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INTERNATIONAL

BEPS UPDATE

Implementation of the OECD's Base Erosion and Profit Shifting (BEPS) Actions continued with the signing of the BEPS Multilateral Convention by 68 countries on 7 June 2017, and the publication a couple of weeks later of draft guidance on:

– Attribution of Profits to Permanent Establishments (Action 7);

– Profit Split methods (Action 10).

Multilateral Convention

The Multilateral Convention will modify more than 1,100 existing double tax treaties between the signatory countries. This follows the BEPS Action 15 recommendation for the development of a multilateral instrument to allow countries to swiftly modify their bilateral treaties to implement tax treaty related measures developed as part of the BEPS work. The treaty measures relate to the following BEPS action points:

– Action 2 (Hybrid mismatches);

– Action 6 (Treaty abuse);

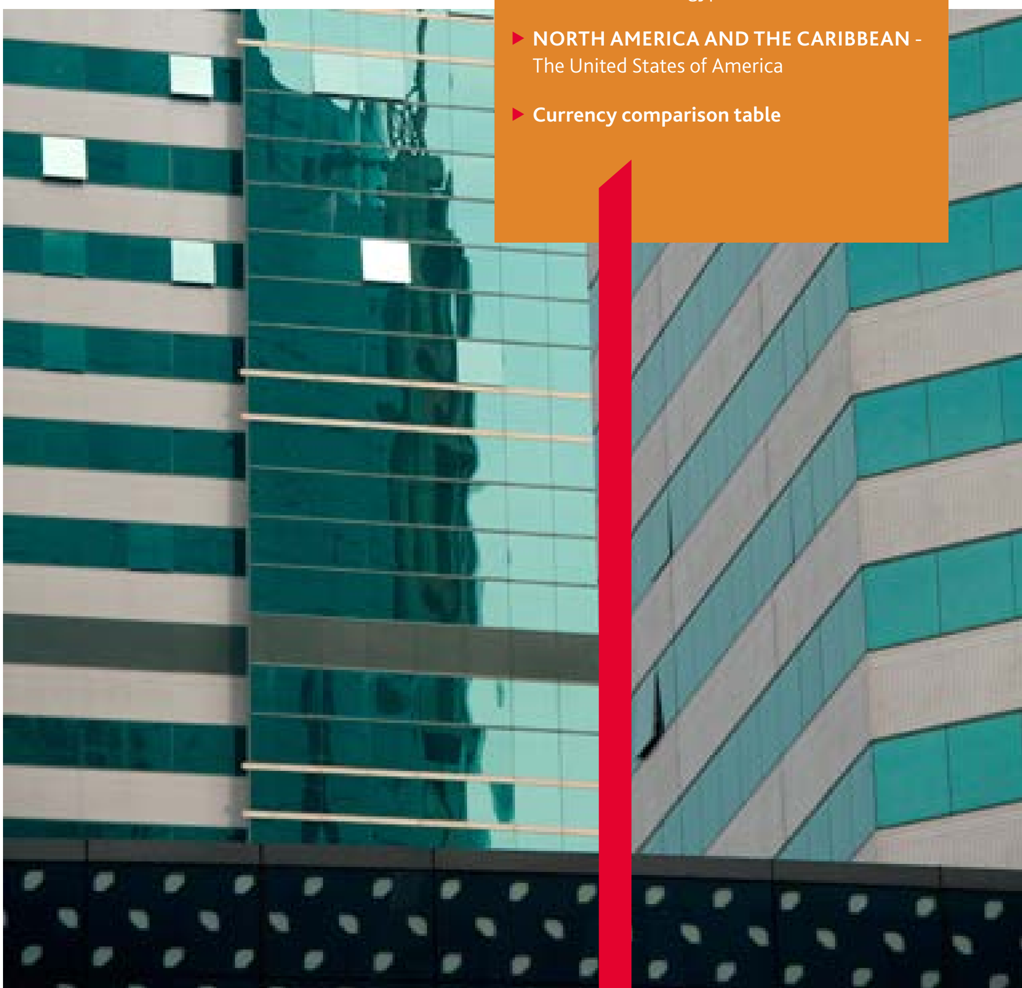
– Action 7 (Artificial avoidance of Permanent Establishment (PE) status); and

– Action 14 (Improving dispute resolution).

The signatory countries have listed the bilateral treaties they wish to be amended, and have selected the measures to be adopted. For some measures choices are available; for example for Action 6, countries can choose which anti-abuse rule to use: either a principle purpose test or a limitation on benefits article. In general, each amendment only takes effect where there is a 'match' in choices, so each treaty will have to be considered individually to determine which amendments/choices are to take effect.

In terms of timing, each treaty state needs to ratify the Convention, and in the case of withholding tax, the changes will not apply until the following 1 January. For the UK, ratification is typically straightforward, and where a treaty is between two such countries, the changes will take effect from 1 January 2018. For other treaties, the changes may not take effect until 1 January 2019 or later.

While some of the BEPS Actions seek to counter complex tax structures, such as Action 2 on hybrid mismatches, Action 7 on PEs has the potential for much broader effect. Most international groups benefit from the treaty provisions regarding PEs which allow a company to make sales in another country without having a taxable presence in that other country, so long as their activities in the other country are below a certain threshold. BEPS Action 7 made recommendations to reduce the threshold level in tax treaties in order to prevent the artificial avoidance of PE status.



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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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Attribution of profits to Permanent Establishments

While the development of the new PE thresholds has involved much consultation, the related question of how profits should be allocated to a PE has received less attention during the BEPS process. On 22 June 2017, the OECD published a Public Discussion Draft titled 'Additional Guidance on Attribution of Profits to Permanent Establishments'. This considers the impact of BEPS on the attribution of profits to PEs under the relevant article in the OECD model tax treaty (Article 7). In summary, the Discussion Draft makes the following points:

- The changes to the PE threshold (e.g. as implemented through the Multilateral Convention), do not require substantive modifications to the existing rules and guidance on the attribution of profits to PEs.
- The profits to be attributed to a PE are to be determined in accordance with Article 7 of the relevant tax treaty. Article 7 is grounded on the basic principle that the profits attributable to a PE are those that the PE would have derived if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions.
- This principle applies regardless of whether a tax administration adopts the authorised OECD approach (AOA) contained in Article 7 in the 2010 version of the Model Tax Convention (MTC), or any other approach used to attribute profits under a previous version of Article 7 of the MTC.

In determining the profits allocation, a functional analysis should be carried out to determine the attribution of risk assumption and economic ownership of assets to a PE. Guidance produced under BEPS Actions 8-10 (and incorporated into Chapter 1 of the OECD Transfer Pricing Guidelines) clarifies that where the party contractually assuming the risk does not control the risk or does not have the financial capacity to assume the risk, that risk should be allocated to the enterprise exercising control and having the financial capacity to assume the risk. Under the AOA, the notion of 'significant people functions' is used for attributing risk assumption and economic ownership of assets to a PE. Broadly, the approaches are consistent in placing emphasis on substance and value creation over contractual form.

From a taxpayer's perspective, the Discussion Draft provides some reassurance in that no new approach to profit attribution to PEs is proposed, beyond applying existing guidance (in a manner consistent with BEPS). Thus, where the threshold for a PE is reduced as a result of a change to a bilateral tax treaty, it may be arguable that no significant profit (if any) should be attributed to the PE. This assumes existing transfer pricing policies are BEPS compliant and the contractual arrangements reflect the substance of the activities in each country.

Summary

Implementation of BEPS Actions limiting treaty benefits (and potentially improving dispute resolution) took a significant step forward with the signing of the Multilateral Convention. The Draft Guidance published on the Attribution of Profits to PEs provides little further insight for taxpayers, but at least does not substantively modify existing rules and guidance.

Groups should continue to evaluate and respond to the impact that the BEPS changes will have on their international structures, trading arrangements, and transfer pricing policies and documentation.

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AUSTRALIA

TRANSFER PRICING INTRA GROUP FINANCING CASE WIN FOR TAX OFFICE CONFIRMED AND FEDERAL BUDGET TARGETS FOREIGN INVESTORS, FOREIGN WORKERS AND BANKS

There has been significant movement in Australia on the International tax front, with a big win for the Australian Tax Office ('Tax Office') in transfer pricing on intra group financing costs as the lead story. The latest Federal Government Budget has targeted foreign property investors, foreign workers, foreign hybrid mismatches and clarification of the Multi-national Anti-Avoidance law (MAAL).

