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Global tax newsletter

Hello and welcome to the Global tax newsletter. Some interesting developments have occurred in the global world of tax law, fiscal policy, and jurisprudence.

This edition features the complete document released by the US Treasury announcing that FATCA went into effect on 1 July 2014. Probably one of the most far reaching tax documentation efforts of any government to date, it affects the worldwide community of financial institutions and requires investments into information infrastructure to be compliant. And, as we have reported in this newsletter, we are already seeing other jurisdictions moving towards adopting similar legislation to monitor the financial arrangements of its citizens and residents abroad.

We see the introduction in a few jurisdictions of situations where additional income taxes are being imposed on wealthy taxpayers under the name of 'tax fairness', an emerging concept where tax law is being bifurcated in application by social class. Also, we have witnessed the issue of permanent establishments (PEs) continues to plague both taxpayers and tax authorities alike.

Tax avoidance initiatives, together with tax transparency reporting, are increasing at the domestic levels as a result of the work of the Organisation for Economic Co-operation and Development (OECD) and the Base Erosion Profit Shifting (BEPS) working parties.

Finally, some interesting papers have been issued by various organisations on matters of tax policy including:

- OECD discussion draft on preventing treaty abuse
- OECD discussion draft in response of its BEPS plan on addressing the tax challenges of the digital economy
- OECD report focusing on income and inequality and taxation and calls for a tax overhaul to ensure that top earners pay a fair share of the tax burden
- a request by the International Monetary Fund (IMF) for input into how national tax policy and tax design choices under the current international tax systems influence economic outcomes for other countries.

We hope you enjoy this edition and we welcome details of any international tax developments in your jurisdiction – be it legislation, a ruling, or a judicial decision. Please submit any ideas to **Russell Bishop**.

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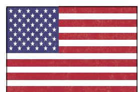
FATCA goes into effect



The US Treasury Department announced that the Foreign Account Tax Compliance Act (FATCA) came into effect on 1 July 2014. Almost 100 jurisdictions are treated as having FATCA intergovernmental agreements (IGAs) in effect and that more than 80,000 financial institutions (FIs) already registered with the US Internal Revenue Service (IRS) are to comply with the act.

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FATCA has become the global standard in combatting international tax evasion and promoting transparency.

What the treasury had to say

WASHINGTON – In a major milestone in the administration's effort to crack down on tax evasion and reduce the tax gap, the FATCA goes into effect today. FATCA was enacted in 2010 by Congress with bipartisan support to target noncompliance by US citizens of tax obligations using foreign accounts. Since that time, FATCA has gained broad support among international partners, including many of the world's largest financial centers, and is poised for a strong start.

"Over the past several years, FATCA has become the global standard in combatting international tax evasion and promoting transparency, and today this important initiative goes into effect," said Deputy Assistant Secretary for International Tax Affairs Robert B. Stack. "With FATCA agreements treated as in effect with nearly 100 jurisdictions and more than 80,000 FIs already registered to comply with the IRS, the international support for FATCA is without question. We will continue to work with our international partners in our efforts to crack down on international tax evasion and create a fairer and more transparent global tax system."

FATCA seeks to obtain information on accounts held by US taxpayers in other countries. Governments have two options for complying with FATCA: they can either permit their FFIs to enter into agreements with the IRS to provide the required information or they can themselves enter into one of two alternative model IGAs with the US. If foreign financial institutions (FFIs) do not agree to identify and report information on US account holders, FATCA requires payers to withhold a portion of certain US source payments made to those FFIs.

Under a 'Model 1 agreement', FFIs report the relevant information to their respective governments, which then relay that information to the Internal Revenue Service (IRS). By contrast, a 'Model 2 agreement' contemplates that FFIs will provide relevant information to the IRS themselves, with government-to-government cooperation serving to facilitate reporting when necessary to overcome specific legal impediments.

Generally, FIs in countries that have not signed IGAs with the US must register with the IRS and enter into a so-called 'FFI Agreement' or be subject to 30% withholding on certain payments from the US.

US Department of the Treasury, 1 July 2014

Belgium's fairness tax

In 2013, Belgium introduced a fairness tax which should be of interest to large companies with a Belgian PE. Here are some facts about the tax:

What is the scope of the tax?

The fairness tax is levied on large companies and Belgian PEs of foreign companies distributing dividends during the year. The tax is due on the amount of qualifying dividends paid to the extent that the taxable profits for the same taxable period were reduced by loss carry-forward and/or the notional interest deduction (NID).

What are qualifying dividends?

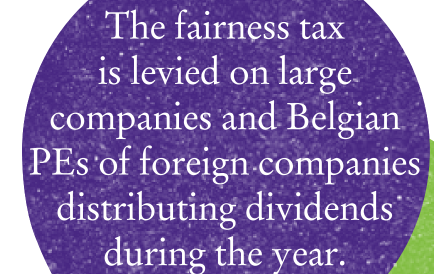
The term 'qualifying dividend' includes not only normal dividends, but also reimbursements of share capital, share premiums and profit certificates.

In the case of PEs, the notion of 'distributed dividends' refers to the portion of dividends distributed by the foreign company pro rata to the portion of the accounting result of the Belgian PE in the global accounting result of the foreign company. In some respects this resembles a second level withholding tax.

How is the tax calculated for 2014?

The taxable base is calculated by means of the following three steps:

1. The positive difference is calculated between the gross dividends distributed during the taxable period and the taxable profits.
2. The amount calculated under the first step is reduced with the amount of distributed dividends stemming from taxable reserves created until the tax year 2014. In order to determine the year from which these dividends originate, the last in first out (LIFO) method is applied. Furthermore, dividends distributed in 2014 are not regarded to be stemming from taxable reserves created in that year.
3. The amount resulting from the second step is multiplied by a coefficient based on the following items:
   - the amount of losses set off and NID used (the numerator)
   - the amount of taxable profits less tax exempt reductions in value, provisions and capital gains (the denominator).



How is the tax assessed?

The fairness tax, levied at the rate of 5.15% (including a 3% surcharge) is imposed by a separate assessment. The fairness tax is not deductible and does not constitute an advance levy. In the case of insufficient pre-payments, the tax is increased.

Are there any tax credits available?

Deemed withholding taxes, credits for foreign tax and pre-payments are credited against the fairness tax. Any excess credit can be refunded if minimal.

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EMEA news

Austria

Due to the recent ECOFIN decision on 14 October 2014 the EU's directive on administrative assistance will be changed.

The renewed version of the directive on administrative assistance shall implement the new OECD-standard on automatic exchange of information in regard of bank-data.

Most EU-countries will adopt the new directive in 2016 and will therefore start to automatically exchange data in September 2017. Although Austria unconditionally supports the necessity to exchange information in order to prevent tax evasion, it has been given additional time to adopt the new directive. This is due to necessary technical measures, which need to be taken before an automatic exchange of information can take place. However, Austria will join the automatic exchange of information in 2018. 2018 is also the timeline which is stipulated by the G-20 for installing an automatic exchange of information. This G-20 resolution includes nations as USA, China, Japan, Brazil, Russia, Canada and Australia.

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Belgium

Belgium has extended its reporting regime for payments to tax havens. A tax haven is any country that:

- during the whole tax year, when the relevant payments were made, are considered by the OECD global forum on transparency and exchange of information as not having effectively or substantially implemented the OECD exchange of information standard
- has no tax or a low tax rate. The threshold is set at a nominal corporate tax rate of 10%.

Also a royal decree establishes the form of a new tax return that Belgian resident individuals must use to declare whether they, their spouse, or their minor children are the founder or beneficiary of a 'legal arrangement'. The disclosure obligation targets trusts, as well as non-resident companies, corporations, associations, foundations that are located in tax havens, if the legal rights to the shares are held entirely or partially by a Belgian resident or if the beneficiary of the economic rights to the assets and capital is a Belgian resident. A company is based in a tax haven if it is not subject to income tax or is subject to an income tax regime that is more advantageous than the Belgian tax regime for capital income and income from movable assets.

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Denmark

A ruling has confirmed passive foreign investors in Danish limited partnerships can have a PE in Denmark. In this case, the limited partnership offered investment products, primarily to institutional investors. The limited partnership had no employees and no board of directors, and it did not have its own premises. The only action of the governing body of the partnership was the general meeting. The limited partnership was managed by a company that had a fixed place of business in Denmark and the general meetings of the limited partnership were held on those premises.

All the limited partners were passive foreign investors who contributed capital and entrusted the general partner with investing the capital. The general partner was fully owned and controlled by a management company and its management team and had overall approval and execution rights on behalf of the limited partnership.

The limited partnership had its registered address at the premises of the management company, and the general meetings of the limited partnership were held at those premises. The general meetings being held at the management company's address was enough for the tax board to conclude that the limited partnership had a PE in Denmark. The investors were therefore investing in an enterprise with a PE in Denmark.

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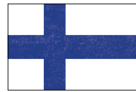

Under Finland's income tax system, earned income is taxed progressively with marginal rates that may exceed 50%. Capital income is subject to a flat tax rate of 30% or 32% depending on the circumstances. Thus, there is an incentive to receive capital income rather than earned income.

The Finnish Supreme Administrative Court held that the use of a holding company scheme for management incentive payments amounted to tax avoidance and that the income received from the holding company qualified as earned income, not capital income.

