International Tax News

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Welcome

Keeping up with the constant flow of international tax developments worldwide can be a real challenge for multinational companies. International Tax News is a monthly publication that offers updates and analysis on developments taking place around the world, authored by specialists in PwC's global international tax network.

We hope that you will find this publication helpful, and look forward to your comments.

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In this issue

Tax Legislation
Belgium

Parliament approves Belgian transfer pricing documentation requirements

On June 29, 2016, the Belgian Parliament adopted the 'programme law' (introduced on June 2, 2016) that contains the introduction into Belgian tax law specific transfer pricing documentation requirements (published in the Belgian Official Gazette of July 4, 2016). These requirements are based on Action 13 of the Organisation for Economic Co-operation and Development (OECD)/ G20 Base Erosion and Profit Shifting (BEPS) project. Only minor adjustments with no effect on the technical content of the draft programme law were made.

The relevant articles of the programme law introduce a three-tier documentation approach as provided under BEPS Action 13: Master file, local file, and country-by-country reporting (CbCR). According to the newly adopted documentation requirements, Belgian entities of a multinational group that exceed one of the following criteria need to submit to the tax authorities a master file and a local file (the detailed form that is part of the local file only when at least one of the business units of the entity has realised intra-group cross-border transactions of more than one million euros [EUR]):

- operational and financial revenue of at least EUR 50 million, excluding non-recurring revenue
- balance sheet total of EUR 1 billion, or
- annual average number of employees of 100 full-time equivalents.

Belgian ultimate parent entities of a multinational group with a gross consolidated group revenue of at least EUR 750 million should file a CbCR. Under certain conditions, the Belgian entity that is not the ultimate parent entity of the multinational group may be required to file the CbCR directly with the Belgian tax authorities.

The master file and CbCR should be filed no later than 12 months after the last day of the reporting period concerned of the multinational group. The local file, however, should be filed with the tax return concerned.

The programme law also introduces specific transfer pricing documentation penalties, ranging from EUR 1,250 to 25,000.

Currently, the Royal Decrees covering the implementation measures of the newly adopted documentation requirements are being drafted. It is expected that these implementation measures will be finalised by the end of September or early October 2016.

PwC observation:
Taxpayers should assess the impact of the above described legislation on their businesses and anticipate whether this could affect their business going forward. As the Belgian transfer pricing documentation requirements deviate to a certain extent from the standard OECD documentation requirements, taxpayers should assess what additional information should be disclosed in Belgium, if any, and whether such information is available within the group.

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China

New Working Guidelines for the Administration and Assessment of High and New Technology Enterprises (HNTEs)

In early 2016, an amended Administrative Measures for the Assessment of high and new technology enterprises (HNTEs) (Guokefahuo [2016] No.32) was issued, setting forth a new regime for HNTE assessment in China. Lately, several ministries jointly released the amended Working Guidelines for the Administration and Assessment of HNTEs (Guokefahuo [2016] No.195, the 'New Working Guidelines') to officially kick off the HNTE assessment under the new regime. The New Working Guidelines took effect on January 1, 2016.

Highlights of the New Working Guidelines include:

Emphasis of the leading role of technology
Encouraging innovation in research and development (R&D) and driving economic upgrades have always been the spirit of HNTE policies. The New Working Guidelines fully reflect this spirit and emphasise the leading role of technology for HNTEs. In addition, the New Working Guidelines have optimised the provisions in relation to intellectual property (IP) rights. For instance, under the new regime, IP rights are classified into two categories. Patents for invention, new varieties of plants, etc. shall fall in category I, whereas utility model patents, software copyrights, etc. shall fall in category II. Category II IP rights are only allowed to be used once for HNTE application.

Refinement of the evaluation mechanism of innovation capability
The New Working Guidelines have upgraded the evaluation mechanism under the previous HNTE regime to an 'innovation capability evaluation mechanism' and made some improvements, which demonstrate the state's growing emphasis on and rigid view in innovation capability.

Clarification to the definition of certain concepts for the assessment purpose
The New Working Guidelines have unified the previously inconsistent definition of certain concepts (for example, main products [services], total employees and scientific and technical personnel, etc.) for the evaluation purpose.

Enhanced supervision and administration
The New Working Guidelines have enhanced the supervision on HNTEs, improved the expert panel evaluation mechanism, and imposed more stringent requirement on qualified intermediary agencies.

PwC observation:
The New Working Guidelines have provided more practical guidance for the HNTE assessment and raised the standard on HNTE's daily management. Hence, a lot of implementation issues will inevitably arise in practice. We suggest that enterprises operating in China put more effort in the management of HNTE qualification and relevant tax preferential treatment, enhance their compliance level, and mitigate relevant risks.

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Hong Kong

Ordinance on implementing automatic exchange of information in Hong Kong

The Inland Revenue (Amendment) (No. 3) Ordinance 2016 was gazetted on June 30, 2016, and went into effect the same day. The Ordinance puts in place a legal framework for Hong Kong to implement automatic exchange of information (AEOI) and commence the first information exchanges by the end of 2018. The Ordinance covers the following five key areas:

- scope of financial institutions (FIs), non-reporting FIs and excluded accounts
- due diligence and reporting requirements
- scope of information to be furnished by FIs
- scope of reportable jurisdictions, and
- enforcement provisions, specifically, the powers of the Hong Kong tax authority and sanctions.

PwC observation:
Following the enactment of the Ordinance, the Hong Kong government aims to identify at least one suitable jurisdiction as an AEOI partner of Hong Kong and conclude negotiations with it by the end of 2016 to pave the way for FIs in Hong Kong to start conducting due diligence procedures with respect to their financial accounts in 2017. FIs are then expected to register with the Hong Kong tax authority by September 2017 and file the first AEOI returns by May 2018.

Given the tight implementation schedule of AEOI in Hong Kong, FIs should closely monitor their progress in putting in place effective information systems and procedures for complying with the relevant due diligence and reporting obligations under the new AEOI regime. They should also stay tuned of the further guidance on the implementation details of the AEOI regime that is expected to be issued by the Hong Kong tax authority.

