGFN – as shown in the tables below.

RFB debts

Option	Minimum Initial Cash Payment	Remaining Balance
1	20% of the debt paid on making the election	Offset with net operating losses (NOL) or with other Federal Tax credits managed by RFB*
2	24% of the debt paid in 24 monthly instalments	Offset with NOL or with other Federal Tax credits managed by RFB*
3	24% of the debt paid on making the election	Payment in up to 96 instalments
4	No payment	Payment in up to 120 instalments**

The NOL to be utilised are the credits calculated up to 31 December 2015 and filed up to 30 June 2016. NOL credits from the controlling or controlled company, resident in Brazil, can also be used.

PGFN debts

Option	Minimum Initial Cash Payment	Remaining Balance
1	20%	Payment in up to 96 instalments
2	No payment	Payment in up to 120 instalments**

Exclusion from PRT

Taxpayers will be excluded from the PRT and required to pay the total debts, in certain circumstances, including:

- Lack of payment of three consecutive or six alternating instalments;
- Lack of payment of one instalment, if the others were paid;
- Fraud verified by RFB or PGFN;
- Bankruptcy or liquidation of the taxpayer.

The main difference from this programme to the previous ones is that there is no discount on penalties and interest, but on the other hand there is the ability to utilise NOL to offset part of the debts.

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* If the NOL is not sufficient to offset the total debt, the remaining balance could be paid in up to 60 monthly instalments.

** The amount of each instalment will be increased by Selic interest and determined applying the following percentage on the consolidated debt:
- Instalment 1 to 12: 0.5%
- Instalment 13 to 24: 0.6%
- Instalment 25 to 36: 0.7%
- Instalment 37 on: remaining balance to be paid in 84 instalments.

UNITED STATES

FOREIGN OWNED DOMESTIC DISREGARDED ENTITIES – FINAL REGULATIONS

Summary

The Department of the Treasury ('Treasury') and the Internal Revenue Service (the 'Service') have issued final regulations under Internal Revenue Code ('IRC') Section 6038A (the 'Final Regulations') in relation to reporting, record maintenance and compliance for domestic disregarded entities wholly owned by a foreign person.

Background

On 6 May 2016, Treasury and the Service issued proposed regulations that would amend Treasury Regulation §301.7701-2(c) to treat a domestic disregarded entity that is wholly owned by one foreign person as a domestic corporation separate from its owner, for the limited purposes of the reporting and record maintenance requirements (including the associated procedural compliance requirements) under IRC Section 6038A.

The proposed regulations are discussed in more detail in our Tax Alert '*IRS Proposes Regulations Requiring New Reporting Requirements Under Internal Revenue Code ('IRC') Section 6038A for Foreign-Owned Domestic Disregarded Entities*' dated May 2016.

The proposed regulations would have applied to taxable years of the entities described in §301.7701- 2(c)(2)(vi) ending on or after the date that is 12 months after the date of publication of the Treasury decision adopting the proposed rules as final regulations in the Federal Register.

In addition to generally soliciting comments on all aspects of the proposed rules, the preamble to the proposed regulations specifically requested comments on possible alternative methods for reporting a domestic disregarded entity's transactions in cases in which the foreign owner of the domestic disregarded entity already has an obligation to report the income resulting from those transactions – for example, transactions resulting in income effectively connected with the conduct of a United States trade or business. The Final Regulations reflect a limited number of changes by Treasury and the Service to the proposed regulations. These changes are discussed below.

Final Regulations

First, the Treasury and the Service state in the preamble to the Final Regulations that the generally applicable exceptions to the requirements of Section 6038A should not apply to a domestic disregarded entity that is wholly owned by a foreign person. Accordingly, the proposed regulations provided that the exceptions to the record maintenance requirements in §1.6038A-1(h) and (i) for small corporations and de minimis transactions would not apply to these entities.

However, the proposed regulations did not address the additional exception provided in §1.6038A-2(e)(3), under which a reporting corporation is not required to file Form 5472, Information Return of a 25% Foreign-Owned United States Corporation or a Foreign Corporation Engaged in a United States Trade or Business (Under IRC Sections 6038A and 6038C), with respect to a related foreign corporation when a United States person that controls the related foreign corporation files a Form 5471, Information Return of United States Persons With Respect to Certain Foreign Corporations, containing required information with respect to reportable transactions between the reporting corporation and the related foreign corporation for the taxable year.

Similarly, the proposed regulations did not address the additional exception provided in §1.6038A-2(e)(4), under which a reporting corporation is not required to file Form 5472 with respect to a related foreign corporation that qualifies as a foreign sales corporation for a taxable year for which the foreign sales corporation files Form 1120-FSC, United States Income Tax Return of a Foreign Sales Corporation. Upon final consideration of the proposed regulations, Treasury and the Service have concluded that, consistent with the scope and intent of the proposed regulations, the reporting requirements of the proposed regulations should apply without regard to the exceptions generally applicable under §1.6038A-2(e)(3) and (4). The exceptions in §1.6038A-2(e)(3) and (4) are revised accordingly in the Final Regulations.

Second, to facilitate entities' compliance with the requirements of Section 6038A, including the obligation of reporting corporations to file Form 5472, the Final Regulations provide that these entities have the same taxable year as their foreign owner if the foreign owner has a United States return filing obligation. If the foreign owner has no United States return filing obligation, the Final Regulations provide that the taxable year of these entities is the calendar year unless otherwise provided in forms, instructions, or published guidance.

Third, Treasury and the Service have concluded that for ease of administration, these regulations should apply to taxable years of entities beginning on or after 1 January 2017, and ending on or after 13 December 2017. The proposed regulations would have applied to taxable years ending on or after the date that is 12 months after the date of publication of the final regulations in the Federal Register, without regard to the date on which the taxable year began.

The Final Regulations adopt the proposed regulations as so amended and with certain other minor clarifications.

BDO insights

The Final Regulations expand the reporting that is required under IRC section 6038A. Please contact a BDO international tax specialist for assistance in reviewing how these rules may impact a Company's reporting requirements.

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CURRENCY COMPARISON TABLE

The table below shows comparative exchange rates against the euro and the US dollar for the currencies mentioned in this issue, as at 7 February 2017.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
Algerian Dinar (DZD)	0.00846	0.00910
Australian Dollar (AUD)	0.71206	0.76594
Azerbaijan New Manat (AZN)	0.48642	0.52326
British Pound (GBP)	1.15957	1.24731
Euro (EUR)	1.00000	1.07555
Indian Rupee (INR)	0.01383	0.01488
Israeli New Shekel (ILS)	0.24797	0.26675
Singapore Dollar (SGD)	0.65953	0.70948
Sri Lanka Rupee (LKR)	0.00613	0.00660
Swiss Franc (CHF)	0.93597	1.00678
US Dollar (USD)	0.92960	1.00000

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