Transfer Pricing – Chevron

The Tax Office has declared victory in its ongoing transfer pricing dispute with Chevron. The case involved intra group financing, and the pricing of finance provided to the Australian Chevron subsidiaries. The Tax Office was victorious in Chevron's appeal to the Full Federal Court, and Chevron has now abandoned any further appeal and has reached a settlement with the Tax Office on other outstanding tax years.

It is apparent that Chevron has now accepted that pricing the cost of intra group financing cannot be done based on the debtor being a stand-alone entity, but rather account has to be taken of the group financing policies and assumed support by the rest of the group.

Since the Full Federal Court decision, the Tax Office issued guidance (PCG 2017/D4) which represents a risk assessment framework on intragroup financing. With the settlement of the case, and the success in Court, it is expected the Tax Office will more aggressively assess the pricing of intragroup financing in multi-national enterprises.

Multi-national groups operating in Australia with intra group financing are recommended to review their financing costs to see if they need to reconsider their pricing in light of these developments.

2017/18 Federal Budget

Foreign Investor withholding payments

From 1 July 2017, the non-final withholding tax on payments made to foreign residents who dispose of selected Australian real property has increased from 10% to 12.5%. The tax is payable on sales of Australian real property; however, for residential property there is a threshold sales value before the withholding tax applies. This residential property value threshold has decreased from AUD 2,000,000 to AUD 750,000 from 1 July 2017.

Main residence exemption

From 9 May 2017, non-residents are no longer able to access the capital gains tax (CGT) main residence exemption. Under this exemption, when an individual (either a resident or non-resident) sells a property which they use as their main residence, the sale does not attract CGT. There are also concessions that allow this exemption to continue where the taxpayer leaves the dwelling for up to six years, where the dwelling becomes income-producing (e.g. receipt of rent) or indefinitely where it is not income-producing. This exemption was used by many people who became non-resident but continued to own their homes in Australia.

This main residence exemption is no longer available where the taxpayer is non-resident at the time of the CGT event (e.g. date of contract to sell the property).

In the Federal Budget, the Government announced the exemption will not be available to both non-residents and temporary residents. However, when the legislation was recently introduced the loss of exemption only applies to non-residents.

Under-utilised Residential Property Levy

The Government has announced its intention to introduce an annual levy which will apply to foreign owners of residential property located in Australia where the property is neither occupied, nor genuinely available for rent for at least six months of the year.

The charge is equal to the foreign investment application fee which is imposed at the time the property is acquired by the foreign owner.

Several State Governments have announced similar measures to combat non-residents purchasing, and then not using, residential properties.

Restricting foreign ownership in new property developments

The Government also announced changes to the property ownership rules that apply to foreign persons. Property developers can apply for an exemption certificate to sell new dwellings in a development to foreign persons (New Dwelling Exemption Certificate). These act as a pre-approval, allowing the developer to sell new dwellings without each foreign purchaser seeking their own foreign investment approval.

From 9 May 2017, the approval of New Dwelling Exemption Certificates will be subject to a condition that the developer may only sell a maximum of 50% of the total dwellings in the development to foreign persons.

Employment restrictions for foreign workers and new levy on employers of foreign workers

The Government announced a change to the visas available to foreign persons seeking employment in Australia, limiting the numbers of foreign persons who may seek employment in Australia and reducing the industries in which foreign workers may seek employment.

The Government has also proposed the introduction of a new levy for businesses with foreign workers on certain skilled visas, with application from March 2018.

Businesses with a turnover of less than AUD 10 million per year will be required to pay:

- An upfront payment of AUD 1,200 per visa per year for each employee on a Temporary Skill Shortage visa;
- A one-off payment of AUD 3,000 for each employee being sponsored on a permanent Employer Nomination Scheme (subclass 186) visa or a permanent Regional sponsored migration Scheme (subclass 187) visa.

Businesses with turnover of AUD 10 million or more will be required to pay:

- An upfront payment of AUD 1,800 per visa per year for each employee on a Temporary Skill Shortage visa;
- A one-off payment of AUD 5,000 for each employee being sponsored on a permanent Employer Nomination Scheme (subclass 186) visa, or a permanent Regional sponsored migration Scheme (subclass 187) visa.

Foreign hybrid mismatches

Tax advantages from hybrid mismatches are being further restricted. In the 2017/18 Federal Budget the Government targeted mismatched hybrid instruments issued by the offshore units of Australian banks and financial institutions. This is the first such anti foreign hybrid mismatches measure after the announcement in the 2016/17 Budget that the Government committed to the OECD measures to neutralise hybrid mismatches.

Under the current law these securities issued by offshore units of Australian banks provided interest returns, meaning the distributions did not need to be franked for Australian tax purposes. The mismatch arises as these securities should have paid a franked distribution if they were issued through the Australian based parent.

Under the changes, the returns on these securities will give rise to franking debits where the capital is not exclusively used in the foreign branch. These rules will apply to returns on investments paid after 1 January 2018, with some transitional arrangements for instruments currently on foot.

Toughening the multi-national anti-avoidance law

The definition of foreign entities to whom the multi-national anti-avoidance law (MAAL) regime applies has been broadened to include the use of foreign trusts and partnerships in corporate structures. The imposition of a more specific definition will afford clarity to taxpayers and tax agents during their self-assessment of whether the MAAL regime is applicable to their existing related party transactions. The MAAL is aimed at discouraging schemes for the avoidance of establishing permanent establishments in Australia.

To fall under the umbrella of the MAAL regime, an entity or individual is currently defined as a 'foreign entity' that is a significant global entity or 'a person'. However, there was doubt whether this would include flow-through entities like partnerships or trusts.

Under the proposed measure, the MAAL will also apply to the following entities:

- Corporate structures that involve the interposition of partnerships that have any foreign resident partners;
- Trusts that have any foreign resident trustees;
- Foreign trusts that temporarily have their central management and control in Australia.

The amendments apply retrospectively from 1 January 2016.

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INDIA

FORMULA 1 RACING CIRCUIT CONSTITUTED A FIXED PLACE PERMANENT ESTABLISHMENT FOR FOREIGN ORGANISER , AND OTHER RECENT DEVELOPMENTS

In a recent ruling the Apex Court of India held that Formula 1 World Championship Ltd (the UK entity taxpayer) had a Permanent Establishment (PE) in India owing to its access to and control over the Grand Prix racing circuit. The key highlights of the ruling are summarised below.

In this case, the commercial rights in the championship were licensed to the taxpayer for a period of 100 years. Only teams having a contract with taxpayer were allowed to participate in the circuit event. Under a Race Promotion Contract the right to host, stage and promote the Grand Prix – India event were granted to an Indian Company Jaypee Sports International Limited (the India Co). Under the agreement, the India Co was permitted to use certain intellectual property belonging to the taxpayer. On the same day, under a separate agreement the India Co transferred circuit rights (media and title sponsorship) and paddock rights to the affiliate companies of the taxpayer.

On the question of whether a PE existed for the taxpayer in India, the Apex Court observed and held that:

- The circuit was a fixed place where an economic/business activity of conducting Grand Prix and activities in relation thereto was carried out;
- Various agreements cannot be looked into by isolating them from each other. A conjoint reading was necessary to bring out the real transactions between the parties and determine who had control over the event;
- A review of the agreements between the parties demonstrates that the entire event is under the control of the taxpayer and its affiliates. The various rights were exploited through commercial activities in India;
- For the duration of the event and the weeks prior to and after the event, the taxpayer had physical control and full access to the racing circuit and spaces where teams were located. India Co's capacity to act was restricted. The taxpayers stamp over the event was loud and clear;
- Though the race, i.e. business, was conducted for only 3 days, this duration is sufficient to constitute a fixed place PE.

It was ruled that the payments made by India Co were in the nature of business income of the taxpayer through the PE and therefore chargeable to tax in India. The case was remitted back to the tax authorities to determine the profit attributable to the PE of the taxpayer in India.