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Hong Kong

Legislation on Hong Kong's open-ended fund company regime

The Securities and Futures (Amendment) Ordinance 2016 was gazetted on June 10, 2016. The Ordinance introduces the legal, regulatory, and tax framework for an open-ended fund company (OFC) regime in Hong Kong. Previously, an OFC could only be established in Hong Kong in the form of a unit trust. The Ordinance provides an extra option for the structure of investment funds domiciled in Hong Kong.

The profits tax and stamp duty treatments for OFCs are set out below:

- OFCs will enjoy the same profits tax exemption as certain public funds and private funds, provided that the specified conditions are met. Specifically, (i) publicly offered OFCs will be exempt from Hong Kong profits tax irrespective of the locality of their central management and control (CMC) and (ii) privately offered OFCs will enjoy the profits tax exemption only if their CMC is located outside Hong Kong.
- Stamp duty will not be payable on the initial allotment and cancellation of OFC shares upon redemption. However, the transfer of shares in OFCs will be subject to stamp duty.
- In regards to an umbrella OFC, each sub-fund under an OFC would be regarded as a separate OFC for stamp duty purposes. As such, the conversion of interest from one sub-fund to another and the transfer of dutiable assets between different sub-funds would be subject to stamp duty.
- Stock transactions involving in-kind allotment and redemption of shares of public OFCs that are open-ended collective investment schemes authorised by the Securities and Futures Commission will not be subject to stamp duty.

The Ordinance will not become effective until a day to be determined by the Secretary for Financial Services and the Treasury by notice published in the Gazette.

PwC observation:
The enactment of the Ordinance gives the green light for using open-ended companies as fund vehicles in Hong Kong. This is another step taken by the Hong Kong government to promote Hong Kong as a premier international asset management centre and fund hub.

We welcome the efforts made to broaden Hong Kong's fund domiciliation platform and agree that providing an alternative Hong Kong domicile investment vehicle to the asset management industry is a positive step in the right direction. In order to ensure the success of the regime, it should cater equally to privately offered funds as well as retail funds and be competitive and attractive or at least on par with investment vehicles domiciled in other jurisdictions such as the Cayman Islands. For this to happen, further work should be done on the tax front, such as exploring ways to achieve a profits tax exemption to onshore private OFCs, whilst striking a balance in the post-Base Erosion and Profit Shifting (BEPS) world.

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Hungary

Modified nexus approach implemented regarding IPs

Starting from July 2016, the tax allowance available for royalties received will be reduced based on a new definition of royalty. The new definition will generally include profit from patents and software copyrights, which means (i) the exclusion of several intellectual property (IP) assets (e.g. know how, trademarks, etc.) from the qualifying assets and (ii) changing the basis of the allowance from a revenue to a profit approach.

Besides the narrowed definition, taxpayers purchasing qualifying IP (either from related or unrelated parties) or research and development (R&D) from related parties to develop the qualifying IP will only be eligible for the tax allowance pro rata to the amount of their own R&D activity, or R&D purchased from unrelated parties. In this respect, a 30% uplift will be available in limited cases when calculating the said pro rata amount.

According to the respective grandfathering provisions, in certain cases, taxpayers will be allowed to apply the former rules, but only until the last tax year ending before or on June 30, 2021.

PwC observation:
This amendment is considered to be the implementation of the modified nexus approach, but even with the Organisation for Economic Co-operation and Development (OECD) recommendations available, the new rules raise several questions. Therefore, any company applying or planning to apply the Hungarian IP regime should review its position.

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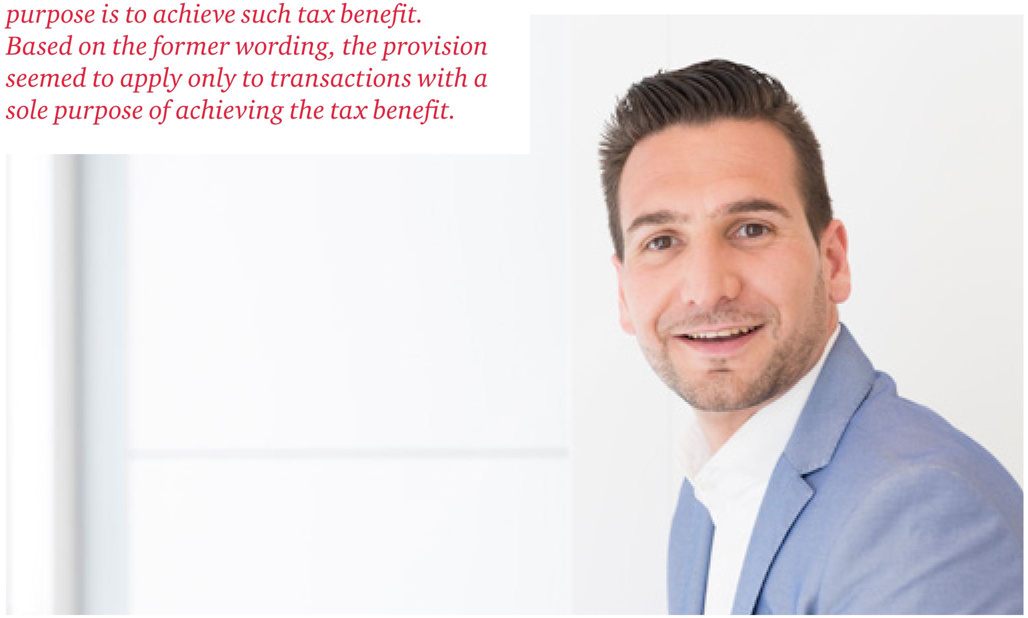
Hungary

More stringent basic tax principles

Starting from January 1, 2017, a stricter principle will apply for Hungarian corporate tax purposes, whereby taxpayers will not be eligible for tax benefits (including taking the respective costs and expenses into account for tax purposes) derived from transactions whose main purpose is to achieve such tax benefit. Based on the former wording, the provision seemed to apply only to transactions with a sole purpose of achieving the tax benefit.