This case dealt with a holding company structure and was an attack on such structures where a holding company-based top management incentive scheme is established. The goal of the arrangements is to create a management remuneration structure that allows for the taxation of the remuneration as capital income. Until the decision, there had been uncertainty about the classification of income received from those holding company structures.

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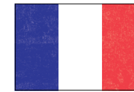

The French Parliament and the local tax authorities are getting serious with regards to tax avoidance and evasion. Guidelines concerning tax evasion have been issued presenting new measures relating to the fight against tax fraud, economic and financial crime. The guidance suggests exchanges between the judicial authority and the tax administration. The French Parliament is to follow these exchanges in order to assess and identify potential problems.

A financial public prosecutor's department was created to increase legal actions against economic and financial crime including tax fraud. The guidelines also establish a policy of prosecution by the tax administration against all persons involved in tax evasion such as organised fraud or the design and marketing of fraudulent software.

The guidelines mention the enforcement of harsher penalties. The maximum penalty can be up to seven years in jail and a €2m fine. New penalties such as seizures and confiscations have been created. Finally, the statute of limitation for tax fraud is extended up to six years (instead of the previous three).

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Germany

The court recently denied the tax authority from enforcing any action against a taxpayer who, despite incurring an annual loss, had been held liable to pay tax on disallowed interest expenses by the tax authority. The judicial hearing was a case brought by a family-owned German company with overseas subsidiaries, who questioned whether the tax authority should be allowed to charge the company tax despite the fact it posted an operating loss. Generally, there is a disallowance for a deduction of interest expenses in excess of 30% of earnings before interest, taxes, depreciation, and amortisation (EBITDA). When applying the thin capitalisation rules, the crux of the issue is where EBITDA is positive but earnings after such amounts are negative. The case will most likely be appealed within Germany.

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Greece

Greece has been financing a portion of its debt with Bonds. From 29 February 2012 to 31 December 2013 a capital gains tax was imposed at the rates of 33% for legal entities and 20% for individuals, but these rates could be lowered through a Double Taxation Agreement (DTA). From 1 January 2014 forward interest on refinancing bonds is exempt from tax. Greece issued a statement clarifying that there is no plan to impose a retroactive tax on foreign investors who have bought government bonds since 1 January 2014.

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Iceland

Iceland has had an interesting case concerning the free movement of people. The case involved, a taxpayer and his wife were both Icelandic citizens who resided in Denmark. During that time, the couple's income consisted of unemployment benefits that the wife received from Iceland and the taxpayer's disability pension from the Icelandic Social Insurance Administration and benefits from two Icelandic pension funds. The taxpayer was subject to limited tax liability in Iceland and consequently paid tax on his income in Iceland.

The taxpayer claimed that they suffered from a higher tax burden because they could not utilise his wife's personal tax credits while they resided in Denmark as compared to the situation if he had remained in Iceland. The Icelandic law at the time required that personal tax credits could be transferred to the other spouse if both spouses are subject to unlimited tax liability in Iceland or they both receive pension from Iceland.

The issue was whether the Icelandic law was compatible with the free movement of workers.

The Supreme Court of Iceland concluded that a pensioner who receives a pension due to a former employment relationship, but who has not carried out any economic activity in another EEA state during their working life, had not only a right of residence in relation to the host EEA state, but also a right to move freely from the home EEA state. The latter right prohibits the home state from hindering such a person from moving to another EEA state. The fact that an EEA state does not give spouses who have moved to another EEA state the option of pooling their personal tax credits for income tax purposes constitutes such a hindrance in a situation where a pension constitutes all or nearly all of that person's income, while the other spouse has no income.

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Ireland

As widely expected, the Double Irish regime has been abolished for new companies from 1 January 2015, with grandfathering provisions for existing structures until the end of 2020. In addition, improvements to innovation based reliefs have been announced, which should help attract intellectual property and related R&D activities to Ireland.

The recent Budget statement and subsequent Finance Bill have introduced significant changes to Ireland's corporate tax regime, aimed at both enhancing its global reputation for transparency and also further enhancing attractiveness as a location for knowledge based activities.

The abolition of the Double Irish structure was well flagged in advance; initial reaction suggests that it will not lead to a flight of capital from Ireland. The six year deferral for existing structures should provide adequate time for groups to restructure their existing Intellectual Property (IP) arrangements in an appropriate manner.

Importantly, both the Budget statement and the Finance Bill provided a clear roadmap for the future of Ireland's foreign direct investment offering. The clear objective is that Ireland's tax regime continues to make a long-term compelling case for overseas investors to locate activities here.

Corporate tax residence changes

The changes to the corporate tax residence rules broadly ensure that any Irish incorporated companies will be regarded as Irish tax resident, unless they would be regarded as tax resident in a double tax treaty jurisdiction under the terms of a treaty with that country. The effect of this change is that it will no longer be possible for an Irish incorporated company to be regarded as solely tax resident, for example, in Bermuda (as Ireland has no tax treaty with Bermuda).

The changes apply to Irish companies incorporated after 1 January 2015. However, existing companies will continue to base their tax residence on current rules until the end of 2020. From 1 January 2021, all Irish incorporated companies will follow the same rules in determining Irish tax residence.

A key issue for many existing companies will be transition from an existing Double Irish structure before 2020. Broadly, the options include migrating the IP to another low tax jurisdiction or moving the IP 'onshore' to a location such as Ireland.

Grant Thornton can provide advice to groups considering their options in this regard, with an assessment of the US tax implication also critical.

For groups considering moving their IP to Ireland, there were several changes announced in the Finance Bill that make Ireland's offering even more compelling. A summary of these changes is outlined below.

Knowledge Development Box

The Irish regime will be significantly bolstered by the introduction of a Knowledge Development Box, likely to be similar in many respects to the UK regime, with an emphasis on substance.

There will be a consultation phase to consider how best to structure the Knowledge Development Box, with legislation expected in 2015. The new regime will provide an income based innovation relief and complement the existing cost based IP regime.

At present there is no detail regarding the applicable tax rate to income generated from the IP or the qualifying criteria for the IP in order to access the new relief. However, a tax rate of 6.25% has been discussed as the potential applicable rate.

Research and development

There were also improvements made to the Irish R&D tax credit regime, which provides a 25% credit (in addition to the standard 12.5% deduction) for qualifying R&D expenditure. The R&D tax credit regime means that the net cost of every €100,000 of R&D spend is €62,500, representing a significant incentive to locate R&D in Ireland.

IP regime

The current Irish IP regime offers tax relief for the capital costs of IP. In a positive move, the recent budget abolished the 80% restriction on capital allowances and interest that may be deducted against related IP income from 2015. Furthermore, the list of specified intangible assets qualifying for relief has been extended to include customer lists. These changes will further enhance the attractiveness of the IP regime and complement the planned Knowledge Development Box.

Attracting foreign executives

Existing income tax relief aimed at attracting overseas executives to Ireland was also enhanced, ensuring that Ireland can offer a full suite of tax incentives to overseas investors.

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Italy

Italy has extended the reduced income tax rate for employees' earnings arising from work arrangements that improve corporate productivity. The reduced 10% individual income tax, which was originally introduced in July 2008 to stimulate increased productivity in the private corporate sector, was amended and extended into 2014. Employees with a total annual income of up to €40,000 in 2013 will be able to receive the 10% tax rate for eligible additional earnings in 2014, within a limit of €3,000 per year. To qualify for the tax incentive, a worker's extra earnings should be received under employment changes that increase an employer's productivity, profitability, innovation, or organisational efficiency, as stipulated within contracts arranged either at company or territorial level.

In the corporate world a 'Ministerial decree' was issued, implementing new rules with regard to the optional deferral of exit tax.

The new decree described the new rules that will apply to transfers of tax residence taking place starting from the tax year 2015.

An Italian company migrating the tax residence to a European Union (EU) member state or to an EEA country which allows an adequate exchange of information and that has entered into an agreement on mutual assistance in tax collection may opt for:

- the immediate taxation of the deemed capital gain pertaining to the assets transferred
- the deferral of the taxation of the deemed capital gain until the moment of actual realisation as identified under Italian tax law, complying with specific reporting obligations
- the payment of the exit tax due in six (previously ten) annual instalments, including interest payments.

In the case of deferral or payment in instalments, the company is required to provide a guarantee for the deferred amount. The same provisions apply to an Italian PE migrated in a qualifying country.

The final amount of tax due is computed at the end of the last tax year of residence in Italy (or, in case of a PE, of existence in Italy), on the basis of the fair market value of the transferred assets, and any losses or gains subsequently accrued will not affect the exit tax liability. Existing tax losses are offset against the taxable income of the last year of residence in Italy, but any excess can then be offset against the gains determined on the migration date.

The tax deferral will automatically terminate if:

- the company subsequently migrates to a non-qualifying country
- the company is liquidated
- following a merger, division or acquisition, the taxable assets are transferred to a resident of a non-qualifying country.

Finally, the decree clarifies that the transfer of residence is defined according to the tax treaty between Italy and the qualifying country in which the residence is transferred, if in force.

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Kenya

Capital Gains Tax (CGT) has made a comeback after a 29 year hiatus in Kenya.

CGT was previously applicable between 1975 and 1985 and has now been brought back though the enactment of the Finance Act 2014 effective 1 January 2015. The CGT rate is 5%, which is a final tax.

