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.

Shi-Chieh 'Suchi' Lee
Global Leader International Tax Services Network
T: +1 646 471 5315
E: suchi.lee@us.pwc.com

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Argentina

Argentine amnesty provisions and other significant tax changes

Law 27,260, with special incentives for Argentine taxpayers (businesses and individuals) to report previously unreported foreign and domestic assets, was published in the Argentine Official Gazette on July 22, 2016.

Assets reported may be subject to a reduced tax rate of 0% (provided that certain reinvestment conditions are met) or ranging from 5% to 15%, depending on the type of asset, the asset's total value, and whether the reporting is done during 2016 or in the first three months of 2017. Reporting should occur by March 31, 2017. The law also allows taxpayers to settle any unpaid tax liability with partial or full exemption of accrued interest, penalty forgiveness, and by using an installment plan.

The law includes modifications to various tax provisions, including the repeal of the 10% withholding tax (WHT) on dividend distributions, a reduction of rates (to 0.25%) of the Argentine wealth tax and an increase of the minimum amount of equity subject to this tax, and the repeal of the Argentine minimum notional income tax.

PwC observation:
Multinational enterprises (MNEs) with operations or investments in Argentina should consider how these new measures may affect them. In particular, elimination of the 10% WHT on dividends may affect repatriation decisions and related modelling exercises. Companies considering the cross-border tax burden of Argentine investments should consider this important modification.

John A Salerno
New York
T: +1 646 471 2394
E: john.salerno@pwc.com

Andres M. Edelstein
Argentina
T: +5411 z4850 4651
E: andres.m.edelstein@ar.pwc.com

Jose Leiman
Miami
T: +1 305 381 7616
E: jose.leiman@pwc.com

Brazil

Reduction of WHT on remittances abroad to cover personal expenses

By way of background, Normative Instruction (NI) 1,611/16, issued by the Brazilian Federal Revenue in January 2016, regulated the levy of withholding tax (WHT) on remittances abroad intended for covering personal expenses of Brazilian individuals when traveling for tourism, business, services, training, or official missions (25% WHT rate). Prior to the issuance of NI 1,611/16, the Brazilian Income Tax Regulations (RIR/99) and Article 60 of law 12,249/10 provided an exemption on these remittances, which expired on December 31, 2015 (see details in March edition).

Further to the issuance of NI 1,611/16, the government enacted Provisional Measure (PM) 713/16, which reduced the above-mentioned WHT rate from 25% to 6% as of March 2, 2016. This reduction aimed to equalise situations where Brazilian individuals would either buy tourism packages through travel agencies or directly buy tickets, book hotels, and perform other similar transactions from foreign providers using credit cards (transactions subject to Tax on Financial Operations at the rate of 6.38%).

On July 20, 2016, PM 713/16 was converted into law (Law 13,315/16), ensuring the application of the 6% WHT rate to the circumstances described above until December 31, 2019. Along this line, NI 1,645 of May 30, 2016, revoked the previous NI 1,611/16 and confirmed the application of the 6% WHT rate.

Nevertheless, law 13,315 and NI 1,645/16 provide that the above mentioned reduction shall not apply when the beneficiary of said remittances is located in a tax haven or subject to a privileged tax regime, except if certain conditions are met.

Furthermore, it should be noted that the 6% reduced WHT rate is applicable to remittances up to a global limit of 20,000 Brazilian real (BRL) per month (for travel agencies, BRL 10,000 per passenger).

PwC observation:
The conversion of MP 713/16 into law is a positive development, as it offers legal certainty in connection with the WHT treatment of the personal expenses mentioned above.