PwC observation:
This amendment shows that the Hungarian tax authority may put a greater emphasis on the review of the underlying purpose of transactions. Nonetheless, the amendment does not actually bring novelty, as the widely accepted interpretation of the formal rules were in line with the wording of the new regulation.



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Hungary

Hungarian advertisement tax

In August 2014, a special tax was introduced in Hungary on certain advertising activities, including, among others, online and other media advertising. It is understood that the Hungarian government's intent is to also tax non-resident advertising companies based on revenues generated from displaying advertisements in Hungary (or in Hungarian language in the case of digital advertisements).

The Act on Advertisement Tax levies obligations for taxpayers performing advertisement activities (subject to the advertisement tax) such as registering to the Hungarian tax authority, submitting advertisement tax returns and providing specific declarations to the purchasers of the advertisement upon their request. However, because the enforcement of the advertisement tax's rules in the case of non-residents is challenging, the Hungarian Parliament introduced strict rules for non-compliance as of 2017.

Per the new regulations, the total amount of default penalties (in certain cases levied upon each day of the non-compliance) in the case of failing to register with the tax authority or failing to provide the specific declarations to purchasers of the advertisement may even reach approximately 3.5 million dollars (USD) by law. In addition, if a taxpayer subject to advertisement tax fails to submit its yearly advertisement tax return, a deemed tax in the amount of approximately USD 11.5 million will be levied by the tax authority. The amount of the deemed tax can only be challenged within a 30 day term of preclusion.

PwC observation:
The potential total exposure in the case of non-compliance is high. Therefore, companies performing advertisement that can potentially be linked to Hungary are encouraged to review their position in terms of the advertisement tax's applicability to them. When doing so, the Hungarian advertisement tax's compliance with international agreements should also be considered.

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Hungary

Changes regarding Transfer Pricing adjustments

Based on the effective legislation and provided that certain criteria are met, in cases of related party transactions, the Hungarian corporate income tax (CIT) base can be decreased by the difference between the arm's-length price and the price used in the related party transaction (downward transfer pricing [TP] adjustment).

Under the current rules, the possibility to decrease the Hungarian tax base is independent from whether or not the related party is making a corresponding adjustment. As of the tax year starting in 2018, in addition to the criteria already included in the legislation, the application of the downward TP adjustment will only be possible if the taxpayer possesses a declaration from the related party stating that it accounts for a corresponding adjustment when determining its CIT (or similar tax) liability.

PwC observation:
These changes may significantly affect the tax position of certain group-financing structures operating in Hungary, especially the existing non-interest bearing loan structures. The interpretation of 'corresponding adjustment' is not entirely clear under the new rules. Thus, a consultation is recommended regarding the current and future Hungarian tax position of such companies.

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Poland

Introduction of the GAAR clause into the Polish tax law

On May 13, 2016, Polish Parliament passed a bill amending the Tax Ordinance Act introducing a General Anti-Avoidance Rule (GAAR) to the Polish tax system. According to the bill, GAAR shall apply to all types of taxes (apart from value-added tax [VAT] where other provisions are proposed to prevent VAT avoidance) and shall preclude a taxpayer from obtaining a tax benefit as a result of artificial transactions. The transactions shall be deemed as artificial if they would not be carried out by a taxpayer acting in reasonable manner and whose objectives are not contrary to the purpose of the tax law.

According to the bill, legal transactions with the main purpose of obtaining a tax advantage (defined very broadly, e.g. including also tax deferral) contrary to object and purpose of the tax regulations shall not result in tax benefit.

The proposed regulations stipulate that if tax authorities detect artificial transactions designed mainly to gain tax benefit, tax consequences of such transactions will be assessed as if alternative 'appropriate' transactions had taken place. What is more, if transactions carried out by a taxpayer do not have any real economic or business rationale other than tax avoidance, tax authorities may completely disregard them.

The GAAR clause will be applied to transactions of anti-avoidance character resulting in tax benefits exceeding 100,000 zloty (PLN).

The new regulations will take effect on July 15, 2016. According to the bill, the GAAR clause will be applicable to transactions carried out before the GAAR provisions came into effect in cases where the tax benefit is achieved after the new law is introduced.

PwC observation:
The main purpose of the GAAR, as announced, is to target multinational companies (MNCs) which minimise their tax liabilities in Poland by applying tax avoidance measures. In addition, based on the new wording of transitional arrangements, in practice, tax authorities may challenge under the GAAR transactions carried out before the effective date of the new regulations if they result in tax benefits after the rules become applicable.

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Proposed Tax Legislative Changes
Netherlands

Dutch State Secretary of Finance seeks to lower the Dutch corporate income tax rate