There are no allowances for indexation/inflation that have been provided for in the Act. However, when computing the transfer value of property, incidental costs incurred by the transferor are deductible. Incidental costs are expenses wholly and exclusively incurred for the purposes of the acquisition or transfer.

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Liechtenstein

Liechtenstein has introduced a new voluntary tax declaration procedure. The new law provides that taxpayers who voluntarily file a first statement of non-tax compliance will be granted immunity from criminal prosecution but will be required to pay tax arrears and late payment interest covering any previously undeclared amounts covering the past five years. There is a fine of 10% on the sum of evaded tax for declaration, in addition to late payment interest and tax arrears.

As a transitional measure, taxpayers reporting undeclared assets and inheritances for the first time between 1 January and 31 December 2014 will have to pay tax at a flat rate of 2.5%, together with a municipal tax surcharge on all undeclared assets (6.25% to 7.5% in total).

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Luxembourg

Luxembourg is a jurisdiction where there is significant investment into local entities which are foreign owned. Foreign owned entities often have debt and equity financing in a foreign currency. Also such structures often create foreign currency risk exposure in filing a host country tax return and making host country tax payments. The local tax authorities issued a 'Circular' on the determination of the taxable base in foreign currency which is a unique approach to this common problem.

Luxembourg entities, including partnerships, that have share capital and commercial accounts denominated in a foreign currency can opt by written request for determining their taxable basis in the same foreign currency. For the conversion, the exchange rates published by the European Central Bank are suggested. Tax returns will be filed in foreign currency and in Euros. All tax assessments will be issued in Euros and taxes due will be paid in Euros.

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Netherlands

A decree was published which contains guidance regarding the application of legal mergers. Generally, gains derived from a legal merger are exempt from corporate income tax.

The decree provides special guidance for:

- situations where approval of the merger has retroactively been granted and any profits resulting from that merger are taken
- for cross-border mergers.

Retroactive effect will not be granted if the merger is undertaken to achieve a one-off tax advantage; or results in a one-off tax advantage. The transfer of losses by the dissolving company (ie carry-forward) can take place without an explicit request having to be made to the tax inspector.

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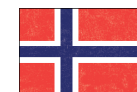

Norway issued regulations exempting certain kinds of securities from the application of the interest deduction limitation rules adopted last year. Norway's interest deduction limitation rules, which were adopted in 2013, limit deduction of interest expenses in relation to related-party debt, or in the case of third-party debt, which is secured by a related party.

Under new regulations, external loans secured by related parties will not fall within the definition of interest deduction limitation rules, and borrower entities will be entitled to claim deductions on the interest expenses so incurred. The new regulations exempt the following securities from the application of the interest deduction limitation rules:

- securities provided by a subsidiary entity which is owned by at least 50% by the borrower entity, directly or indirectly
- securities provided by the borrower entity in the form of pledge of shares or loan notes.

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Poland

Poland will join the club of countries with controlled foreign company (CFC) anti-avoidance legislation. The parliament approved the proposal introducing the concept of the CFC. The main features of the CFC regime, which will apply to Polish resident companies and individuals are:

- a non-resident entity is deemed to be controlled by a Polish resident (a company or individual) if it has a seat or place of management either in a listed or low-tax jurisdiction
- if it has a seat or place of management in any other jurisdiction, it is deemed to be controlled by a Polish resident (a company or individual) only if the following 'control test' criteria are met:
  - a Polish resident holds for a period of minimum 30 days, directly or indirectly, at least 25% of the share capital, 25% of the voting rights, or 25% of the yields in the foreign company
  - at least 50% of the foreign company yield is generated from passive income
  - the passive income is exempt from tax in the country of the foreign company's seat or place of management, or is subject to tax at the rate by at least 25% lower than the corporate (or individual) tax rate in Poland.
- the CFC income attributable to the Polish resident is computed by applying the Polish provisions regulating the computation of business income. The taxable base is income generated by the CFC in proportion to the shareholding of the Polish resident in the yield of the CFC, decreased by dividends received from the CFC and proceeds from the disposal of the share in the CFC.

The CFC regime will not apply to foreign companies established in the EU or EEA.

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United Kingdom

The upper tax tribunal upheld an earlier ruling that internal loans made within a group of companies did not constitute a loan relationship. The arrangement involves one company providing a loan to a subsidiary, and then transferring the right to receive interest to another subsidiary in return for preference shares issued by that other subsidiary. Her Majesty's Revenue and Customs (HMRC) said that the aim was for one company in the group to receive tax relief on interest paid to another group company, without the other company paying tax on the income it received. The upper tribunal noted that this arrangement may now be subject to double taxation on gains as a result of taking part in such a structure.

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APAC news

Australia

Thin capitalisation is not only within the BEPS radar but has been an anti-avoidance weapon in the arsenal of many treasury departments worldwide. Treasury released an exposure draft that deals with the proposed changes to the thin capitalisation rules. The draft states that recent data suggests that actual leveraging levels across a range of industries are higher than 'the normal gearing levels of most corporates with truly independent financing arrangements'. It also suggests that it expects independent financing to be less than 1:1 on a debt-to-equity basis.

The following proposed changes to the current thin capitalisation rules:

- reduces the safe harbour debt-to-equity ratio for general non-authorised deposit-taking institution (ADI) entities from 3:1 to 1.5:1 and for financial non-ADI entities from 20:1 to 15:1
- increases the minimum capital allowed to ADIs under the thin capitalisation rules from 4% of the Australian risk weighted asset to 6%. The capital is calculated under the local regulatory rules; and
- reduces the maximum worldwide debt limit for outward investing non-ADI entities from 120% of the worldwide gearing to 100% and increase the minimum worldwide capital limited for outward investing ADIs from 80% to 100%.

The proposed changes do not impact the arm's length test and will allow inward investing entities to access the worldwide gearing test broadly in the same way as the test applies to the outward investing entities.

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China

China has had general anti avoidance rules (GAAR) in place for several years. The State Administration of Taxation (SAT) published a guideline on GAAR for public comment. The guideline addresses such questions as:

What are the main features of tax-avoidance arrangement?

- the sole or main purpose, or one of its main purposes, is to obtain tax benefits
- the legal form of the arrangement is in compliance with the tax law and regulations, but the arrangement is not in conformity with economic substance.

The tax benefits should be construed as reduction, exemption or deferral of tax payable of enterprise income tax.

What are the GAAR methods of tax adjustments?

Special tax adjustments should be made by adhering to the substance-over-form principle and by reference to similar arrangements with a reasonable commercial purpose and economic substance. The methods of tax adjustments would include:

- re-characterisation of the whole or part of the arrangement
- denial of the existence of a party to the transaction for tax purposes, or treating one of the party and other parties to the transaction as one entity
- re-characterisation of the income, deductions, tax incentives or foreign tax credit or reallocation of them between the parties to the transaction
- any other reasonable method.

Which controls Specific Anti Avoidance Rules (SAAR), treaty provisions, or GAAR?

Special tax-avoidance rules (SAAR) on transfer pricing, cost sharing arrangement, CFC and thin capitalisation all have preference over the GAAR. However, if the arrangement falls within the applicable scope of the treaty provisions on beneficial ownership and limitation of benefits the treaty provisions have preference over the domestic rules.

What happens in a GAAR Investigation?

The tax authority would issue a GAAR inspection notice to the taxpayer who will be requested to provide documentation to prove that its arrangement does not constitute a tax avoidance arrangement within 60 days after receiving the notice.

The documentation would include:

- information on the background of the arrangement
- explanatory documents on the commercial purposes of the arrangement
- internal information on the decision-making process and governance such as resolutions of the board of directors, memos and email exchanges etc.
- detailed documents on the transactions of the arrangement such as contract, supplements to the contract and evidence of payments etc.
- information on the communications between the taxpayer and its tax advisors
- information on the communications between the taxpayer and other parties to the transaction
- other documents proving the non-tax avoidance nature of the arrangement
- other documents required by the tax authority.

What is the obligation of the tax professional?

The tax authority is authorised to require the tax professional, whether or not it is an entity or individual, to provide related documents or evidence. The guideline imposes an obligation on tax advisors to provide information on their clients. The tax advisers or intermediary would be notified by a letter if its cooperation/assistance is required.

What are the possible outcomes of a GAAR investigation?

The outcome of the investigation could be one of the following three ways:

- there would be no tax adjustment
- the arrangement is found to be subject to special tax adjustment and the competent local tax authority would issue the preliminary decision on special tax adjustment to the taxpayer
- the State Administration of Taxation's (SATs) view and the decision of the local tax authority are different, then the local tax authority would follow the SAT's view and review the outcome.

If a preliminary decision on the special tax adjustment is issued to the taxpayer, it may appeal to the tax authority within seven days.

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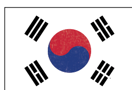
Korea



The following developments have been announced in Korea.

Tax credits for the transfer of technology

In order to promote the transfer of technology between companies, a tax credit has been introduced. The tax credit will reduce by 50% the income tax on income received by small and medium enterprises (SMEs) from the transfer of patents (ie a Korean Patent Box Regime). Additionally, it is expected that the regime will be expanded to also include non-SMEs, in line with the three-year economic innovation plans announced by the President.