[Civil appeal Nos. 3849, 3850, and 3851 of 2017]

Capital gains tax

The Indian Income tax law provides for exemption from long term capital gains tax for transfers of equity shares or mutual fund units if securities transaction tax (STT) is paid on such transfers. In order to curb sham transactions, an amendment was recently made to deny such exemption to cases where no STT was paid on purchase of such shares/ units. It is now notified that exemption would not be denied in genuine cases, like:

- Acquisitions approved by Court or regulatory authorities;
- Acquisitions by non-residents in accordance with foreign direct investment guidelines;
- Acquisitions under an employee stock option scheme or employee stock purchase scheme framed under Securities and Exchange Board of India guidelines.

However, exemption would not be available in the following cases (generally used in penny stock scams):

a) Acquisitions of existing listed equity shares in a company, not frequently traded in a recognised stock exchange of India, through a preferential issue;

b) Acquisitions of existing listed equity shares in a company not entered through a recognised stock exchange of India;

c) Acquisitions of equity shares during the period beginning from when a company is delisted, and ending when such company is listed again on a recognised stock exchange in India.

[Notification No. 43/2017 dated 5 June 2017]

Taxation regime for offshore funds

The Indian Income tax law provides relief to offshore funds managed from India from constituting a business connection (similar to the concept of a PE) in India on fulfilment of certain conditions. Amongst various conditions provided in the law, the following conditions no longer need to be met for Category I or Category II foreign portfolio investors (FPIs) registered under Securities and Exchange Board of India (SEBI) Regulations:

a) The fund has a minimum of 25 members, not directly/indirectly connected persons;

b) Members of the fund along with connected persons shall not have any participation interest exceeding 10%;

c) Aggregate participation interest of 10 or less investors (along with connected persons) shall be less than 50%.

The law further provides that fund management activity carried out in India shall not constitute a business connection if inter-alia, the fund is established or incorporated or registered in a country or territory to be notified by the Government. For this purpose, a list of 121 countries/ territories has been announced.

[Notification No. 77/2017 and 78/2017 dated 3 August 2017]

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INDONESIA

NEW CERTIFICATE OF DOMICILE FOR INDONESIAN AND FOREIGN TAX RESIDENTS

The Indonesian Directorate General of Tax (DGT) recently updated its provisions on the Certificate of Domicile (CoD) for Indonesian and foreign tax residents.

New CoD for Indonesian tax residents

For Indonesian tax residents, the DGT has issued new Regulation No. PER-08/PJ/2017 (PER-08) on 12 May 2017 and revoked Regulation No. PER-35/PJ/2010 (PER-35).

The new CoD format provides more information to the offshore counterpart in the statement that validates the residency of an Indonesian tax resident when entering into a transaction with the offshore counterpart in a certain tax period. The Indonesian tax resident is required to provide information on the transaction, including the transaction value, with the offshore counterpart in its CoD application letter.

Indonesian banks, capital markets, insurance, pension funds, leasing, and other financial services (referred to as 'Financial Services') are exempted from this requirement.

An Indonesian tax resident must submit an application with necessary attachments to the tax office where it is registered in order to obtain a CoD. A CoD application can be made for:

1. Current tax year or tax period, where the taxpayer must:
   - Have submitted the latest Article'25 Monthly Tax Return or the 1% Article 4(2) Final Income Tax Return that is due upon the CoD application.
2. Prior tax years, as long as they have not passed the statute of limitation of 5 years, where the taxpayer must have submitted:
   - The latest Article 25 Monthly Tax Return or the 1% Article 4(2) Final Income Tax Return if the CoD application is submitted prior to the deadline to submit the Individual Income Tax Return;
   - A filing extension request if the CoD application is submitted after the deadline to submit the Individual Income Tax Return; or
   - The Individual Income Tax Return.

The CoD is valid for 12 months after the issue date (36 months for Financial Services). The tax office must issue a Decision within 10 working days upon receipt of complete CoD application, whereas previously it was 5 working days. CoD applications submitted before 12 May 2017 are still based on PER-35, and valid CoDs are still applicable up to the end of the validity period.

New CoD for foreign tax residents

For foreign tax residents, the DGT has issued new Regulation No. PER-10/PJ/2017 (PER-10) on 19 June 2017 that is effective on 1 August 2017 and revokes both Regulation No. PER-61/PJ/2009 (PER-61) as amended by Regulation No. PER-24/PJ/2010 (PER-24) and Regulation No. PER-62/PJ/2009 as amended by Regulation No. PER-25/PJ/2010 (PER-25). Valid CoDs based on prior regulations are applicable up to the end of the validity period.

There are two types of CoDs, one for banking institutions (form DGT-2) and one for non-banking institutions (form DGT-1). Form DGT-2 is unchanged from the previous version, while the new form DGT-1 includes various new residency tests and a new set of beneficial ownership tests, which is to be completed only if the foreign tax resident receives Indonesian dividends, interest or royalties. The CoD remains valid for 12 months. However, the new CoD format now specifies the validity period and must be in English.

For general residency tests, the test that the entity has its own management to conduct the business and has independent discretion remains the same. However, there are four new and amended tests:

1. There are relevant economic motives or other valid reasons for the establishment of the foreign entity;
2. The entity has sufficient movable and immovable assets to conduct business other than the assets generating income from Indonesia;
3. The entity has sufficient and qualified personnel to conduct the business; and
4. The entity has an active business activity other than receiving dividends, interest, and/or royalties sourced from Indonesia.

In addition, a new set of beneficial ownership tests is introduced, which has to be met if the foreign tax resident receives dividends, interest or royalties. As with the old form DGT-1, there is still an anti-base erosion test (i.e. no more than 50% of the entity's income is used to satisfy claims by other persons). However, the following four tests have been added:

1. The entity is not acting as an agent, nominee, or conduit;
2. The entity has controlling rights or disposal rights over the income, assets, or rights that generate the income;
3. The entity bears the risk on its own assets, capital and/or liabilities; and
4. The entity has no contracts which oblige it to transfer the income received to residents of third countries.

Under PER-10, the requirement that the Indonesian income be subject to tax in the domicile country has been removed. Also, certain tax-exempt institutions (e.g. central banks or government institutions as mentioned in the respective tax treaties) should submit a CoD confirming their tax-exempt status, whereas previously, these institutions were not required to submit form DGT-1, DGT-2 or CoD.

The CoD must be submitted together with the relevant monthly tax return when the income tax is due and can be submitted in an electronic format. Where income tax is over-withheld due to a delay in completing the CoD when the relevant monthly tax return has been submitted, or there is an incorrect application of the tax treaty, PER-10 indicates that taxpayers can refer to the Minister of Finance Regulation No. 187/PMK.03/2015 for a refund. PER-10 also confirms that taxpayers have the right to obtain treaty benefits through the Mutual Agreement Procedure when a withholder fails to remit the relevant withholding tax to the tax office.

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JAPAN

INCREASE OF PENALTY TAX RATES FOR VOLUNTARY DISCLOSURES

To increase taxpayers' compliance, as part of the 2016 tax reform, penalty tax rates for voluntary disclosures of tax have increased. The new rule applies to taxes for which the filing due date falls on or after 1 January 2017.

Amended tax returns filed after an advance notice for tax audit

The penalty tax rate for under-reporting income, failing to file and failing to pay withholding tax for an amended tax return or payment of withholding tax before expectation of an assessment under an audit is either 0% or 5%.

After an audit notice but before expectation of an assessment, penalty tax rates for under-reporting income and failing to file have increased by 5% respectively.

After the start of a tax audit, with an assessment expected, penalty tax rates for under-reporting income, failing to file and failing to pay withholding tax for an amended tax return or payment of withholding tax are either 10% or 15%.

The penalty taxes are summarised as follows:

Type of penalty taxes	Return filed or payment made before tax audit notice (No change of penalty tax rates by the tax reform)	Return filed or payment made after tax audit notice received but before expectation of assessment		Return filed or payment after start of tax audit and assessment expected (No change of penalty tax rates by the tax reform)
		Previous rule	New rule	
Under-reporting penalty	0%	0%	5% (10%)[1]	10% (15%)[2]
Failure to file penalty	5%	5%	10% (15%)[3]	15% (20%)[4]
Failure to pay withholding tax	5%	5%		10%

[1] The penalty amount is 5% of the increase in tax, and the penalty increases to 10% of the portion of the increase in tax that is more than the greater of (i) the tax originally reported, or (ii) JPY 500,000.