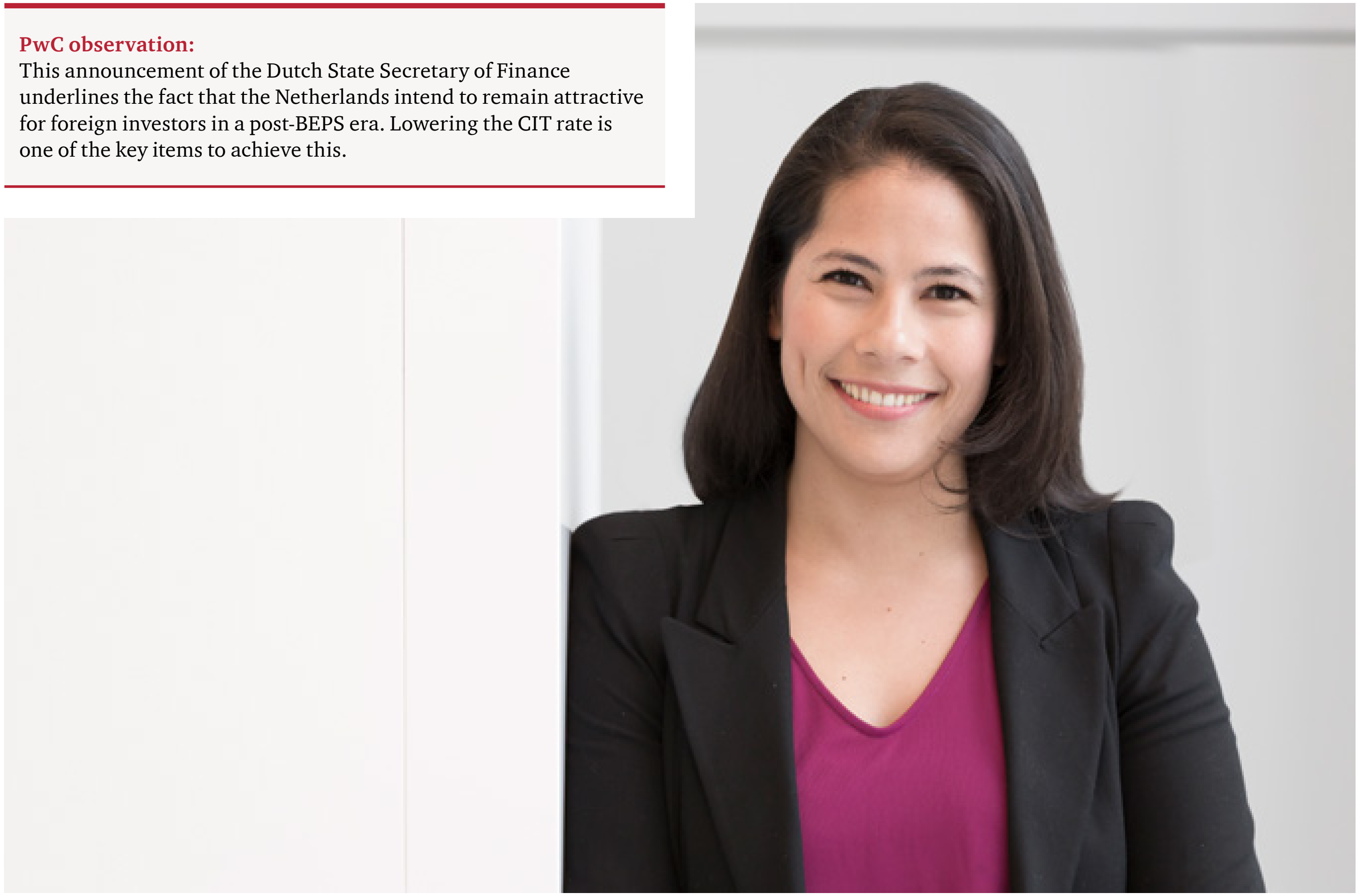
The Dutch State Secretary of Finance stated that it was inevitable for the Netherlands to bring its corporate income tax (CIT) rate (currently 20% on the first 200,000 euros [EUR], 25% on the excess) in line with competing jurisdictions such as Switzerland and the UK (corporate tax rates in the range of 15% – 18%).

The Netherlands Foreign Investment Agency and Dutch tax authorities informed the Dutch State Secretary of Finance that there currently is uncertainty for (potential) foreign investors with respect to the fiscal climate in the Netherlands, mainly resulting from recent Base Erosion and Profit Shifting (BEPS) developments.

On Budget Day 2016 (September 20, 2016), the Dutch State Secretary of Finance will therefore propose legislation in order for the Netherlands to remain attractive for foreign investors, whereby a reduced CIT rate is one of the items. This is justified in his view, as 40% of all jobs in the Netherlands are with multinationals, and as such, it is of great importance to remain attractive for these companies. A reduced CIT rate is deemed to be key in this respect.

As political consensus is required in order to realise this, both the current government as well as the newly elected government (elections will take place in March 2017) will have to work on this.

PwC observation:
This announcement of the Dutch State Secretary of Finance underlines the fact that the Netherlands intend to remain attractive for foreign investors in a post-BEPS era. Lowering the CIT rate is one of the key items to achieve this.



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New Zealand

BEPS implementation strategy

On June 27, 2016, the New Zealand government and Inland Revenue released several papers regarding New Zealand's implementation strategy of the Organisation for Economic Co-operation and Development (OECD) recommendations to address Base Erosion and Profit Shifting (BEPS). These papers outline the steps that have been taken to date, as well as other changes New Zealand will make to implement certain recommendations.

The papers released characterise New Zealand's tax system as already quite robust by international standards. Consequently, no changes are proposed to some aspects of New Zealand's tax system, for example, the controlled foreign company (CFC) regime. The papers suggest that New Zealand will introduce legislation to require multinationals to prepare country-by-country reports (CbCR) in August 2016. Legislation could also be introduced in March 2017 to facilitate the application of revised OECD Transfer Pricing Guidelines to address the shifting of profits to low tax jurisdictions.

The papers also outline that the government will be consulting on hybrid mismatch and interest limitation rules in August/September this year. Draft legislation could then be introduced in March 2017. The government seeks to consult on domestic legislation which creates hybrid mismatch rules in an effort to prevent multinationals structuring themselves or entering arrangements to take advantage of differences between New Zealand and other jurisdictions' tax legislation.

The government is also seeking to consult on the interest limitation rules, which are intended to prevent multinationals stripping profits out of New Zealand by way of deductible interest payments.

The government has also signalled that it will:

- sign up to the OECD's multilateral instrument in 2017. This instrument will contain a new anti-treaty abuse article, a new definition of permanent establishment (PE), anti-hybrid entity rules and dispute resolution articles, and
- consider diverted profits tax (DPT) regimes introduced in other countries (namely, United Kingdom and Australia) and other proposals on increased public transparency of information about the tax paid by multinationals in New Zealand.

PwC observation:
The proposed actions, and those taken to date, are reflective of New Zealand's overall support of the OECD workstreams.