Incentives to promote mergers and acquisitions (M&A)

The government announced a series of non-tax and tax measures to stimulate the Korean M&A market. The tax measure announced was that the taxation of any capital gains/losses from the exchange of shares arising from a restructuring exercise will be deferred until such shares are disposed.

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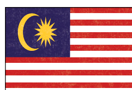

The Inland Revenue Board of Malaysia (IRBM) issued a public ruling explaining the tax treatment of income received by foreign and local investors which engage foreign fund management companies.

The ruling lists the criteria for income tax exemptions applicable to dividend and interest income and capital gains from the realisation of investments:

- the nature of the income
- whether the income is derived inside or outside Malaysia
- the residence status of the recipient
- whether the recipient is a local or foreign investor
- whether the recipient is a corporate entity or an individual.

It should be noted that that foreign income is generally not taxable in Malaysia (unless derived in Malaysia or received by a resident company carrying on the business of banking, insurance or transport by sea or air) and that capital gains are generally not taxed, unless they relate to real property in which case the real property gains tax will apply.

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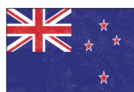
New Zealand



The Inland Revenue has released an interpretation statement dealing with foreign tax credits (FTCs).

A taxpayer is entitled to a credit for foreign tax paid if the foreign tax is income tax. The foreign tax must be substantially of the same nature as income tax imposed in New Zealand.

The foreign tax must be:

- compulsory and enforceable by law
- imposed by, and payable to, a central, state or local government
- intended for a public purpose
- an 'income tax' as defined in the Income Tax Act (ITA)
- calculated as a proportion of income, at any rate of tax whether fixed or on a progressive scale
- imposed on net income, taxable income, or provisional income for withholding tax purposes.

The foreign tax may not be a penalty, service fee or a contribution to a scheme or fund where the benefits are limited to the contributors of the scheme or fund.

The following taxes do not satisfy the requirements for the foreign tax credit:

- Goods and Services Tax (GST) and Value Added Tax (VAT)
- customs or import duties
- insurance levies
- property rates
- asset taxes
- wealth taxes
- gift duties
- inheritance taxes and estate duties
- excise taxes and duties.

The onus is on the taxpayer to prove that the foreign tax is eligible for the foreign tax credit. The taxpayer must make an adjustment to the foreign tax credit if he subsequently receives a refund of foreign tax.

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Singapore

The distinction on whether the gain is 'revenue' or 'capital' is important as Singapore does not impose tax on capital gains. The Singapore Court of Appeal delivered a decision on whether investment gains made by an insurance company should be taxed as 'revenue' or treated as 'capital gains'.

The taxpayer is a general insurance company which was formerly part of a group of companies (A Group). The taxpayer had to establish separate insurance funds for each class of insurance business. Additionally, the taxpayer was also required to ensure proper attribution of assets, liabilities, receipts and expenses to relevant funds, and as such had established the Singapore Insurance Fund (SIF) and the Offshore Insurance Fund (OIF) in respect of its Singapore and overseas policies respectively. The funds were used to invest in the shares of X Bank, Y Ltd and Z Ltd.

In 2001, G Bank made an offer to acquire X Bank. The taxpayer was offered a cash consideration as well as shares in G Bank. The taxpayer accepted the offer made by G Bank and disposed of its entire stake in X Bank. A year later, the taxpayer also sold its shares in Y Ltd and Z Ltd to G Bank.

The comptroller of income tax (comptroller) was of the view that since the insurance act required the taxpayer to retain insurance premiums in separate insurance funds to meet potential liabilities arising from risks it had underwritten, any gains arising from assets purchased by these funds are part of the taxable insurance business. The comptroller issued revised assessments.

The taxpayer objected and requested an amendment of the assessments. The taxpayer's argument was that the purpose of the insurance act was to regulate and not tax the insurance industry. The taxpayer also noted that the requirement to retain the insurance premiums in separate funds was to protect the policyholders and this should not determine how it should be taxed. Additionally, the assets do not become a 'revenue asset' just because it could potentially be used to meet the company's liabilities.

The taxpayer filed notices of appeal against the assessments and the Income Tax Board Review (ITBR) allowed the appeals.

The comptroller proceeded to appeal to the high court which upheld the ITBR's decision.

The high court's decision was affirmed and held that the shares were capital assets and as such, the gains arising from the disposal were capital-in-nature and not subject to tax.

The taxpayer had acquired the shares to secure its long-term strategic position meaning the shares were 'capital assets' and gains arising from the disposal of such assets were not taxable.

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Taiwan

The Ministry of Finance has proposed to introduce two new anti-avoidance measures.

CFCs

Currently, there are no CFC rules in Taiwan. Taiwan companies are only taxed in Taiwan on income from foreign subsidiaries if the dividends are distributed. This lack of CFC rules creates tax avoidance opportunities. The CFC rules are intended to combat this practice, however, will only apply to Taiwan corporations; individuals are not subject to these rules.

Place of effective management

The concept of 'place of effective management' will be introduced to create tax liabilities for non-resident companies that operate a branch in Taiwan from a low tax jurisdiction and have their place of effective management in Taiwan. The rules on the place of effective management are also targeted at individuals who operate through offshore holding companies under trust arrangements in Taiwan.

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Americas news

Argentina

The Argentine Supreme Court has dealt with tax issues concerning the calculation of export tax refunds. The court held that export tax refunds must be made in the same currency of the relevant export tax payment.

The court held that domestic law dealing with foreign currency payments of export taxes is not applicable to export tax refunds. The court decided that export tax refunds must be made in the same currency paid by the exporter.

Since the taxpayer paid the export tax in domestic currency, the tax must be refunded in domestic currency. Accordingly, the court considered that there is no tax amount in US dollars to be refunded and converted into domestic currency.

Both the tax court and the court of appeals had decided in this manner because it was reasonable that, if the export tax must be calculated in US dollars, the tax refund must also be calculated in US dollars and subsequently converted to domestic currency at the exchange rate existing on the date of the actual refund.

In another supreme court decision, the circumstances under which taxpayers may be exempted from paying the minimum deemed income tax (IGMP) was discussed.

IGMP is levied at the rate of 1% on business assets held by taxpayers at the end of the tax period. The income tax liability in the tax period may be credited against the IGMP liability of that period, but the excess of income tax over IGMP may not be carried forward. However, where the IGMP liability exceeds the income tax liability, the excess may be carried forward for ten years to set-off against income tax liability (of the tax year where the income tax liability exceeds the IGMP liability).

The court held that the IGMP presumes the existence of minimum profits derived from the exploitation of business assets and, therefore, where the actual net result is a loss, the legal presumption is no longer valid in which case the IGMP must not be levied.

The financial statements and the income tax assessments of the company were showing losses for the relevant tax years. However, the lower court held a different interpretation. The court's position was that the financial statement, although showing losses, were insufficient to demonstrate that the business assets were incapable of generating income, and this proof was necessary to dispense the taxpayer from IGMP taxation.

The supreme court overturned the lower court's decision and confirmed the previous case law. Accordingly, the taxpayer is exempt from IGMP when it incurs losses, and it is not necessary for this purpose to provide evidence that the business assets are incapable of generating income.

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Brazil

What happens under Brazilian domestic tax law when the CFC is resident in a country that has signed a tax treaty with Brazil?

In a court decision, the judges concluded that the business profit article in tax treaties signed by Brazil prevents the application of Brazilian CFC legislation. As a result, the court decided in favour of the taxpayer and denied the application of Brazilian CFC legislation to its CFCs. The CFC legislation was considered applicable though, to the CFC located in a non-treaty jurisdiction, as no tax treaty exists with Brazil.

According to the prevailing opinion in this decision was that Brazilian CFC legislation violates tax treaties.

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Canada

On 30 October 2014, the federal government announced a number of proposed personal tax measures with income splitting being the most significant one.

Income splitting

The government is proposing to allow income splitting for couples who have children under the age of 18, effective for the 2014 tax year. The higher-income earning spouse or common-law partner will be able to transfer up to $50,000 of income to the lower-income earning spouse or common-law partner each year. Tax savings will be capped at a maximum of $2,000 per year per family and will be provided as a non-refundable tax credit. This measure (with the exception of the $2,000 cap) was first announced in 2011, and its implementation was made contingent on the government first balancing the budget.

The proposed measure, the so-called 'Family tax cut', will only benefit those couples with minor children where there is either one income-earner or where there are two income-earners where one spouse or common-law partner is subject to a lower marginal rate of tax than the other. For example, assume 'taxpayer one' earns income of $200,000 per year and is, therefore, subject to the highest marginal federal rate of tax, at 29%. 'Taxpayer two', earns income totalling $45,000 and is subject to a much lower federal marginal tax rate. 'Taxpayer one' can transfer $50,000 of his income to 'taxpayer two', so that it will be notionally taxed in the second taxpayers hands at a lower rate (mostly at 22%). Although the actual reduction in the overall combined tax liability for the couple in this case would normally be more than $2,000 (after non-refundable tax credits are claimed by each), the tax savings allowed would be capped at $2,000, as a non-refundable tax credit. The credit will be able to be claimed by either person, but not both.