[2] The penalty amount is 10% of the increase in tax, and the penalty increases to 15% of the portion of the increase in tax that is more than the greater of (i) the tax originally reported, or (ii) JPY 500,000.

[3] The penalty amount is 10% of the increase in tax, and the penalty increases to 15% of the portion of the increase in tax that is more than JPY 500,000.

[4] The penalty amount is 15% of the increase in tax, and the penalty increases to 20% of the portion of the increase in tax that is more than JPY 500,000.

Repeated failures to file, falsification or concealment over a short period

To prevent fraudulent practices, for persons that have been subject to penalties for non-reporting or fraud due to anticipating a correction in the last five years, and who file an amended tax return once again based on failure to file, falsification or concealment, a further 10% has been added to both non-reporting penalties and fraud penalties as described below:

Type of penalty taxes	Have the persons been subject to penalties for non-reporting or fraud due to anticipating a correction in the last five years?	
	No (under new rule)	Yes (under new rule)
Failure to file penalty	15% (20%)[5]	25% (30%)[5]
Heavy penalty tax (imposed in lieu of under-reporting penalty or failure to pay withholding tax)	35%	45%
Heavy penalty tax (imposed in lieu of failure to file penalty)	40%	50%

The above new rule also applies to taxes for which the filing due date falls on or after 1 January 2017.

For clarification or further details on any of the above matters, please contact:

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[5] The penalty amount is 15% or 25% of the increase in tax, and the penalty increases to 20% or 30% of the portion of the increase in tax that is more than JPY 500,000.

SINGAPORE

SINGAPORE MINISTRY OF FINANCE INVITES COMMENTS ON DRAFT INCOME TAX (AMENDMENT) BILL 2017

In July 2017, the Ministry of Finance (MOF) carried out a public consultation exercise on the draft Income Tax (Amendment) Bill 2017 ('draft Bill') and invited the public to give their feedback on the draft Bill. After a thorough review, where appropriate, the MOF will incorporate the comments received from the public into the draft Bill prior to its introduction in Parliament for approval.

The draft Bill essentially contains 34 proposed legislative amendments to the Singapore Income Tax Act, and includes amendments to give legislative effect to proposals announced under Budget 2017 earlier in February 2017, as well as other non-Budget related changes. We provided an update on Budget 2017 in an earlier issue of *BDO World Wide Tax News*.

We highlight four of the proposed changes as follows:

1. Tax treatment for foreign companies domiciled in Singapore

Under the draft Bill, foreign companies which have re-domiciled into Singapore will be subject to the following tax treatment, which amongst others includes:

i) Eligibility to claim capital allowances for transferred-in plant and machinery used for business in Singapore;

ii) Eligibility to claim writing-down allowances for transferred-in intellectual property rights used for business in Singapore;

iii) Disallowance of transferred-in trade receivables that have subsequently become bad or impaired after the re-domiciliation;

iv) Allowance of tax credit to relieve double taxation on Singapore-sourced income on an approval basis; and

v) Eligibility to claim tax deduction on pre-commencement expenses incurred by a re-domiciled company that has not commenced business in the original jurisdiction.

We expect the Inland Revenue Authority of Singapore (IRAS) to announce further details on qualifying conditions for enjoying some of the tax treatments mentioned above in due course.

2. Tax incentives

The draft Bill includes amendments to give legislative effect to the following Schemes that were announced in Budget 2017:

i) Extension and refinement of the Aircraft Leasing Scheme;

ii) Extension of the tax exemption on payments made to non-resident non-individuals for structured products offered by financial institutions; and

iii) Extension of the Tax Incentive Schemes offered for Infrastructure Projects.

Legislation on Intellectual Property Development Incentive (IDI) which was announced in Budget 2017 was not included in the Draft Bill. IDI will incentivise income generated from the exploitation of intellectual property arising from R&D activities conducted in Singapore or outsourced to third parties. The incentive was slated to take effect from July 2017; however, to date, the Economic Development Board has not yet issued details on this incentive.

3. Transfer pricing changes

The draft Bill also includes amendments to give legislative effect to the following:

i) Introduction of a mandatory transfer pricing documentation requirement and penalties for non-compliance;

ii) Imposition of a surcharge for transfer pricing adjustments made;

iii) Lifting of the statutory time bar for Mutual Agreement Procedures cases; and

iv) Requirement for contemporaneous transfer pricing documentation to support any claim for error or mistake on transfer pricing.

The MOF states that the proposed amendments above are intended to 'strengthen the transfer pricing regime' of Singapore. Looking at the various enhancements made to the Transfer Pricing Guidelines in recent years, it is clear that Singapore is moving towards greater alignment with the transfer pricing action items under the OECD Base Erosion and Profit Shifting (BEPS) initiative.

4. Cost Sharing Agreements (CSAs) for Research & Development (R&D) projects

The draft Bill provides for the following liberalised tax treatment for payments made under CSAs for R&D projects:

i) Payments made under CSAs need not be related to the taxpayer's trade or business, and need not be undertaken in Singapore if unrelated to the taxpayer's trade or business, in order to be deductible; and

ii) Allowance of an additional 50% tax deduction on qualifying costs incurred on R&D performed in Singapore by the taxpayer or an R&D organisation performing R&D on its behalf, under CSAs, even if the costs are reimbursed under the CSAs. The additional 50% deduction is subject to a prescribed cap.

While we await the final Income Tax (Amendment) Bill, it is clear that these changes are here to stay and some of the changes may be further clarified by the IRAS by way of Tax Circulars. Hence, it is important to watch this space to stay updated with the final changes. We are happy to have a discussion with you to analyse how the changes may affect your overall tax position.

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BELGIUM

SUBSTANTIAL REFORM OF CORPORATE INCOME TAX LEGISLATION

On 26 July 2017, the Belgian federal government came to an agreement on the budget for 2018. This budget agreement includes a substantial reform of the corporate income tax legislation.

The eye-catcher is, no doubt, the significant reduction in the corporate tax base rate to stimulate the Belgian economy and to increase the competitiveness of Belgian businesses. The agreement also intends to oxygenate small and medium sized enterprises (SMEs), start-ups, innovation and investments.

Reduction of the corporate income tax rate

From 2018, the basic corporate income tax rate will decrease from 33% to **29%**. It will be lowered to **25% by 2020**.

SMEs as defined in article 15 of the Belgian Companies Code will be able to benefit from a **20%** tax rate on the first tranche of EUR 100,000.

From 2018, the crisis surcharge that comes on top of the basic rate will be reduced from 3% to 1.5%, and will be abolished in 2020.

Capital gains on shares

As a simplification measure, the 0.412% tax that currently applies to capital gains on shares realised by large companies will be abolished from 2018.

As a consequence, capital gains on shares will, again, be entirely tax exempt. However, in line with the conditions for the dividend received deduction, the exemption will apply if, during at least one year, the participation equals at least 10% or if the acquisition value of the shares equals at least EUR 2,500,000.

R&D related measures

The **professional withholding tax** exemption for R&D staff will be extended to holders of certain professional **bachelor** degrees. Together with this extended exemption, the well-received new innovation income deduction, the maintained R&D investment deduction (that is even for SME's temporarily increased to 20%), and the R&D tax credit, Belgium has become a prime location for attracting R&D activities.

Consolidation

A system of **fiscal consolidation** will be introduced from 2020.

The tax reform is partially financed by means of new rules in relation to a limitation of certain tax deductions for companies.

Revision of the notional interest deduction

From 2018 the notional interest deduction will only apply to equity increases.

Further transposition of the EU Anti Tax Avoidance Directives

Controlled foreign company (CFC) legislation will be introduced, modifications to the deductibility of interest and further regulation against hybrid mismatches will be transposed in 2020.

Minimum tax

A minimum taxation level will apply for companies with profit in excess of EUR 1 million. Companies generating a profit that exceeds that amount will have to consider the fact that certain tax deductions will no longer be fully deductible.

Other compensating measures include:

- A 10% separate tax rate for companies (including holding companies) that do not pay a minimum of EUR 45,000 per annum salary to at least one company director (the 10% will be applied on the balance between what has been paid and EUR 45,000);
- Adoption of a fiscal matching principle;
- Capital decreases will partly be subject to withholding tax;
- An increased drive against tax fraud;
- More strict limitations to the deduction of tax losses of foreign permanent establishments (PEs) and a more economic approach of the concept of a PE;
- Abolition of the possibility of decreased depreciation; and
- Certain personal income tax matters like a 0.15% charge on securities accounts (the first tranche will, however, be tax exempt).