The timeframes for the draft legislation are ambitious, and indicate that the government is eager to ensure New Zealand does not fall behind its main trading partners on the application of BEPS initiatives.

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New Zealand

Review of New Zealand foreign trusts regime

The New Zealand government released a report containing recommendations on New Zealand's foreign trust rules. This report is the product of an independent review undertaken by a New Zealand tax expert on the foreign trust disclosure rules.

Although the inquiry found that foreign trusts are legitimate vehicles and found no direct evidence of illicit foreign funds being 'hidden' in New Zealand trusts, the report recommends that regulations could be strengthened. Recommendations include greater information disclosure on initial trust registration (for example, the disclosure of country of tax residence and tax identification of all the people connected to the trust), the creation of a foreign trust register, and the requirement for foreign trusts to file annual returns, including their financial statements and details of distributions.

PwC observation:
The government has not yet released a formal response to the recommendations outlined in the report. Although we expect the majority of the recommendations to be accepted, we await this confirmation from the government.

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Poland

Draft bills amend Polish CIT and PIT law

On June 24, 2016, the Council of Ministers adopted a draft bill which amends the Polish corporate income tax (CIT) law and the Polish personal income tax (PIT) law submitted by the Minister of Finance (MoF).

This draft bill would introduce a new lower (compared to current standard 19% CIT rate) CIT rate of 15% for so-called small taxpayers (i.e. reporting gross sales for the preceding tax year of no more than of 1.2 million euros [EUR]), as well as a number of other important changes.

The draft bill would introduce to the CIT law and expand in the PIT law a catalogue of income categories of non-resident taxpayers that are deemed earned in the territory of Poland and, hence, subject to taxation in Poland. Income earned in Poland by non-residents would also include income from securities and derivatives quoted on Polish stock exchange, as well as income from direct or indirect transfer of shares in a company, partnership, or investment fund whose assets are composed in at least 50% of real estate or rights to real estate located in Poland. Also, dividends, interest, and other payments subject to withholding tax (WHT) would be deemed earned in Poland.

In addition, the draft bill provides that the deferral of taxation with respect to share for share exchange would not be applicable where one of the primary aims of the transaction is tax avoidance. This would be deemed to be the case where share for share exchange does not have a proper business justification.

The proposed amendment changes rules on recognition of taxable revenues related to in-kind contribution of assets other than a going concern. Taxable revenues would no longer be equivalent to the face value of the shares issued in exchange for the contribution. Instead, taxable revenue would correspond to the market value of contributed assets.

It is also proposed that one of the conditions for application of exemption from WHT of interest and royalties paid to associated companies from the European Union would be that the interest recipient is the beneficial owner thereof. In order to apply the WHT exemption, the Polish payer would have to obtain a written statement which, besides other items, would confirm that the recipient company or a permanent establishment (PE) is the beneficial owner of the payment.

The draft amendment addresses also certain ambiguities relating to demerger of companies where the number of shares in a company being demerged remains unchanged while the nominal value thereof is decreased.

It is envisaged that the changes to the legislation would generally come into force as of January 1, 2017, while CIT taxpayers whose tax year will begin before that date would still be subject to current regulations until the end of such tax year.

PwC observation:
The draft bill, to a large extent, is aimed at the prevention of the tax avoidance. It also eliminates certain tax planning schemes that were commonly used by taxpayers. With the introduction of the amended CIT law, taxpayers should pay larger attention to the business justification and substance of their planned transactions.

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United Kingdom

UK votes to leave the EU

In a referendum on June 23, 2016, voters in the United Kingdom chose to leave the EU (European Union) (so called 'Brexit').

In order to leave the EU, the UK needs to invoke Article 50 of the Treaty on the Functioning of the European Union (TFEU), and this will then trigger a two year exit procedure. At the time of writing, it is not clear when Article 50 will be invoked and, thus, the timing of the UK's exit from the EU is not yet known. The UK will need to negotiate a withdrawal agreement and agree the terms of its relationship with the EU and the rest of the world following exit which could take some time.

PwC observation:
Although Brexit will undoubtedly affect how people and businesses in the UK are taxed, the implications will depend to a substantial extent on the terms on which exit is agreed and, therefore, remain unclear at this stage. If the UK remains a member of the European Economic Area (EEA), but as a non-EU Member (like Norway), the TFEU fundamental freedoms would still continue to apply under the EEA Agreement, but most EU Directives (such as the Interest and Royalties Directive) would not. Alternatively, the UK could negotiate either a customs union or bilateral free trade agreements with the EU. This would be likely to result in more far-reaching changes, in particular because it is likely that all or some of the TFEU fundamental freedoms would cease to apply.

The UK government has signalled the importance of 'Britain open for business'. Depending on the terms of exit, the UK government may feel free to implement measures to attract foreign investment as part of the 'Britain open for business' initiative.

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United Kingdom

Progress of the UK Finance Bill 2016 through Parliament

The UK's Finance Bill 2016 (the Bill) was published on March 24, 2016.

A Finance Bill must pass through various stages (Readings, Committees, and Report stages) in the House of Commons, and then in the House of Lords before it receives Royal Assent and becomes law. While typically a Finance Bill receives Royal Assent in mid-July, the passage of this year's Bill has been significantly delayed by the UK's EU (European Union) referendum.

Despite the delay, certain of the Bill's clauses will take effect at an earlier date than previously announced.

On June 27, 2016, HM Revenue & Customs (HMRC) issued a revised technical note on provisions to be introduced in the Bill regarding the deduction of income tax at source on royalties. The note confirms that changes to the definition of a royalty and to the rules which determine whether a royalty has a UK source (for the purposes of the deduction of income tax rules), and consequential changes to diverted profits tax, will apply to payments of royalties made on or after June 28, 2016.

On June 28, 2016, HMRC announced that it will introduce legislation on the taxation of non-resident developers of UK property at the Committee stage instead of the Report stage (which is later). It is expected that the legislation will take effect from its introduction at the Committee stage.