Michela Chin
Sao Paulo
T: +55 11 3674 2247
E: michela.chin@pwc.com

China

China issued new transfer pricing compliance requirements

On June 29, 2016, China's State Administration of Taxation (SAT) issued the Public Notice regarding Refining the Reporting of Related Party Transactions and Administration of Transfer Pricing Documentation(TPD) (SAT Public Notice [2016] No.42, Public Notice 42) to provide new transfer pricing compliance requirements. Public Notice 42 has adopted the master file and local file recommended by Base Erosion and Profit Shifting (BEPS) Action Plan 13 and replaced the existing annual reporting forms for related party transaction (previous RPT Forms) with a new version (new RPT Forms). Special issue files for thin capitalisation and cost sharing arrangement are also introduced. Meanwhile, the Country-by-Country Reporting (CbCR) as mentioned in BEPS Action Plan 13 is included as schedules of the new RPT Forms. Public Notice 42 will be applicable to fiscal year of 2016 and subsequent years.

New TPD requirements

Public Notice 42 adopts a three-tiered approach for TPD, including master file, local file, and special issue file, and sets different thresholds for each file and type of transactions.

- **Master file:** The master file is focused on providing details of the overall operation of the multinational enterprises (MNEs) group. If a company meets either of the following criteria, a master file should be prepared and submitted to Chinese tax authorities:
  - have cross-border related party transactions and belong to a group which has prepared the master file, or
  - the total amount of related party transactions exceeds one billion renminbi (RMB).
- **Local file:** Compared to the previous TPD requirements, the local file requires significantly great information disclosures and transfer pricing analyses. The thresholds are dependent on the types of related party transactions, which are listed below.
  - RMB 200 million for tangible assets transfer (in the case of toll processes, the amount in the annual customs record for toll processing should be included).
  - RMB 100 million for financial assets transfer.
  - RMB 100 million for intangible assets transfer.
  - RMB 40 million for other related party transactions in total.
- **Special issue file:** The special issue file is required for taxpayers engaging in cost sharing agreement or falling under the thin capitalisation requirement. There is no specific threshold criterion for the special issue file.

The local file/special issue file should be completed by June 30 following the year during which the related party transactions occur, i.e. June 30, 2017 for the 2016 fiscal year, while the master file should be completed within 12 months after the close of the fiscal year of the group's ultimate holding company.

New RPT Forms

Compared to the previous RPT Forms, the number of new RPT Forms has increased from nine schedules to 22 schedules, including the CbCR Forms. In particular, the CbCR Forms are required for a Chinese resident enterprise if:

- it is the ultimate holding company of the group with consolidated revenues over RMB 5.5 billion, or
- it is nominated as the CbCR reporting entity.

The annual CbCR filing requirement mainly applies to the ultimate holding companies in China. However, a subsidiary of MNE in China may also be required to submit CbCR in a transfer pricing investigation, if its ultimate holding company is required to prepare the CbCR according to the regulation of the jurisdiction it resides and one of the following conditions are met:

- The MNE group has not provided the CbCR to the tax authority of any jurisdiction.
- Although the group has submitted the CbCR, the jurisdiction collecting the report has not had the exchange of information mechanism with China.
- Although the MNE group has provided the CbCR, and the jurisdiction collecting the CbCR has had the exchange of information mechanism with China, the CbCR has not been successfully exchanged to China.

The new RPT forms should be submitted together with the annual corporate income tax (CIT) filing package. If the ultimate parent company of an MNE is a Chinese tax resident enterprise and the information may be relevant to the national security, then part or all of the CbCR Forms can be exempted based on the relevant regulation.

Matthew Mui
China
T: +86 10 6530 3028
E: matthew.mui@cn.pwc.com

PwC observation:

Public Notice 42 replaces the provisions relevant to related party reporting and TPD in Implementation Measures of Special Tax Adjustments (Trial) (Guoshuifa [2009] No.2, Circular 2). It is estimated that the SAT will gradually revise the remaining parts of Circular 2 in the form of various Public Notices later.

Considering the tax compliance burden increased by Public Notice 42, although the first-year compliance obligation under the new transfer pricing requirements will be effective in a year, taxpayers are suggested to take following action as soon as possible:

- assess and revisit related party transactions under the new TPD thresholds
- identify the gap between the existing TPD report and the new TPD requirements and start to prepare the additional documentation and disclosure to bridge the gap
- create and operate a consistent and coordinated approach to prepare group TPD reports
- collect data and conduct a trial run if necessary for the new RPT forms.