Other measures

The Canadian government has also announced the following proposed measures:

- the 'Universal Child Care Benefit' will be raised from $100 per month per child for each child under the age of six, to $160 per month. In addition, a new benefit of $60 per month per child will apply for each child between the ages of six and 17. This measure will go into effect for the 2015 tax year, and will begin to be reflected in monthly payments to recipients in July 2015. The July 2015 payment will include up to six months of benefits to cover the January to June 2015 period. However, the existing child tax credit is to be eliminated.
- the maximum child care expense deduction will increase by $1,000 per child, effective for the 2015 tax year.
- the Children's fitness tax credit will be doubled. The maximum amount of eligible expenses that may be claimed under the credit will be doubled from its current $500 limit to $1,000 (for a maximum federal credit of $150 per eligible child (the child must be under 16 years of age (or under 18 if eligible for the disability amount) at the beginning of the year in which the eligible fitness expenses are paid)).

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Colombia

Representative offices are often a tax efficient structure to establish as a beachhead in a foreign country. This such structure often features favourable tax positions. The National Tax Authority issued guidance on the compliance with tax obligations for representative offices established in Colombia.

A representative office whose only purpose is to promote and advertise services for their financial entity cannot be regarded as a PE in Colombia as those activities, considered to be 'preparatory and auxiliary', are excluded from the PE tax treatment. Unless the representative offices perform activities other than preparatory and auxiliary, or act in Colombia as dependent agents of a foreign financial entity, they do not constitute a PE.

Representative offices have the following tax obligations:

- file income tax returns
- apply the withholding income tax provided by the law, when it is involved in transactions, which are subject to such obligation
- register in the national tax registry in the name of the foreign entity
- comply with VAT or the tax on financial transactions.

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Mexico

The Mexican Maquila (companies that process or assemble imported materials and parts for resale to the country of origin or other parts of the world) have faced many tax amendments as Mexico tries to deal with its fiscal issues.

From 2014 onward, non-residents carrying out transactions with Maquila companies must fulfil new conditions for not constituting a PE in Mexico. All the income obtained by Maquila companies must derive exclusively from Maquila operations. These items may be considered income from Maquila operations:

- provision of services of personnel
- leasing of movable and immovable property
- disposal of scraps from materials used as part of maquila operations
- alienation of movable and immovable property
- interest
- other income related to its operation, except for the sale and distribution of certain goods.

Additional activities considered as part of a Maquila operation include:

- the income derived from such additional concepts is lower than 10% of the total income derived from Maquila operations
- segmented accounting related to the Maquila operation and the rest of activities must be maintained
- in transactions between related parties, the compensation received from the concepts above-mentioned is agreed as it has been agreed between independent parties in comparable transactions according to the income tax law
- Maquila, manufacturing and export service companies must segment the information related to these concepts in the informative return.

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Peru

The tax administration's report has been released concerning the taxation of share transfers. The report describes the tax treatment of income derived from the transfer of shares, issued by resident companies, and between non-resident persons. The report states:

- in order to establish the seller's net income, it is necessary to have the recovery of invested capital certificate issued by the tax administration, in order to deduct the acquisition costs
- the income tax must be paid within the first 12 working days of the following month, computed from the moment when the seller receives the income
- if the transaction price is not paid and the purchase-sell contract is declared null, there is accordingly no obligation to pay income tax.

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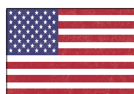

A recent case concerning the foreign tax credit and taxes of a foreign country under a totalisation agreement should be of interest to US citizens on foreign assignment in France.

The US tax court disallowed US FTCs for two French taxes at issue, general social contribution (CSG) and contribution for the repayment of social debt (CRDS).

The taxpayers were dual citizens of the US and France. The taxpayers resided in France, and they paid various taxes to France, including CSG and CRDS.

When the taxpayers filed their US income tax returns, they claimed FTCs for these French taxes against their US income tax liability. After the US Internal Revenue Service (IRS) disallowed the credits, the taxpayers filed a suit in the US tax court.

The US Tax Court noted that the parties agreed that the CSG and CRDS satisfied the standards for creditability, but stated that the question was whether the credit was precluded by a domestic provision, which bars deductions and credits, including FTCs, against US tax for taxes paid by an individual to a foreign country 'in accordance with' the terms of a social security totalisation agreement between the US and such foreign country with respect to any period of employment or self-employment that is covered under the social security system of such foreign country. In the present case, there was no dispute that the taxpayers paid CSG and CRDS with respect to a period of employment that was covered under the French social security system.

The US Tax Court first held that, if particular foreign taxes are covered by, or within the scope of, a totalisation agreement, the payment of those taxes to the foreign country is consistent with the obligation of the taxpayer under the agreement, and the taxes are thus paid 'in accordance with' the agreement.

The US Tax Court then determined that CSG and CRDS are covered by, or within the scope of, the totalisation agreement.

The US Tax Court accordingly concluded that CSG and CRDS are not creditable foreign taxes for US federal income tax purposes and thus affirmed the IRS's denial of FTCs for the French taxes.

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Uruguay

Effective 1 June 2014, no export operations may be constituted under the benefits of export financing regime, except for specific goods under transitional rules which apply until 31 December 2014.

The export financing regime was applied to the acquisition or production of goods intended to be exported. Under the regime, the exporter made a deposit equal to 10% or 30% of the total amount of the export that is being financed (through a local financial institution) for a period of 180, 270 or 360 days, but derived interest during this period for the total amount of export.

To compensate for the abolishment of this regime, higher rates of refund have been established of indirect taxes paid by exporters with respect to exports of specific goods. The increase ranges from 2% to 3% and from 4% to 6%.

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Transfer pricing news

Albania

Albania has introduced new transfer pricing legislation. The first period of application of the transfer pricing documentation requirement is for transactions carried out from 4 June or later and for recurring transactions continuing after that date.

The new rules provide definitions of controlled transactions, which, among others, include transactions with any entity resident in a tax haven jurisdiction, related parties and comparability. Moreover, the new law contains a description of the accepted transfer pricing methods, which are in line with the OECD guidelines.

Finally, the new law allows the possibility of an Advance Pricing Agreement (APA) and introduces a provision for the implementation of Mutual Agreement Procedures (MAPs) of an applicable tax treaty.

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Greece

Greece's Ministry of Finance released a decision which amends transfer pricing documentation rules and applies to financial years starting 1 January 2014. The decision distinguishes between two types of transfer pricing documentation: a master file and a Greek file.

According to the new measures, the master file should include:

- a general description of the group's organisational, legal, and operational structures
- a description of any changes in the ownership of intangibles within the group during the tax year
- a description of transactions carried out during the tax year with entities that would subsequently become related parties or with entities that had been, but were no longer, related parties
- a description of the nature of the transactions (sales of goods or services, financial transactions, and so on), the flow of invoices, and the value of the transactions
- a description of the pricing policy confirming adherence to the arm's-length principle in intragroup transactions
- a list of cost-sharing agreements.

The Greek file should include:

- a description of transactions, including the nature of the transactions, the flow of invoices, and the value of the transactions
- a description of extraordinary operations or events, including business restructurings
- a description of the method adopted to comply with the arm's-length principle in related-party transactions involving intangible assets
- a description of the intercompany pricing policy
- a description of the taxpayer's strategy, including any changes made from the previous tax year
- a comparative analysis, including internal or external comparables if available
- the taxpayer's commitment to provide, within a reasonable amount of time, any additional information relating to intercompany transactions requested by the tax administration, particularly in the case of a tax audit
- a detailed description and explanation of any adjustments made to achieve transfer pricing comparability
- additional information about related-party transactions with entities located or resident for tax purposes in jurisdictions that do not cooperate in tax matters
- a flowchart of transactions
- copies of contracts supporting controlled transactions.

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India

Transfer pricing adjustments have been at the centre stage of every public discussion on Indian tax legislation. In a recent dispute, the Indian revenue authorities made a transfer pricing adjustment on the under valuation of shares issued by an Indian subsidiary to its foreign holding company. The revenue authorities alleged that the shares were undervalued and treated the shortfall on the premium as income and also computed notional interest on the same.

Vodafone India was subject to such an adjustment on issue of equity shares to its holding company. It issued 2,89,224 equity shares of face value 10 Rupees (Rs) each on a premium of 8,509 Rs per share to its holding company. The revenue authorities valued each equity share at 53,775 Rs and considered shortfall of 45,256 Rs per share as premium. Further, the shortfall was deemed as a loan given by Vodafone India to its holding company and interest was imputed thereon.

Vodafone challenged the jurisdiction of Indian revenue authorities to undertake said adjustment before the Bombay High Court. Vodafone argued that pre requisite for application of transfer pricing provisions is that the income should arise from an international transaction. In this case, no income arises from the issue of equity shares and capital receipts are not income under the Act unless specifically provided for.

The Bombay High Court upheld Vodafone's arguments that income arising from an international transaction is a condition precedent for application of transfer pricing provisions. Income will not, in its normal meaning, include capital receipts unless it is so specified in the Act. The amount received on issue of share capital, including the premium, is on capital account. In this case, what is being sought to be taxed is capital not received from a non-resident, ie premium not received on application of arm's length price. Therefore, absent express legislation, no amount received, accrued or arising on capital account transaction can be subjected to tax as income. Thus, the High Court quashed the order of revenue authorities ruling that they have no jurisdiction to make a transfer pricing adjustment on the issue of shares at a premium as it does not give rise to any income from an international transaction.