PwC observation:
Despite the delay in the passage of the Bill through Parliament, taxpayers may be affected by certain of its clauses at an earlier date than its enactment. Therefore, it is important to monitor the progress of the Bill in the forthcoming weeks. We predict that Royal Assent will take place in mid-October.

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United States

House Republicans outline plan for comprehensive tax reform

House Republicans on June 24, 2016 released a 35-page report on tax reform that proposes to lower corporate and pass-through business tax rates, reduce individual tax rates, provide full expensing for business costs (with no deduction for net business interest expense), and move the United States from a worldwide international tax system to a 'territorial' dividend-exemption system.

Under the House Republican plan, the top US corporate income tax (CIT) rate will be reduced from 35% to 20%. A new pass-through business income tax system with a top rate of 25% is proposed for non-C corporation business entities, including S corporations, limited liability companies (LLCs), partnerships, and sole proprietorships.

The proposed full expensing for business costs (in lieu of depreciation and amortisation) will apply for investments in both tangible property (such as equipment and buildings) and intangible assets (such as intellectual property [IP]). It will not apply to land.

As part of the move to full expensing for business investment, the plan eliminates the current deduction for net business interest expense associated with debt incurred to finance such investment. Businesses will be allowed to deduct interest expenses only against any interest income. 'Any net interest expenses may be carried forward indefinitely and allowed as a deduction against net interest income in future years'.

The report states that the House Republican plan 'envisions tax reform that is revenue neutral'. It states that House Republicans measure revenue neutrality by referring to a 'current policy baseline' under which temporary tax provisions are assumed to be extended and by including the positive revenue effects from economic growth. No revenue estimates of specific provisions are included in the report. The report states that the House Ways and Means Committee will draft statutory language in the future.

PwC observation:
The release of the House Republican plan for comprehensive tax reform provides an opportunity for the business community to have a voice in the ongoing development of tax reform proposals. The direction of future tax reform efforts ultimately will be influenced by the results of the 2016 elections for control of the White House and Congress.

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United States

Proposed tax reporting rules for US disregarded entities could expose taxpayers to penalties

The Treasury Department and internal revenue service (IRS) issued proposed regulations on May 11, 2016 that would create tax reporting requirements for certain US disregarded entities (DEs). Specifically, the proposed rules would generally require US entities that are owned 100% by a foreign person and are disregarded as entities separate from those foreign owners for US federal income tax purposes to file an annual Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. This requirement would apply even if a US DE subject to these proposed reporting rules had no transactions or income that would otherwise be reportable for US federal income tax purposes.

The proposed regulations reclassify a US DE that is wholly owned by one foreign person as a US corporation separate from its owner for the limited purposes of Section 6038A's reporting and record maintenance requirements (including the associated procedural compliance requirements). Thus, the proposed regulations would amend Treasury Reg. Sec. 301.7701-2(c) but would not change the general entity classification regime or the treatment of such entities for other purposes under the code.

The reclassification would treat affected DEs as foreign-owned US corporations for the specific purposes of Section 6038A, making them reporting corporations. Thus, they would be required to file Form 5472 for reportable transactions between the entity and its foreign owner or other foreign related parties.

Companies required to file such reports would be liable for penalties of at least 10,000 dollars (USD) for each Form 5472 that is not filed or filed inaccurately. The proposed rules would come into effect a year after the regulations are published in final form.

PwC observation:
The proposed regulations would create new reporting and record-keeping obligations for certain US DEs with foreign owners, including those ultimately owned by certain US persons. Complying with those obligations may add significant complexity and costs for some companies. Failure to meet the requirements could result in substantial penalties.

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Tax Administration and Case Law
Brazil

Decision released regarding the application of the new Brazilian CFC rules

On May 6, 2016, the Federal Court of Curitiba handed down a decision in relation to Process No. 5005596-52.2015.4.04.7000/PR. The single court judgement concludes that a Brazilian taxpayer may remove from the calculation of its corporate income tax (CIT) (IRPJ) and social contributions (CSLL), results of its controlled foreign subsidiaries located in Argentina and Chile, until those results are effectively made available to the Brazilian controller. The decision represents the first time the issue of controlled subsidiary results has been considered under the recently amended controlled foreign corporation (CFC) rules introduced in May 2014 by Law No. 12,973/2014 (which applies generally from January 1, 2015 unless adopted earlier).

By way of background, pursuant to the new Brazilian CFC rules, in general, Brazilian taxpayers are required to submit to tax profits earned in a calendar year (regardless of distribution) by CFCs as well as affiliates in certain circumstances. Pursuant to the new law, the investment in each directly or indirectly controlled foreign entity should be managed in individual sub-accounts and should be adjusted annually to reflect the change in the investment value corresponding to the profits or losses of the entity, in proportion to the Brazilian entity's participation, any accounting profit (before taxes and excluding foreign exchange) of the foreign entity being added to the calculation base of IRPJ and CSLL in Brazil.

Turning to the present case, fundamentally, the taxpayer argued that the taxation of undistributed profits prior to an effective distribution is illegal, except where the entities are located in 'tax havens'. Further, that in the present circumstances, the double tax treaties (DTTs) Brazil signed with Chile and Argentina should prevail over the domestic law to prevent taxation of such profits in Brazil. The Brazilian Administration considered that the previous jurisprudence provides that such law should only be unconstitutional to the extent that it applies to 'affiliates' (e.g. non-controlling interests) not located in tax havens. Further, that in relation to the discussion on the DTTs, the tax authorities argued that the law does not seek to tax the profits of the relevant subsidiary but rather the profit of the Brazilian controller earned through the foreign subsidiary (i.e. the adjustment being made in Brazil).