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HUNGARY

COMPETITIVE TAX REGIME IN HUNGARY WITH A ONE-DIGIT CORPORATE TAX RATE

For years, the Hungarian government has been focusing on developing Hungary into an attractive location for foreign investors. Although the tax rules effective before 1 January 2017 were also favourable, with a flat 9% corporate tax rate recently introduced, Hungary is ready to become one of the first target jurisdictions when group structuring plans are considered.

One-digit corporate tax

By introducing a 9% flat corporate income tax rate as of 1 January 2017, Hungary offers by far the lowest tax rate within the EU. This 9% tax rate applies to all Hungarian companies, regardless of their activities or shareholders. Obtaining this tax rate does not require separate tax agreements with the tax authority.

Although assessing corporate taxation also needs to take into account the fact that local municipalities may levy local business tax on enterprises up to the level of 2% of their adjusted turnover, this tax can be mitigated or even avoided with the careful choice of the location of the entity.

Favourable holding and IP location

As a result of the recent changes to the corporate tax legislation, Hungary has become an efficient holding company location, competing with traditional holding jurisdictions like Luxembourg and the Netherlands. As part of the rules, dividends received by a Hungarian entity (except for dividends received from controlled foreign companies) are exempt from corporate tax. Capital gains realised on the sale of shares can also be tax exempt if certain conditions are met (under the so-called registered shareholding regime); however, capital losses or impairment losses cannot be deducted. This regime provides good planning opportunities both for multinational groups searching for tax-efficient holding locations and Hungarian domestic groups wishing to achieve capital gains tax exemption on the sale of a Hungarian or non-Hungarian company. Exemption may also be available for companies registered outside Hungary with an effective place of management in Hungary.

Apart from the holding company rules, the Hungarian intellectual property (IP) legislation also offers various opportunities for structuring. While Hungary needed to align the IP tax incentives to the BEPS requirements, profits from royalties realised by a Hungarian company can still enjoy a 50% tax deductibility (leading to a 4.5% effective tax rate). Furthermore, similarly to the concept of the registered shareholding outlined above, the Hungarian corporate tax law also provides exemption on capital gains on the sale of so-called registered IPs under certain conditions, and double deduction of the direct cost of a company's own R&Ð activity is still available.

Based on the above, multinationals can continue to use Hungary as a centre for IP developments and R&D activities.

No withholding taxes

Under its domestic legislation, Hungary levies no withholding tax on dividends, interest or royalties received by foreign enterprises from Hungary. This withholding tax exemption applies irrespective of whether the recipient foreign company is subject to tax in its jurisdiction, whether it is a tax transparent, look-through, or any other special type of entity which is not taxable in the country of residence for any specific reason.

Summary

In the light of the above, it can be concluded that the Hungarian tax regime offers all the advantages of the customary holding and IP locations. The position of Hungary is also reinforced by its membership in the European Union: after Brexit, it is already considered as an advantage that Hungary provides all the benefits and legal tax guarantees accorded to an EU Member State.

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ISRAEL

NEW CASE LAW REGARDING FOREIGN TAX CREDITS

Recently, two Israeli case law decisions were issued with respect to foreign tax credits claimed by the taxpayers for tax paid in the US and Canada, respectively. The first decision confirms and legitimises for the first time the position of the Israeli tax authorities as set out in a Tax Bulletin in 2004 with respect to the manner in which a US resident limited liability company (LLC) and its income and losses are treated for Israeli tax purposes. The second decision determines the proper method for calculating foreign tax credits when business losses are involved. The following is a brief overview of the decisions and their effect on the foreign tax credit system in Israel.

Case 1 – Yono Simol Ltd. & Others

The first case (Yono Simol Ltd. & Others – Tax Appeal 55858-12-15) involves an Israeli resident company ('The Company') which is deemed a transparent entity for Israeli tax purposes. As such, the profits/losses of the company are attributed to the designated shareholder and taxed according to his personal marginal tax rates. The company owned 67% of a US LLC, the income of which was deemed transparent for US tax purposes and attributed to its members in accordance with US tax laws. In the years 2012 and 2013 the LLC distributed funds to the company in accordance with its holding percentage in the amounts of approximately USD 1.7 million and USD 2.6 million, respectively. The LLC withheld the relevant taxes due and passed these on to the US tax authorities.

The Israeli resident designated shareholder of the company ('The Individual') reported the income received from the LLC as dividend income on which he claimed credit for the taxes paid in the US. The Israeli tax authorities did not accept the individual's claims and refused to grant the foreign tax credit.

The Israeli district court ruled that the individual cannot claim the foreign tax credit and utilise this to offset his taxable income received from the LLC. The court's ruling was based on the following determinations:

- The individual did not elect to deem the LLC as a transparent entity in accordance with the Israeli tax authorities' bulletin mentioned above. The individual therefore cannot credit his Israeli tax with foreign tax paid in the US.
- The individual's argument that the LLC's income should be deemed as dividend income based on the fact that the US tax law determined a withholding tax upon such income is irrelevant. The withholding tax is only a manner of collection and it does not have any significant impact on the nature of the income. This can be clearly understood if the individual of the LLC were to be a US resident who would then pay the taxes due for the income of the LLC in the framework of his own personal tax report with no mention of withholding.
- Since the income attributed to the individual was business income, the tax paid is most certainly tax on business income and not reduced tax on dividend income as the individual claimed.

Case 2 – Amot Investments Ltd.

The second case (Amot Investments Ltd. Tax Appeal 48642-02-14) involved Amot Investments Ltd., an Israeli resident public company ('Amot Israel') which held a wholly owned Canadian resident subsidiary – Amot Investments Canada Ltd. ('Amot Canada'). The group's activity consisted primarily of ownership, rental and management of several real estate investment projects around the world, executed via local subsidiaries. In 2007, Amot Canada sold an investment property located in Canada which was purchased in 2001 and leased to a third party during the period the property was held. Amot Canada paid Canadian corporate tax of approximately USD 11 million on the capital gains from the realisation of the property. In 2008, Amot Canada distributed the remaining capital gains of approximately USD 43 million to Amot Israel, on which roughly USD 6 million was withheld at source by the Canadian tax authorities in accordance with the double tax treaty between Canada and Israel.

With respect to the dividends received from Amot Canada in 2008, Amot Israel elected to implement the indirect foreign tax credit method available only for directly held subsidiaries (minimum 25% holding) and one level down indirectly held subsidiaries (minimum 50% holding). This allows an Israeli company to request to be taxed at the corporate income tax rate in Israel on the foreign sourced income derived by its subsidiaries abroad and receive credit for both the local corporate tax and the withholding tax levied in that jurisdiction of dividends distributed, if relevant, up to but not exceeding the Israeli tax due. Following the utilisation of the indirect tax method, no further tax was due for Amot Israel in Israel on the dividends received from Amot Canada.

In addition, after reaching a compromise agreement with the Israeli tax authorities, Amot Israel recorded business losses in its 2008 tax report in the amount of roughly ILS 35 million. These losses were to be carried forward to 2009 to be offset against any potential income generated by Amot Israel in 2009.

The Israeli tax authorities claimed that Amot Israel's calculation of the indirect foreign tax credit was incorrect given that business losses must first be offset against the foreign income in accordance with the indirect foreign tax credit stipulations set forth in the Israel Tax Ordinance, even if this makes the foreign tax credit irrelevant, and only then can any remainder be carried forward. It should be mentioned that neither according to Amot Israel's position nor the Israeli tax authorities' position was tax was due for Amot Israel in 2008, and the dispute between the two affected only the utilisation of the carry forward losses for 2009.

The Israeli court ruled in favour of the Israeli tax authorities and stated that the taxpayer must first offset his losses from foreign sourced income and only then calculate the foreign tax credit.

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ITALY

DIVIDENDS – ITALIAN SUPREME COURT SHEDS SOME LIGHT ON THE 'BENEFICIAL OWNER' CONCEPT

On 28 December 2016 the Italian Supreme Court, with Decision No. 27113/2016, helped to clarify the correct meaning of the concept of 'beneficial owner' under Italian Law.