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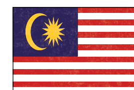

Malaysia first introduced specific transfer pricing legislation in May 2012, mandating taxpayers having transactions with related parties to prepare and maintain contemporaneous transfer pricing documentation. In this context, 'contemporaneous' means the period of time when such a transaction is being developed or implemented.

Where there are material changes to such a transaction, documentation which has been prepared shall be updated prior to the due date for furnishing a return for that basis period for that year of assessment.

The Malaysian Inland Revenue Board (IRB) has issued a new requirement relating to transfer pricing in the 'Corporate Income Tax Return Form' for 2014. This new 'check-the-box' declaration of whether transfer pricing documentation has been prepared is a sign of the increasing focus and scrutiny on transfer pricing matters by the IRB, in particular that statutory documentation requirements have been met.

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Mexico

The Mexican Supreme Court issued a ruling on the deductibility of expenses incurred abroad and prorated to Mexican taxpayers. The most common prorated expense charged by headquarters relates to activities conducted for the benefit of other affiliated companies by either the corporate headquarters or by entities that concentrate on certain corporate functions. Most of these activities can be classified as services and should be analysed using the intercompany service regulations. There are no specific transfer pricing regulations for intragroup services in Mexico

In the ruling, the Supreme Court gave a systematic analysis of transfer pricing principles and the Mexican income tax law provision that specifies that expenses incurred outside Mexico and prorated to corporate or individual taxpayers in Mexico are non-deductible. Based on the analysis conducted, the Supreme Court concluded that the deductibility of prorated expenses does not bear on the method used to determine the expenses but rather on whether the charge is strictly necessary, made at arm's length, and supported by (all) the relevant documentation. The ruling stated that support documentation must prove that the transaction is authentic, is based on sound accounting and tax criteria, has a legitimate (tangible) business purpose, and effectively considers the benefit for the Mexican taxpayer making the payment.

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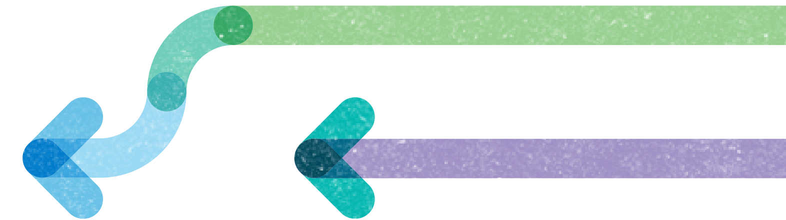
Tanzania

New transfer pricing regulations were issued in Tanzania which:

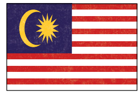
- explicitly state that they apply not only to cross border transactions but also to domestic transactions between associates
- requires contemporaneous transfer pricing documentation to be prepared before the tax return is submitted
- allows taxpayers to apply for APAs
- enables a corresponding adjustment in Tanzania in cases where a transfer pricing adjustment has been made by a tax authority of a country with which Tanzania has a DTA
- indicates that the traditional transaction method should be used in the first instance and thereby imposes a hierarchy of method which is no longer the OECD position
- has specific provisions dealing with intragroup services, intangible property and intragroup financing.

To discuss this information in more detail please contact your usual Grant Thornton contact or any of the contacts shown in this newsletter.

Indirect taxes news



Malaysia



The GST regime is expected to be implemented with effect from 1 April 2015, but what will it look like?

GST will be levied and charged at 6% on the taxable supply of goods and services made by a taxable person in the course or furtherance of business in Malaysia. GST will also be charged and levied on imported goods and services into Malaysia. All exported goods and services from Malaysia to places outside of Malaysia will be zero-rated.

The GST regime for Malaysia will comprise of a credit-invoice mechanism consisting of input tax and output tax. Businesses will charge GST on the output of taxable goods or services (output tax), but will be allowed to claim as credit any GST incurred on their purchases (input tax).

However, where the supply is regarded as an exempt supply, no input tax credits can be claimed. Where a person's output tax exceeds his input tax, the difference must be remitted to Customs. Conversely, where his input tax exceeds his output tax, a claim for a refund can be made to Customs.

Registration for GST purposes is mandatory for any person who makes a taxable supply for business purposes and where the annual taxable turnover of such supply exceeds the prescribed threshold. The threshold is proposed to be fixed at RM500,000.

Businesses will need to be registered in order to charge GST and claim input tax credits. Businesses below the mandatory registration threshold of RM500,000 annual turnover may still voluntarily apply to be registered for GST. A business that voluntarily registers for GST must remain registered for two years.

Preparing for GST's implementation

The upcoming months before 1 April 2015 are a critical period for businesses to prepare for the implementation of GST. Amongst other necessary steps, companies will need to introduce relevant systems and software for GST compliance, consider the impact of GST on its business operations, consider transitional issues and minimise the cash flow impact.

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Poland

In a recent case, a Polish taxable person called W Poland entered into a cooperation agreement with a Cyprus resident company, W Cyprus. According to the agreement, W Cyprus would run a website to hold auctions, where W Poland would offer and sell goods for its own account. The customers were required to buy bidding credits from W Cyprus, to be entitled to take part in the bids on the website.

To maintain the website, W Cyprus made use of W Poland's employees and technical equipment, for which W Poland received payment from W Cyprus. At a later stage, W Cyprus purchased all of the shares in W Poland.

W Poland did not pay VAT in Poland on the payments received from W Cyprus, as they considered the place of supply of the services to be in Cyprus. However, the Polish tax authorities assessed that W Cyprus had to pay VAT in Poland as they considered that W Cyprus had a fixed establishment in Poland which was the recipient of the services.

The Advocate General (AG) noted that VAT is payable in the state where the recipient of the services is established or has a fixed establishment.

The AG considered that a fixed establishment is deemed to be an establishment that has a sufficient level of permanence and an appropriate structure of human and technical resources. It is relevant that the establishment had its own staff, an ability to conclude agreements and make decisions about the day-to-day management. It was not of importance whether the establishment could not only use the services but also perform the services itself.

The AG noted that interested parties consider that it is not of importance whether W Cyprus had a fixed establishment in Poland but whether the consideration paid by W Cyprus for the services supplied to it were to be seen as partial consideration for the supply of goods by W Poland to the customers.

The AG stated that, provided there is a direct link between the supply of goods by W Poland to the buyers on the website and the payments made by W Cyprus to W Poland for the services, the payments for such services could be seen as third party consideration for the goods, received by W Poland for the trade on the website.

If that were the case, the taxable amount for W Poland will consist of the value of the goods sold to the customers and the consideration received from W Cyprus. It is for the referring court to decide whether there is a direct link between the two payments.

Concluding, the AG stated that a fixed establishment shall be deemed to be an establishment having a sufficient permanence and an adequate structure, in terms of human and technical resources, to be able to receive these services and use them for its own needs.

The AG emphasised it is not necessary for the establishment to have its own personnel and technical resources if the external resources are available to the establishment in the same way as if they were those of the establishment itself.

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Sweden

The AG of the European Court of Justice (ECJ) held that an overseas company with a branch in Sweden can be included in a VAT group and that its transactions with its Swedish branch should not be subject to VAT. However, the AG suggested that the combination of the use of a branch structure and participation in a VAT group should not lead to non-taxation for VAT purposes, as that would contravene EU law.

VAT grouping allows EU member states to treat two or more companies as a single entity for VAT purposes. This means that transactions between VAT group members normally will be disregarded for VAT purposes.

The case involves the VAT treatment of charges made by a US head office to its Swedish branch, which had joined a Swedish VAT group. The head office purchased information technology services from a third party and made those services available to the branch. The head office charged the branch for the costs of the externally purchased IT services with a 5% markup. The branch used the supplies to provide services to recipients both within and outside the VAT group.

The costs charged by the US head office to the Swedish branch were disregarded for VAT purposes. However, the Swedish tax authorities maintained that the supplies from the head office to its Swedish branch were subject to VAT in Sweden, and they therefore assessed tax on the branch. The taxpayer appealed the assessment, and the Swedish courts requested a preliminary ruling from the ECJ on the following:

- whether supplies of externally purchased services by a head office to its branch constitute taxable transactions if the branch belongs to a VAT group
- if so, whether the head office should be considered a taxable person that is not established in the EU member state where the branch is located.

The AG held that a branch of an overseas entity cannot be included in a VAT group independently from its head office, implying that the overseas entity should join the VAT group.

The AG also held that supplies between a head office and its branch are not supplies for VAT purposes and are not taxable transactions. However, the treatment is different for supplies between the branch and its customers, which qualify as taxable transactions regardless of whether the customers are in the same VAT group as the branch providing the supplies.

The AG held that if supplies between the head office and the branch are taxable, the branch's VAT group should pay the VAT.

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United Kingdom

A recent case concerned whether a taxpayer should be paid compound rather than simple interest by HMRC on any overpayments of VAT which taxpayers make. The central issue in the case was whether simple interest paid provided adequate indemnity for overpaid VAT.

Although the taxpayer succeeded in full before the high court, HMRC has been granted permission to appeal to the court of appeal.

The taxpayer had overpaid VAT over a 31-year period between 1973 and 2004 in relation to its home shopping catalogue business. HMRC repaid the overpaid VAT plus simple interest between 2005 and 2008. However, The taxpayer claimed that the simple interest payments were insufficient based on principles of EU law, and contended that they were entitled to the compound interest on the money they had paid to HMRC.