The judge considered the relevant article of the new CFC law unconstitutional on the basis that it creates a hypothetical situation requiring taxation of a different economic base than that contemplated by the constitution. In general terms, there may be restrictions on the ability of the foreign entity to distribute the profits and, therefore, the mere adjustment of the value of the investment in the foreign entity does not appear to supply the legal availability of the underlying profits. The judge went further to provide that regardless, in the present case, both of the relevant subsidiaries are located in jurisdictions which have signed a DTT with Brazil, including a clause providing that profits can only be taxed in the state in which the entity is located, except where the entity has a permanent establishment (PE) in the other state (i.e. 'business profits' article). In the case at hand, the foreign entities did not have a PE in Brazil.

For the reasons outlined above, the judge concluded that the request of the taxpayer should proceed and the profits should be removed from the calculation of the Brazilian entity's IRPJ and CSLL. An appeal has already been filed by representatives of the Brazilian Administration.

PwC observation:
The decision represents a welcome development for taxpayers in terms of how the new law should be applied, as well as the interaction of the law with executed DTTs. However, as the decision has yet to be ratified by a superior court and the amended law remains relatively untested, taxpayers should continue to carefully monitor the developments of the issue in the jurisprudence.

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Cyprus

Computer software included in the concept of copyrights for the purposes of the Double tax Convention between Brazil and Finland

Effective January 1, 2015, Cyprus introduced a notional interest deduction (NID) on qualifying new equity for corporate income tax (CIT) purposes, with new equity being paid-up share capital and share premium introduced to a company from January 1, 2015, whether in cash or in kind.

The NID is calculated as 'the NID interest rate' multiplied by 'new equity' and it is deductible in a similar manner as for actual interest expense, subject to a maximum cap of 80% of taxable profit as calculated prior to the NID.

The NID interest rates are set annually. The minimum rate is the yield on ten year Cyprus government bonds plus a 3% premium, as of December 31 of the prior tax year. The interest rate may be higher if the Cyprus company utilises the funds raised outside of Cyprus. In such a case, the rate applied is the yield on the ten year government bonds in the country where the funds are utilised plus a 3% premium, if higher.

The Cyprus tax authorities recently announced the applicable rates for NID purposes of ten year Cyprus government bonds and for other selected countries for tax year 2016. Based on the announcement, the 2016 NID rates for funds employed in the mentioned countries are set out below:

- Cyprus, Czech Republic*, Germany*, Latvia*, Poland*
  (*the Cyprus rate is used, as it is the minimum rate): 6.685%
- Romania: 6.703%
- United Arabian Emirates: 10.490%
- India: 10.758%
- Russia: 12.570%
- Ukraine: 12.622%.

PwC observation:
The Cyprus tax authorities have established an important part of the NID calculation for 2016 for the listed countries.

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Treaties
China

Double tax treaty (DTT) between China and Germany entered into force

China and Germany signed a new double tax treaty (DTT) and an accompanying protocol on March 28, 2014. In June 2016, China's State Administration of Taxation (SAT) issued SAT Public Notice [2016] No.37 to announce that the DTT and the Protocol entered into force on April 6, 2016 and will be applicable to the income derived on and after January 1, 2017.

PwC observation:
With the effectiveness of the new DTT, qualified German enterprises could benefit from the reduced withholding tax rate (from 10% to 5%) for dividends repatriated from China on and after January 1, 2017. It is also noted that the new DTT incorporates a number of anti-treaty abuse provisions which reflects the determination of both countries to tackle treaty shopping. Enterprises are suggested to assess/adjust their current structures and arrangements to leverage the treaty benefits.

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Cyprus

Cyprus and Latvia sign first double tax treaty

Cyprus and Latvia on May 24, 2016, signed the first double tax treaty (DTT) between the two countries. On June 30, 2016, Cyprus ratified the treaty. The treaty will take effect January 1 in the year after both countries complete the legal formalities to bring the treaty into force.

The treaty provides for a 0% withholding tax (WHT) rate on dividends, interest, and royalties if the payer is a company that is resident in one country and the beneficial owner of the income is a company that is resident in the other country i.e. company-to-company payments.

For all the other cases — not company-to-company payments — except for certain governmental interest, the treaty provides for a WHT rate of 10% on dividends and interest and 5% on royalties.

Under the treaty, Cyprus retains the exclusive right to tax capital gains from the disposition of stock in Latvian companies, except for dispositions in which more than 50% of the value of the shares is derived directly or indirectly from immovable property located in Latvia or more than 50% of the value of the shares relates directly or indirectly to certain Latvian offshore rights or property.

PwC observation:
Irrespective of the WHT provided for in this treaty on non-company-to-company payments, per the domestic Cyprus tax legislation, there is no Cyprus WHT on dividend, interest, and royalty payments to non-Cyprus tax residents in all cases, except where the royalty relates to rights used within Cyprus.

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Cyprus

Cyprus and India complete negotiations for a revised double tax treaty (DTT)

The revised Cyprus-India tax treaty, announced on June 30, 2016, is expected to be signed in the coming months, and will enter into force following ratification by both countries.

Complete details of the treaty have not yet been released. However, the announcement revealed that the treaty includes provisions for source-based taxation of capital gains from the disposition of stock. The announcement also referenced a 'grandfathering' clause for investments acquired prior to April 1, 2017, providing the seller's country the exclusive right to tax future disposals of such investments.

Once the treaty enters into force, Indian authorities will rescind the classification of Cyprus as a 'Notified Jurisdictional Area', effective retroactively from November 1, 2013 — the date that Cyprus was first classified as a 'Notified Jurisdictional Area'. One of the effects of the current classification is that, in certain circumstances, a taxpayer may rely upon the existing treaty only by following certain administrative procedures in India.

PwC observation:
The grandfathering of stock investments acquired prior to April 1, 2017 is a welcome development that provides clarity to taxpayers holding existing investments. When a Cyprus tax resident disposes of a grandfathered investment, Cyprus retains the exclusive right to tax the realised gains under the revised tax treaty, which is consistent with the existing tax treaty.

The upcoming rescission of Cyprus's status as a 'Notified Jurisdictional Area' by the Indian authorities also is a welcome development. Because this will occur once the revised tax treaty enters into force, taxpayers must continue to comply with the Indian 'Notified Jurisdictional Area' requirements until they are rescinded retroactively.