The issue considered by the Supreme Court

This case involved a French company which held all of the group's European subsidiaries, owning 100% of the shares of a company resident for tax purposes in Italy and which had its ultimate parent company resident in the United States. The French company claimed a tax credit under the Italy-France Double Tax Treaty; however, the Italian Tax Authorities (ITA) denied the tax refund by considering two relevant elements:

- The French company was not the beneficial owner of the dividends, as it was a mere conduit company.
- The French company did not have its operational management place (administrative/managerial structure), nor any employees or related costs, in France.

Earlier court rulings

The First Tier Tax Court decided in favour of the taxpayer, while the Regional Tax Court (Second Tier Tax Court) reversed the decision.

The Second Tier Tax Court ruled that the French company was a mere conduit company whose only purpose was to take advantage of the tax benefits deriving from the Double Tax Treaty, also having the intention to transfer all the profits to the 'real beneficial owner' in the United States. In detail, the Regional Tax Court based its conclusion on the following four considerations:

- The Italian dividend payer was controlled through a chain of ownership, and the United States parent company was the real beneficial owner of the dividends, and the tax treaty between Italy and the United States did not provide for a dividend tax credit;
- The balance sheet of the French company certified huge amounts of shareholdings, while the operating receivables were modest;
- The French company had neither employees nor organisational structure;
- In consideration of a lack of economical substance, the French company did not meet the requirements to be a 'beneficial owner' and did not have an operational management office in France.

After these decisions, the case was submitted to the Italian Supreme Court.

The Supreme Court's decision

The Supreme Court disagreed with the Second Tier Tax Court, pointing out that the conditions of 'beneficial owner' and 'place of effective management' both needed to be verified. The lack of organisational structure, as well as both the absence of employees and the presence of limited operating costs and receivables, do not prevent a holding or sub-holding company from qualifying as 'beneficial owner' of dividends and from being eligible to obtain a dividend tax credit, as provided by the Double Tax Treaty.

In the Supreme Court's view, the beneficial ownership condition should be assessed by considering whether the holding company:

- Was created only to benefit from a tax relief;
- Has the effective power to manage and control its subsidiaries;
- Has the legal and economical right to use the dividends.

The Supreme Court found that neither the ITA nor the Regional Tax Court were able to prove that any of those conditions were not met. While investigating whether the requirements of the 'place of operational management' were respected, the Supreme Court had to suppose that the French company's registered office was placed in France, that it was eligible to be a taxpayer in France, that the directors were also resident in France and that most of the decisions concerning the management of the company had been taken in France. For these reasons, the Supreme Court argued that there was no proof that the 'place of operational management' was not in France.

The Supreme Court did not agree with the conclusion of the Tax Court for the following reasons:

- The French company was the real owner of the shareholdings and recipient of the dividends that were certified on the balance sheet and could have been used;
- The Supreme Court recognised that the structure of the group had already existed since 1946, while the Italy-France Tax Treaty was signed in 1989 and ratified in 1992.

Conclusion

The Supreme Court seems to be in line with EU Judgments Halifax C-255/02 and Cadbury Schweppes C-196/04. The concept of the 'beneficial owner', relevant for tax treaty purposes, will be assessed by looking at the activity of the relevant company. The lack only of personnel and organisational structure are not decisive elements for the characterisation of pure (sub)holding companies as conduit vehicles.

This judgment and position should constitute a valid and authoritative document that can be used in order to settle previous and/or future ITA assessments based on the beneficial owner condition.

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LATVIA

TAX REFORM FINALLY ACCEPTED

On 8 August 2017, the Latvian government finally approved law changes regarding tax policy in Latvia, which will take effect from 1 January 2018. However, the accepted tax changes are far from the initial proposals discussed in the previous issue of *BDO World Wide Tax News* where we wrote about the tax reform planned by the Ministry of Finance (MoF) of the Republic of Latvia, following the World Bank and OECD review of the Latvian tax system. The accepted reform is discussed in more detail below.

Personal income tax (PIT)

Changes to the PIT regulations will introduce a progressive tax rate from 20% to 31.4%. For income up to EUR 20,000, the rate will be 20%, while for income from EUR 20,000-EUR 55,000 a year it will be 23%, and for income over EUR 55,000 per year the rate will be 31.4%. The tax rate in respect of income from capital and capital gains will also increase, as it will be a flat 20% instead of the existing 10% or 15% respectively.

There will be a two-year transition period for previously accrued profit pay out which will be subject to 10% PIT. Moreover, if dividends are received from offshore companies, then PIT is mandatory.

Corporate income tax (CIT)

Next year, entrepreneurs will be provided with a new corporate income tax (CIT) payment regime introducing a reinvested earnings model. The reinvested profit will not be taxed, but dividends will be taxed at a rate of 20% instead of the previous CIT rate of 15%. However, the actual tax rate will be 25% since the law states that for calculating the payable tax the taxable base has to be divided by 0.8. The calculated dividends will be taxed at the company level at a rate of 20%, so dividends received by a natural person will no longer be subject to PIT. However, if CIT for dividends has not been paid then PIT will have to be paid.

Moreover, in the new regime starting from July 2018, CIT will no longer be paid in advance. On top of this, from 2018, CIT declarations will have to be submitted every month (until now – once a year).

The appropriate CIT rebates will be subject to a transitional period:

- The tax rebate for initial long-term investments approved by the end of 2017 will be applied until 2035;
- The tax rebates in Free Ports and Special Economic Zones of 80% will be applicable only for paid dividends (so far, the effective tax rate was 3%, but after 2018 it will be 4%);
- The period of transfer of losses will be five years, and the tax on paid dividends can be reduced by 50% of transferred losses.

State Social Insurance Compulsory Contribution (SSICC)

From 2018 there is an obligation to deduct SSICC from royalties, which will be redirected to pension insurance. The paying agent will pay 5% SSICC of the paid royalty from its own funds in the State budget.

Furthermore, the SSICC rate for employer and employee will be increased by 0.5%, both of which will be attributed to health care.

Micro-enterprise Tax

A single tax rate of 15% of turnover will be maintained for companies subject to the micro-enterprise tax, but the maximum turnover will be reduced from the previous EUR 100,000 to EUR 40,000 per year.

Value Added Tax (VAT)

At the same time, the changes will reduce the annual turnover threshold from the previous EUR 50,000 to EUR 40,000 per year, up to which the entrepreneur is allowed not to register in the State Revenue Service (SRS) as a VAT payer. Also, the VAT deciphering threshold in the VAT return will be reduced from the previous EUR 1,430 to EUR 150.

In addition, from 2018 the reverse VAT charge will also apply to the supply of building materials, metal products, home appliances and gaming consoles, thereby expanding the scope of the reverse VAT regime.

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UNITED KINGDOM

FINANCE BILLS UPDATE

The **'Summer Finance Bill' 2017**, which includes measures which were deferred from the previous Finance Act 2017 due to the snap general election (see *BDO World Wide Tax News Issue 44*), has now been published. **Some draft Finance Bill 2018 clauses** have also been published.

Summer Finance Bill 2017

The Bill includes all of the measures deferred from the previous Finance Act, with minor amendments in some cases. All policies originally announced to start from April 2017 will be effective from that date, which will be welcomed by taxpayers who were planning (or who had carried out) some action on the basis of the original draft clauses.

The main proposals (again, see *BDO World Wide Tax News Issue 44* for details) include:

Corporate tax

– Loss reforms;

– Corporate interest relief restriction;

– Relaxations to the Substantial Shareholdings Exemption.

Personal tax

– New regime for non-UK domiciled individuals.

Finance Bill 2017-2018

Despite the Chancellor's stated intention to improve the Finance Bill cycle, the Winter Finance Bill, published on 13 September 2017, proved to be a bit of a token effort. Only a small proportion of the expected legislation was published – the final Finance Bill for 2017-2018 is likely to be much larger.

The proposals were published to allow for technical consultation ahead of the Budget on 22 November 2017. We understand that the Government will publish the full Finance Bill 2017-18 following the Budget, with the timing expected to be much the same as in previous years.

The draft clauses published on 13 September 2017 concerned:

– Partnership taxation – proposals to clarify tax treatment;

– Draft legislation – tackling disguised remuneration – avoidance schemes;

– Offshore trusts – anti-avoidance;

– Pensions Tax registration;

– Termination payments – removal of foreign service relief;

– Income Tax – debt traded on a multilateral trading facility;

– Bank Levy – changes to scope and administration;

– Landfill Tax – disposals not made at landfill sites.