In 2012, the Court of Justice of the European Union held that EU law requires reimbursement of tax collected in breach of EU law and the payment of interest, but left it to the national law to determine whether the interest is calculated on a simple, compound or other basis bearing in mind the EU law principles of equivalence and effectiveness.

In relation to the latter principle, the court said that the national rules should not deprive the taxpayer of an adequate indemnity for the loss occasioned by the undue payment of VAT. The court said that this was a matter for the national court to determine.

Following the introduction of VAT in 1973, the taxpayer mistakenly overpaid more than £200 million in VAT as a result of the incorrect VAT treatment of commission arrangements between the taxpayer and its network of agents, which sold goods to the general public.

The court allowed the taxpayer's claim to succeed in full, awarding over £1.2 billion in compound interest on the overpaid VAT. In its judgment, the court sought to provide an adequate indemnity for the loss occasioned to taxpayer by the overpayment of VAT. Such indemnity required the payment of interest that was broadly commensurate with the loss of use value of the overpaid VAT, which was correctly reflected in an award for compound interest.

Additionally, the court held that, as it was clear that the right to interest on unlawfully levied tax was itself protected by EU law, the same principles had to apply in relation to interest. Accordingly, no account could be taken of additional corporation tax that would have been paid, had the overpayments of VAT not been made, as to do so would deprive an 'adequate indemnity'.

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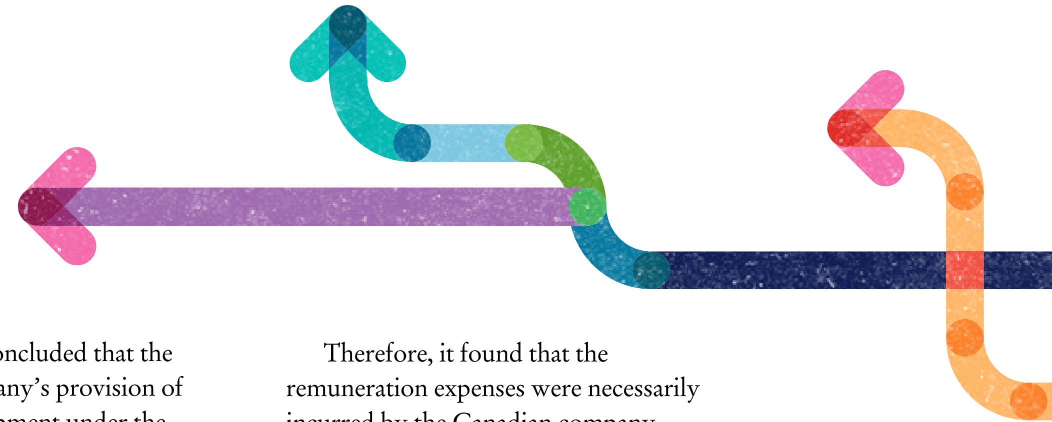
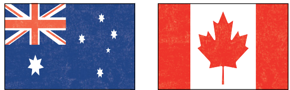
Treaty news



Australia/Canada



Moving service technicians on short term assignments can create surprises such as an application of the PE article to the employer and taxation to the employee.

The Australian Taxation Office (ATO) released an interpretative decision stating that Australia may tax the employment income of a non-resident employed by a Canadian-resident employer who is in Australia on a four-month secondment if the employee's remuneration is attributable to an Australian PE and deductible by the parent company.

The decision looks at the application of the Australia-Canada tax treaty to a case in which a Canadian equipment provider leased substantial equipment to an Australian firm for four months and entered into a separate service contract with the lessee to provide an operator of the equipment. An employee of the Canadian company went to Australia for four months, during which time he was employed solely by the Canadian company.

Under the Australia-Canada tax treaty, Australia can tax the employment income of a Canadian resident only if the employee is present in Australia for half a year or longer, unless the remuneration is deductible by the parent when calculating taxable income in Australia from an Australian PE.

The ATO concluded that the Canadian company's provision of substantial equipment under the lease arrangement gave rise to a PE in Australia.

The issue then became whether the Canadian company could deduct the remuneration expenses of its employee, when calculating the PE's profits, when the service agreement related to the equipment operator was entirely separate from the equipment leasing agreement.

Although the provision of equipment and the provision of an operator were treated as separate arrangements in the contracts, it appears that the ATO concluded that all parties viewed them as a single business arrangement.

Therefore, it found that the remuneration expenses were necessarily incurred by the Canadian company from the leasing arrangement and were thus deductible by the company when calculating its business profits from the leasing operation. Because the cost of remuneration was not taxable for the employer, the exception to the 183-day rule applied and the employee's salary could be taxed in Australia.

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Australia/UK

Nominee ownership is frequently encountered and raises the question of whether or not share ownership by a nominee, entitles the nominee's principal full treaty benefits.

The ATO issued a draft ruling concerning a UK resident owning at least 10% in an Australian company.

The issue – does a United Kingdom resident company (UK Co) that beneficially owns a dividend paid by an Australian resident company (Aus. Co), 'hold directly' at least 10% of the voting power in Aus. Co for the purposes of the UK convention in the following circumstances:

- a nominee shareholder owns shares carrying at least 10% of the voting power in Aus. Co for the benefit of UK Co
- the nominee undertakes UK Co to exercise all rights of voting and other privileges attaching to the shares in such manner as UK Co shall direct or approve?

The ruling concluded that the nominee ownership is considered as ownership under the treaty. UK Co, which beneficially owns a dividend paid by Aus. Co, 'holds directly' at least 10% of the voting power in Aus. Co for the purposes of the convention in the following circumstances:

- a nominee shareholder owns shares carrying at least 10% of the voting power in Aus. Co for the benefit of UK Co
- the nominee undertakes to UK Co to exercise all rights of voting and other privileges attaching to the shares in such manner as UK Co shall direct or approve.

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China

Beneficial owner status is important to achieve treaty benefits. Some taxpayers have been denied such status and therefore were not entitled to low treaty withholding tax rates on Chinese source income. In this regard a Chinese circular gives the following factors used to disqualify an applicant's beneficial owner status:

- the applicant is required to remit or distribute all or a large majority (more than 60%) of the income to a resident of a third jurisdiction within a stipulated period (for example, 12 months from the date of the applicant's recipient of the income)
- the applicant carries out little or no business activity other than the activity in connection with which the applicant owns the property or rights that generate the income
- if the applicant is a company or any other entity, its assets, business operations and personnel are too small to match its income
- the applicant has little or no power to control – or dispose of – the income or the income generating property or rights, and assumes little or no risk for the income, property or rights
- the foreign contracting jurisdiction does not impose tax on the income, exempts the income from tax, or imposes a very low effective tax rate
- in the case of interest income, the applicant has a similar loan agreement (in terms of principal, loan rate, and issuance date) with a third party in addition to the loan agreement that generates the interest income
- in the case of royalty income, the applicant has another agreement with a third party under which the applicant obtained ownership of, or the right to use, a copyright, patent or technology from the third party in addition to the copyright, patent or technology license agreement that generates the royalty income.

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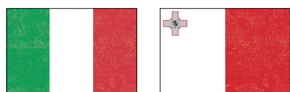

In the world of e-commerce, online gambling has become a big business. The Italian Supreme Court recently held that a company incorporated under the laws of Malta that offered online gaming services in the Italian market should not be considered an Italian tax resident because Italy was not the main place of business.

The litigation involved a Maltese corporation that provided online gaming services through a server located in Malta. The online gaming service was offered almost exclusively to customers in Italy, and the company had obtained a license to operate in the Italian market. An Italian group company provided the Maltese company with marketing and client assistance services, while the gaming platform was managed entirely from Malta.

The Maltese company deposited the money it received from the online gaming activities in its bank account in Italy. The company requested a transfer of those funds to a foreign bank account, but the Italian bank suspended the request because of applicable anti-money-laundering legislation.

Based on these facts, the Italian tax authorities claimed that the Maltese corporation should be considered an Italian tax resident because its main place of business was Italy.

The court held that the fact that the company obtained an Italian license to offer its online gaming activities in the Italian market was in itself insufficient to conclude that it must be considered an Italian tax resident based on the main place of business criteria.

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Kenya/Mauritius

The Cabinet Secretary for the National Treasury in Kenya has announced a DTA with Mauritius.

The agreement was signed with a view to affording relief from double taxation in relation to income tax and any other taxes of similar nature imposed by the laws of either country.

The DTA between Kenya and Mauritius shall come into force on 1 January 2015.

The Kenya Revenue Authority (KRA) is alive to the fact that businesses will, in view of the new DTA, seek to maximize on the tax arbitrage. It is therefore safe to assume that the KRA will enhance the level of scrutiny of transactions with Mauritian tax residents in order to safeguard Kenya's tax base.

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Austria

Austria concluded a double tax treaty with Montenegro on 16 June 2014. The treaty follows the official OECD approach on administrative and legal assistance, however the treaty has yet to come into force.

Austria has also concluded a Tax Information Exchange Agreement (TIEA) with Jersey, which came into effect on 1 January 2014.