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Cyprus

Cyprus double tax treaties with Georgia and Bahrain entered into force

The first double tax treaties (DTTs) signed by Cyprus with Georgia and Bahrain recently entered into force and, per the provisions of the treaties, will take effect on January 1, 2017.

Both treaties provide for a 0% withholding tax (WHT) rate on payments of dividends, income from debt claims, and royalties.

Under both treaties, Cyprus retains the exclusive rights to tax capital gains from the disposition of stock by Cyprus tax residents of shares in Bahraini and Georgian companies, including companies holding immovable properties located in both countries.

PwC observation:
Cyprus has an ideal geographic location for the establishment of regional headquarters for business in Eastern Europe, North Africa, and the Middle East. These treaties further expand the Cyprus tax treaty network in these regions.

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Spain

Protocol to the US-Spain treaty

Under the role of the US Senate to participate in the ratification of treaties, Senators Rand Paul (R-KY), Mike Lee (R-UT), and Ted Cruz (R-TX) have shown privacy concerns with regard to seven bilateral double tax treaties (DTTs) (including the 2013 Protocol to the Spain-US DTT) and have asked for a textual change of the respective Exchange of Information (EoI) articles.

The Senators made clear that they are against tax cheats. However, as a bank account reveals everything about the life of individuals (such as the foods they like and doctors they visit), they do not support the bulk collection of financial records of US citizens living abroad. They fear that under 'the new and ambiguous language' that is included in the treaties, the US government could exchange information with foreign governments without sufficient justification. Therefore, the Senators requested the amendment of the EoI articles to make sure that information about US citizens can be exchanged 'only for cause and with individualised suspicion'.

PwC observation:
The ratification of the Protocol to the US-Spain treaty remains uncertain, as US Senators request changes to further protect privacy and rights of US citizens living abroad.

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United States

US and Luxembourg announce retroactive change to triangular branch rules in treaty

The United States and Luxembourg, after almost a year of discussions commenced at the request of the United States, announced on June 22, 2016 an agreement in principle to include in a protocol to the existing income tax treaty an amendment that addresses the potential for double non-taxation for US-sourced income of a Luxembourg company that is attributable to a US branch of the company. The amendment would change the so-called 'triangular branch rule' for taxpayers using US branches that are not taxed in either the United States or Luxembourg.

The proposed new rule differs from the current, more limited triangular branch rule that normally provides for a 15% tax rate when triggered. Under the agreement, the proposed new rule would deny treaty benefits to a Luxembourg company for US-sourced income attributable to permanent establishments (PEs) where, by virtue of attribution to the PE, the income is taxed in neither the United States nor Luxembourg. The US branch structure has been used for holding loans or intangibles.

Once ratified, the provision could have retroactive effect to three days after Luxembourg parliamentary action, the timing of which is uncertain.

PwC observation:
Companies that presently have a US branch structure that eliminates taxation of US-sourced income attributable to the US branch of a Luxembourg company should be aware that they may have only three days' notice for denial of the structure's tax benefits. Of course, the denial of tax benefits will only become effective if the contemplated protocol is agreed to and enters into effect. Nevertheless, given its proposed retroactive effect, it is possible that taxpayers might no longer be able to rely on receiving the benefit.

On a related note, absent further modifications to the Luxembourg treaty in the ongoing negotiations, Britain's June 23, 2016 vote to leave the European Union may make it more difficult for Luxembourg companies that rely on ownership by residents of the United Kingdom to continue to qualify for benefits under the US-Luxembourg treaty once the departure is finalised.

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United States

UK vote to leave EU impacts US income tax treaties

One of the key means by which European companies with cross-border European operations qualify for benefits under US income tax treaties is under the so-called derivative benefits provision of the various treaties' limitation on benefits (LoB) articles. Although there are some variations from one treaty to the next, under most treaties' derivative benefits provisions, a company formed in one European country can qualify for benefits if it meets two tests:

- Seven or fewer 'equivalent beneficiaries' directly or indirectly own 95% or more of the vote and value of the company being tested.
- Less than 50% of the company's gross income for the taxable period under consideration is paid or accrued, directly or indirectly, to a person or persons who are not equivalent beneficiaries in the form of deductible payments for tax purposes in the company's state of residence.

In general, a person may be an equivalent beneficiary if it is entitled to benefits under a treaty between the country of source and the country in which the person is resident, as long as it is a resident of a member state of the European Union (EU), the European Economic Area (EEA), the European Free Trade Association (EFTA), or the North American Free Trade Association (NAFTA), and the resident would be entitled to all the benefits of a treaty that contains a comprehensive LoB article and which provides benefits equal to or better than those accorded under the treaty under consideration. The exact European membership groupings vary by treaty.

The exact impact of the vote is still unknown, but its impact on access to US treaty benefits would be most severe if the United Kingdom ultimately departs from both the EU and the EEA. Whether or not it will be politically feasible for the United Kingdom to remain in the EEA after a departure from the EU is still to be determined. If the United Kingdom leaves both groups, absent competent authority agreements between the United States and other EU and EEA countries or some other unilateral action by the US Treasury with respect to US source income, EU/EEA country companies that rely on UK owners for access to benefits under other EU/EEA country treaties may lose access to US treaty benefits unless the relevant treaty is modified to address this concern.

PwC observation:
Companies that rely on a UK tax resident for treaty eligibility under a derivative benefits provision in a US treaty, either with the United Kingdom or a third country, should monitor developments regarding the UK exit from the EU and possibly the EEA as well. Taxpayers should seriously consider whether restructuring options may exist that would continue to confer benefits that could be lost once the departure(s) occurs.

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Worldwide Tax Summaries:
Corporate taxes 2015/16

If you're operating globally, are you aware of changes to the myriad tax rates in all the jurisdictions where you operate? If not, we can help – download the eBook of our comprehensive tax guide, or explore rates in over 150 countries using our online tools, updated daily.

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