Other changes

The main other announcement was that the timetable for the introduction of a new digital record keeping and reporting regime (Making Tax Digital (MTD)) has been amended, so that MTD will be implemented in a more measured way.

It is now proposed that:

– Only businesses with a turnover above the VAT threshold (currently GBP 85,000) will have to keep digital records, and only for VAT purposes;

– They will only need to do so from 2019;

– Businesses will not be asked to keep digital records, or to update HMRC quarterly, for other taxes until at least 2020.

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ARGENTINA

PROJECT TO PROVIDE FOR UPDATING THE VALUE OF COMPANY ASSETS

The Argentine government expects to send to the Congress, at the end of October 2017, a bill whose objective will be to update the value of certain assets – personal property, real estate, intangibles and shares – at their real value, both for individuals and for legal entities. Therefore, taxpayers will pay income tax based on equity in accordance with the real value.

Background

This project arises because, due to the lack of fiscal balance updating, many companies ended up paying income tax on profits that were fictitious, and consequently went to the courts to file the respective claims. The cases which successfully progressed before the Supreme Court of Justice were those where the taxpayer could prove payment of tax calculated without any adjustment. The problem originated when after exiting convertibility with the US Dollar, no indexing was allowed in spite of significant inflation.

The case with strong repercussions was 'Candy', in which the Supreme Court of Justice in 2009 established the unconstitutionality of the prohibition to adjust for inflation to determine income tax for the fiscal year 2002.

Details of proposal

The project will be optional and not retroactive. That is, companies will not have the option of claiming an inflation adjustment for past fiscal years, but it is intended to regularise current balances, recognising past inflation. It is an alternative limited to inflation adjustment that was in force in Argentina between 1978 and 1992.

Revaluation process

In order to be able to revalue assets, individuals who choose this option will have to pay a one-time excise tax, which, although not yet specified, is estimated to range from 5% to 10% of the value of the revaluation.

Individuals who do not pay the tax, will only be able to adjust the value of their assets for new investments made and not for existing assets.

Revaluation will enable companies to reduce income tax, as they will be able to deduct the updated depreciation of assets. Also, when selling the assets they will pay less income tax as a consequence of the higher base cost of the assets.

According to the statements of several officers, there are two methods for adjusting the asset value to be used: a presentation through experts appointed by the company involved, or a weighted index defined by the Ministry of Finance.

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EGYPT

INCOME TAX AND STAMP TAX AMENDMENTS

On 18 June 2017, Tax-Law No. 76 for the year 2017 was issued, amending the Income Tax and Stamp Tax laws. The effective date of the Law No. 76/2017 is the next day from the date of publication in the official gazette, which was on 19 June 2017.

On 21 June 2017, Tax-Law No. 82 for the year 2017 was issued, further amending the Income Tax Law. The effective date of the Law No. 82/2017 is the next day from the date of publishing in the official gazette, which was on 21 June 2017.

Details of the above amendments, which in the case of the capital gains and stamp tax changes apply to transactions both by individuals and corporates, are as follows:

Tax on capital gains

The application of Tax on Capital Gains from listed securities is temporarily ceased/exempted for three years starting from 17 May 2017.

Capital gains are subject to tax when they are generated from unlisted securities or shares in companies at the applicable income tax rate.

Tax treatment on the Changes of Legal Form

Amendments to article no. 53 which outlines the tax treatment of Changes of Legal Form.

Stamp tax on financial securities

A stamp tax will be levied, to be paid by the buyer, and the same to be paid by the seller, on all purchase/sale transactions of financial securities, be they Egyptian or foreign.

The Stamp Tax rate for such transactions will be as follows:

- 0.125% to be paid by the buyer, and the same to be paid by the seller, to be applied from the effective date of the Law until 31 May 2018;
- The above rate will be amended to 0.15% from 1 June 2018 until 31 May 2019;
- The above rate will be further amended to 0.175% from 1 June 2019 until 31 May 2020.

Stamp tax on purchase or acquisition transactions

A stamp tax of 0.3% will be levied, to be paid by the buyer, and the same to be paid by the seller, without deduction, on purchase or acquisition transactions, in the following two cases:

- Purchase or acquisition of at least 33% of the assets or voting rights – whether in terms of number or value – in a resident company;
- Purchase or acquisition of at least 33% of the assets and liabilities of another resident company, in exchange for shares in the buying company.

Individuals' income tax

Amended income tax rates on individuals' income are as follows:

	Tax rate
The first EGP 7,200	Zero
More than EGP 7,200 up to EGP 30,000	10%
More than EGP 30,000 up to EGP 45,000	15%
More than EGP 45,000 up to EGP 200,000	20%
More than EGP 200,000	22.5%

The law has granted taxpayers in the following bracket, a discount from the tax due as follows:

Bracket	Tax discount
Between EGP 7,200 and EGP 30,000	80%
More than EGP 30,000 up to EGP 45,000	40%
More than EGP 45,000 up to EGP 200,000	5%

The discount will be granted once for the bracket that applies to the taxpayer.

The above changes related to individual income tax will be applied from:

- July 2017, for salary tax;
- The fiscal period ending after 21 June 2017, for other individuals' income.

VAT

Under VAT law No. 67 of 2016 issued on 7 September 2016, the standard VAT rate changes with effect from 1 July 2017 to 14% instead of 13%.

Social insurance

Under Law No. 120 of 2014, the maximum limit of the basic salary which is subject to social insurance, is increased to EGP 1,370 per month instead of EGP 1,240, with effect from 1 July 2017.

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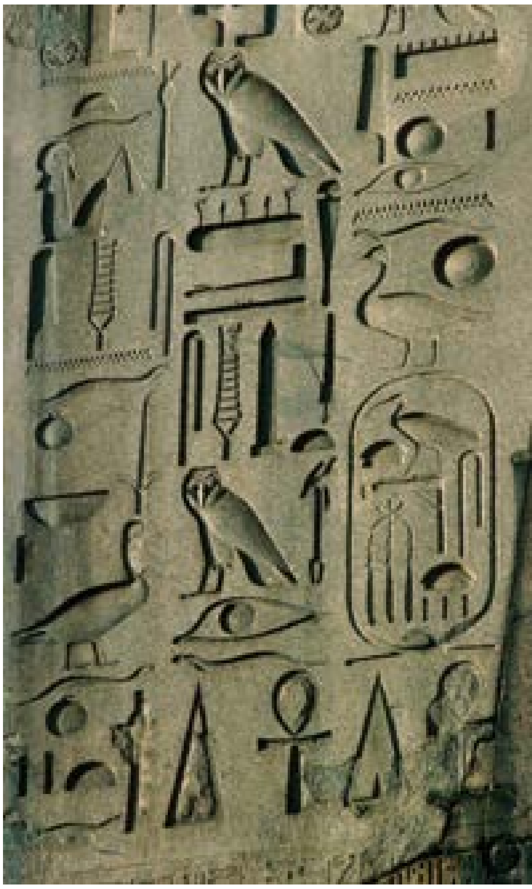

THE UNITED STATES OF AMERICA

TAX COURT RULES THAT FOREIGN PARTNER IS NOT LIABLE FOR TAX ON CERTAIN GAIN RECOGNISED FROM THE DISPOSITION OF A PARTNERSHIP INTEREST

On 13 July 2017, the Tax Court held in Grecian Magnesite Mining, Industrial & Shipping Co., SA v. Comm'r, 149 T.C. No. 3 (2017) that the petitioner, a foreign corporation that disposed of its interest in a partnership that was engaged in a US trade or business, was not liable for tax on a certain gain recognised on the disposition. In particular, the Tax Court held that the portion of the gain recognised that was attributable to non-US real property interests was a capital gain that was not US source income and that was not effectively connected with a US trade or business. Accordingly, the Tax Court held that the foreign corporation was not liable for US income tax on the portion of the gain that was attributable to non-US real property interests.[6]

Details

In Grecian, a foreign corporation purchased an interest in a US limited liability company that was recognised as a partnership for US tax purposes (hereinafter 'PS') in 2001. PS was engaged in a US trade or business and thus, under IRC §875(1), the foreign corporation was also deemed to be engaged in a US trade or business as a partner in PS. In 2008, the foreign corporation's interest in PS was redeemed. A portion of the gain recognised by the foreign corporation was attributable to US real property interests and the foreign corporation conceded that such portion of the gain should be Effectively Connected Income (ECI) and subject to tax under IRC §§ 897(g) and 882.[7] The foreign corporation contended that the remainder of the gain (the 'disputed gain') was not subject to US tax.