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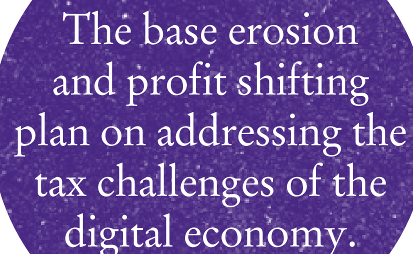
Tax policy

Taxation of the digital economy

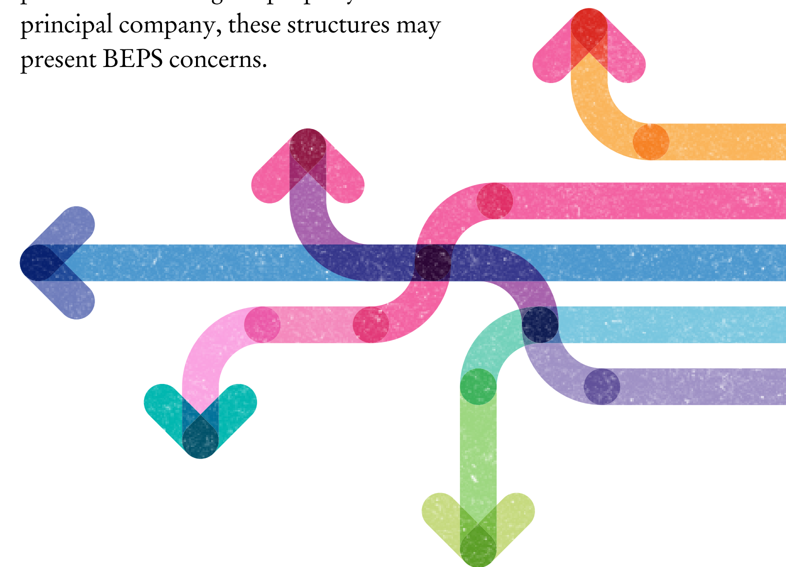
The OECD released a report in response to its base erosion and profit shifting plan on addressing the tax challenges of the digital economy.



Focusing on direct taxation only, the report notes that typical examples of digital economy structures that minimise assets and risks in market jurisdictions including using a subsidiary or PE to perform marketing or technical support, or to maintain a mirrored server to enable faster customer access to the digital products sold by the group, with a principal company contractually bearing the risks and claiming ownership of intangibles generated by these activities.

A company may, for example, limit risk at the local company level by limiting capitalisation of that entity so that it is financially unable to bear risk. In the case of businesses selling tangible products online, a local subsidiary or PE may maintain a warehouse and assist in the fulfilment of orders. These subsidiaries or PEs will be taxable in their jurisdiction on the profits attributable to services they provide, but the amount they earn may be limited. Alternatively, functions purported to be undertaken by local staff under contractual arrangements may not correspond with the substantive functions performed by the staff.

For example, staff may not have formal authority to conclude contracts on behalf of a non-resident enterprise, but may perform functions that indicate effective authority to conclude those contracts. If purported allocations of assets, functions, and risks do not correspond to actual allocations, or if less-than-arm's length compensation is provided for intangible property of a principal company, these structures may present BEPS concerns.



The report also notes that another common technique to reduce taxable income is to maximise the use of deductions for payments made to other group companies in the form of interest, royalties, service fees, etc. In many cases, multi notational entities engaging in BEPS practices attempt to reduce taxable income in a source country by artificially inflating the amount of deductible payments made to affiliates in other jurisdictions.

For example, an affiliate in a low-tax jurisdiction may, due to a favourable credit rating, be able to borrow money at a low rate. It may then lend money to its subsidiaries in high-tax jurisdictions at a higher rate, thereby reducing the income of those subsidiaries by the amount of the deductible interest payments. Alternatively, an affiliate may take advantage of hybrid instruments to create deductible payments for a subsidiary in a source country that result in no inclusion in the country of residence of the affiliate.

Payments (including underpayments) for the use of intangibles held by low-tax group companies or for services rendered by other group companies are other typical ways to reduce taxable income in the market country. Many structures put in place by digital businesses appear to make use of these techniques, with the taxable income from the local operations being reduced to extremely low amounts.

The report sets forth a number of proposals to minimise the loss of direct taxation within a digital economy including recommendations to prevent:

- treaty abuse
- artificial avoidance of PE status
- effects of hybrid mismatch arrangements
- limit base erosion for payments of interest and royalties transfer pricing outcomes inconsistent with value creation
- erosion of CFC anti deferral regimes.

In addition to direct taxation, the report also addresses the impact on of the digital economy on consumption taxes.

OECD announces report on income inequality and taxation

This report focuses on income inequality and taxation and calls for a tax overhaul to ensure that top earners pay a fair share of the tax burden. The report notes that tax reforms in almost all OECD countries over the past 30 years have substantially cut top personal income tax rates. This reduction has been closely associated with rising top income shares. Other taxes which play a role for top incomes were also lowered such as the corporate income tax and taxes on dividend income for distributions of domestic source profits.

The paper outlines a series of reforms governments could make to help ensure that top earners contribute their fair share of the tax burden. These include:

- abolishing or scaling back a wide range of those tax deductions, credits and exemptions which benefit high income recipients disproportionately
- taxing as ordinary income all remuneration, including fringe benefits, carried interest arrangements and stock options
- considering shifting the tax mix towards a greater reliance on recurrent taxes on immovable property
- reviewing other forms of wealth taxes such as inheritance taxes
- examining ways to harmonise capital and labour income taxation
- increasing transparency and international cooperation on tax rules to minimise ‘treaty shopping’ (when high-income individuals and companies structure their finances to take account of favourable tax provisions in different countries) and tax optimisation
- broadening the tax base of the income tax, so as to reduce avoidance opportunities and thereby the elasticity of taxable income
- developing policies to improve transparency and tax compliance, including continued support of the international efforts, led by the OECD, to ensure the automatic exchange of information between tax authorities.

International Monetary Fund (IMF)

The IMF requested input into how national tax policy and tax design choices under the current international tax systems influence economic outcomes for other countries.

Specifically, the IMF sought input into its own assessment of how national policy and tax design choices under the current international tax architecture influence economic outcomes for other countries, together with your wider assessment of that architecture and alternatives to it.

Their published paper explores the nature, significance and policy implications of spillovers in international corporate taxation, ie the effects of one country's rules and practices on others. The IMF work complements the current initiatives focused on tax avoidance by multinationals, notably the G20-OECD project on BEPS. The specific questions the IMF wants respondents to address were:

1. How does the current network of bi-lateral DTAs, and the spillovers that can arise from treaty shopping, affect low income countries? What changes in the design of treaties could be beneficial for those countries? Is the existence of bi-lateral tax treaties important to the attraction of international capital, and if so why/how?
2. How (if at all) does the asymmetric tax treatment of debt and equity contribute to any unintended reduction in the tax bases of individual countries, and of the world's overall taxable profit? What solutions would you prefer, if you see this as a problem?
3. Have you observed any shifts in capital or investment flows as a consequence of recent shifts in large capital exporting economies toward territorial taxation and away from worldwide taxation?
4. Would an end to deferral of taxation under worldwide taxation regimes (such as that in the US) be beneficial for some countries?
5. Do you have suggestions regarding amendments or the introduction of possible special regimes under the arm's length pricing method that would be of benefit for developing countries, in terms of revenue outcomes and/or administration?
6. Do you have views on the potential outcomes of an adoption of formulary apportionment and/or unitary taxation – of some degree (including, for example, some form of 'residual profit split') – for developing countries? Other countries? International business? If you support such a system, what allocation factors would you suggest?
7. How should the international tax architecture treat jurisdictions where significant corporate profits are booked, but which have relatively little substantive economic activity?
8. In your view, does the existence of tax competition – whether directly, through the setting of tax rates, or indirectly, through the shifting of tax bases – serve a useful purpose? Can one identify particular forms of tax competition that are 'harmful'?

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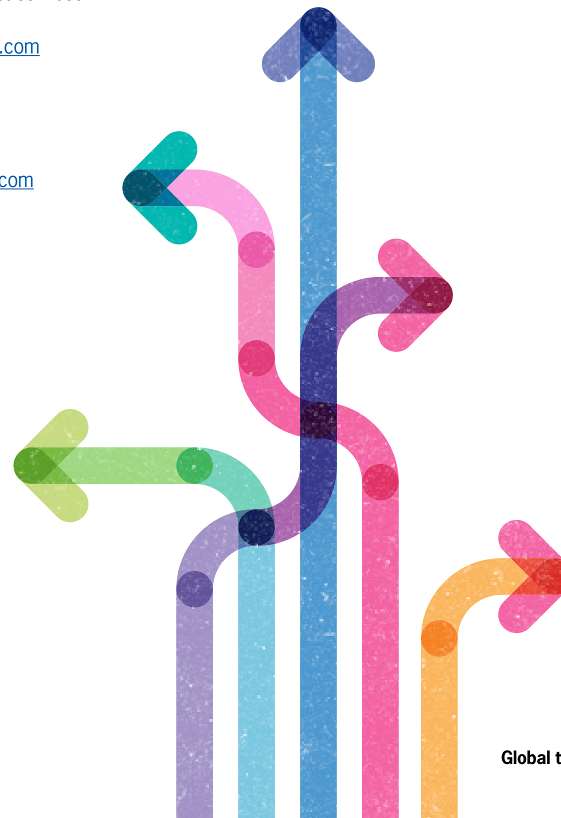

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