The central issue in Grecian was whether the disputed gain should be subject to US income tax.

I. Basic principles

Foreign persons are generally subject to US income tax on:

1) US source fixed and determinable, annual or periodic (FDAP) income (e.g., dividends, interest, rents, royalties, etc.); and
2) Income that is effectively connected with the conduct of a US trade or business (ECI).[8]

The Commissioner contended in Grecian that the disputed gain recognised by the foreign partner was ECI and thus, subject to US income tax.[9]

The Code and Treasury Regulations do not include specific rules that determine the ECI characterisation of gains recognised by a foreign partner on the disposition of its partnership interest except for in IRC §897(g) and the Treasury Regulations promulgated thereunder (dealing with US real property interests).

Given the lack of specific guidance, one of two distinct theories of partnership taxation under subchapter K should apply. For income tax purposes, a partnership could be considered as not having its own distinct existence but simply as being an 'aggregation' of its partners. Under the 'aggregate approach', each partner is generally treated as an owner of a proportionate interest in the partnership assets. In the context of applying the aggregate approach to the disposition of a partnership interest by a foreign partner (as the Commissioner contended in Grecian), the source and ECI characterisation of the gain on the disposition of the partnership interest would be determined based on the assets that make up the partnership's business.

Under the 'entity approach', a partnership is an entity separate from its partners and a partner generally does not have direct ownership in the partnership assets. Applying the entity approach to the disposition of a partnership interest by a foreign partner (as the taxpayer contended in Grecian), the source and ECI characterisation of the gain on the disposition of the partnership interest would be determined based on the sale of a single asset, the partnership interest under IRC § 741 (subject to IRC §§ 751 and 897(g)).

II. Rev. Rul. 91-32[10]

The IRS in Grecian relied heavily on Rev. Rul. 91-32 and argued that deference should be given to the ruling. Rev. Rul. 91-32 holds that gain realised by a foreign partner on the disposition of its interest in a US partnership should be analysed asset by asset (i.e., an aggregate approach), and that, to the extent the assets of the partnership would give rise to ECI if sold by the partnership, the disposing partner's pro rata share of such gain on its partnership interest should be treated as ECI. In other words, Rev. Rul. 91-32 essentially adopts a look-through approach similar to IRC §751(a) for inventory and unrealised receivables, except that the revenue ruling applies that look-through approach for a category of assets (i.e., ECI-generating assets) that are not addressed in §751.

Many tax practitioners consider Rev. Rul. 91-32 to be unpersuasive on its technical merits and the Tax Court agreed with such practitioners in Grecian, stating that the ruling lacked 'the power to persuade' and the revenue ruling's treatment of certain partnership provisions was 'cursory in the extreme'. Thus, the Tax Court declined to defer to Rev. Rul. 91-32 and instead, chose to follow a more conventional reading of the Code and Treasury Regulations to determine whether the disputed gain was ECI.

[6] While not the focus of this alert, the Tax Court also held that the petitioner was not liable for penalties on a separate tax liability because it had reasonably relied on the erroneous advice of its accountant.

[7] IRC §897(g) provides that under regulations prescribed by the Secretary, the amount of any money, and the fair market value of any property, received by a non-resident alien individual or foreign corporation in exchange for all or part of its interests in a partnership, trust or estate shall, to the extent attributable to United States real property interests, be considered as an amount received from the sale or exchange in the United States of such property.

[8] See, IRC §§ 871(a) and (b), 881 and 882.

[9] See, IRC §§ 865 and 864, along with the Treasury Regulations promulgated thereunder for purposes of determining whether gain is US source and whether gain is treated as ECI.

[10] There have been budget proposals in the past under the Obama Administration to codify the holding in Rev. Rul. 91-32.

III. Tax Court opinion in Grecian

The Tax Court held in Grecian that subchapter K mandates treating the disputed gain as capital gain from the disposition of a single asset. In reaching its conclusion, the Tax Court relied on the statutory text in IRC §§ 736(b)(1), 731(a) and 741.[11] In addition, the Tax Court stated that the enactment of IRC §897(g) reinforces the conclusion that the entity approach is the general rule that applies for the sale or exchange of an interest in a partnership because without such a general rule, there would be no need to carve out an exception to prevent US real property interests from being swept into the indivisible capital asset treatment that IRC §741 otherwise prescribes.

The Tax Court also concluded that the disputed gain was not US source and not ECI.[12] In reaching that conclusion, the Tax Court stated that the 'material factor' test in IRC § 864(c)(5)(B) was not satisfied because the office was not material to the transaction itself and the gain realised therein.[13] In addition, the material factor test was not satisfied because the partnership's actions to increase its overall value were not an essential economic element in the realisation of the income that the foreign corporation received upon the disposition of its partnership interest.[14]

The Tax Court also concluded that the 'ordinary course' requirement in Treas. Reg. §1.864-6(b)(1) was not satisfied because the gain realised on the disposition of the partnership interest was not realised in the ordinary course of the trade or business carried on through the US office or fixed place of business.[15]

As the Tax Court concluded that the disputed gain recognised on the disposition of the partnership interests was not attributable to a US office or other fixed place of business, the disputed gain was not US source income under IRC §865(e)(2)(A) and consequently, not ECI. As the disputed gain was determined to not be ECI, the foreign corporation was not liable for US income tax on the disputed gain that was recognised.

BDO comment

Despite the IRS's longstanding position in Rev. Rul. 91-32, the Tax Court in Grecian ultimately concluded that such a position was not supportable from a technical standpoint under the Code and Treasury Regulations. The decision in Grecian provides additional support that an entity approach (rather than an aggregate approach) could apply in determining the source and ECI characterisation of the gain recognised by a foreign partner from the disposition of an interest in a partnership engaged in a US trade or business (subject to IRC §§ 751 and 897(g)) so that certain foreign partners may not be subject to US income tax on a portion or all of the gain recognised. It is not clear at this stage whether the IRS and Treasury will seek to appeal or effectively overturn the Tax Court's decision via publication of regulations. Care should continue to be taken in structuring investments to be held by foreign investors.

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[11] In particular, the Tax Court in *Grecian* relied on the following language from the relevant Internal Revenue Code sections stating that "[i]n sum, section 736(b)(1) provides that payments such as those giving rise to the disputed gain '**shall** *** be considered as a distribution by the partnership'; section 731(a) provides that such gain '**shall** be considered as gain *** from the sale or exchange of **the partnership interest** of the distributee partner'; and section 741 provides that such gain '**shall** be considered as gain *** from the sale or exchange of **a** capital **asset**.' (Emphasis added)."

[12] Generally, income from non-US sources is not treated as ECI except for certain types of income described in IRC §864(c)(4). As the disputed gain is not a category of income described in IRC §864(c

[13] IRC §864(c)(5)(B) provides that income gain or loss is attributable to a US office if the US office "is a material factor in the production of such income, gain, or loss" and "the US office 'regularly carries on activities of the type from which such income, gain, or loss is derived."

[14] The partnership's efforts to develop, create, or add substantial value to the property sold was not considered a material factor in the realization of the disputed gain by the Tax Court pursuant to Treas. Reg. §1.864-6(b)(2)(i).

[15] Treas. Reg. §1.864-6(b)(1) provides that income, gain or loss is attributable to an office or other fixed place of business which a non-resident alien individual or a foreign corporation has in the United States only if such office or other fixed place of business is a material factor in the realization of the income, gain, or loss, and if the income, gain, or loss is realized in the ordinary course of the trade or business carried on through that office or other fixed place of business.

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 26 September 2017.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
Australian Dollar (AUD)	0.63550	0.75531
Japanese Yen (JPY)	0.00713	0.00848
Euro (EUR)	1.00000	1.12902
US Dollar (USD)	0.79928	1.00000
Israeli New Shekel (ILS)	0.22760	0.27052
British Pound (GBP)	1.07923	1.28270
Egyptian Pound (EGP)	0.04515	0.05367

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