Companies should bear in mind that their transfer pricing structure under the new international tax landscape should reflect the principle that profit allocation matches with value creation. The actions taken by Chinese tax authorities in respect of transfer pricing administration and investigation could be more frequent, stringent and complicated in the future in a post-BEPS era.

Hungary

More stringent rules on preferential transfer of assets

Currently, in the case of a preferential transfer of assets (being the implementation of the European Union [EU] Merger Directive's provisions in respect of 'transfer of assets'), the transferor may decrease its corporate income tax (CIT) base by the amount of the difference between the revenues accounted for upon the transfer and the book value of the assets transferred (i.e. the capital gain), provided the transferee calculates its tax liability in respect of the assets and liabilities taken over by taking into account the tax values as they were recorded at the transferor (and provided that certain administrative criteria are met). Hence, the taxation of the gain arising on the transaction is deferred at the transferee, creating a quasi deferred tax liability.

From January 1, 2017, the application of the above beneficial (deferred) treatment of the preferential transfer of assets will be subject to an additional criterion. In order to apply the beneficial tax treatment, the transferor performing a preferential transfer of assets shall not alienate (excluding the case when the shares are derecognised due to vis major) the shares acquired upon the transaction as long as the transferee has remaining deferred tax liability as a result of the transfer. Should the transferor not meet this requirement, it will be required to increase its CIT base by the amount it previously used as a tax base decreasing item in the year of alienation, provided that such amount did not already flow into the tax base of the transferee. In such a case, going forward, the transferee will be entitled to calculate its tax base according to the general rules (without deferral).

PwC observation:
Previously, on the basis of domestic law, the application of tax benefits connected to the preferential transfer of assets could have been applied irrespective of the fact whether the transferor alienated the newly acquired shares following the transfer. As a result of the above changes, the respective tax benefits will not be available (or only in a limited amount) in such cases in the future.

In the absence of relevant tax authority practice, it is currently unclear if the above holding requirement should be applied only for alienation to third parties or to a related party as well. Further, there is also uncertainty whether this amendment will affect transactions performed before January 1, 2017 (the date at which the amendment enters into force). Based on the above, if a preferential transfer of assets is planned in the future (or even in the case of transactions performed in recent years), more detailed discussions are recommended.

Dora Mathe
Budapest
T: +36 1 461 9767
E: dora.mathe@hu.pwc.com

Gergely Juhasz
Budapest
T: +36 1 461 9359
E: gergely.juhasz@hu.pwc.com

Hungary

Tax audit of binding rulings

From July 1, 2016, a new type of tax audit was introduced whereas binding rulings may be fact-checked by the tax authority.

The tax authority may start this type of audit regarding a taxpayer's past tax years to find out whether the facts and circumstances of the transactions covered by a binding ruling resolution are actually in line with the facts as they are set out in the resolution. During the audit, the tax authority may only request documents which are specifically mentioned in the ruling resolution as the precondition of the fulfilment of facts and circumstances serving as a basis of the resolution. Following the audit, the tax authority issues a resolution confirming whether the respective binding ruling resolution is actually binding on the tax authority in respect of the reviewed tax year(s) based on the facts confirmed.

PwC observation:
Previously, the tax authority also had the option to invalidate binding rulings stating that there was a substantive difference between the actual facts and circumstances and those set out in the ruling resolution. The introduction of this new type of tax audits indicates that the tax authority will lay a greater emphasis on fact-checking the binding rulings and their binding nature.

Dora Mathe
Budapest
T: +36 1 461 9767
E: dora.mathe@hu.pwc.com

Gergely Juhasz
Budapest
T: +36 1 461 9359
E: gergely.juhasz@hu.pwc.com

Hungary

More stringent principles on preferential transformation and transfer of assets

The Hungarian corporate tax regulation was amended so that it explicitly states that taxpayers performing a preferential transformation or a preferential transfer of assets (both being the implementation of the respective Merger Directive regulations) will be required to justify the business rationale behind the transaction.

PwC observation:
According to the general tax principles, taxpayers should have been able to prove the business rationale of a transaction even before this new amendment. Therefore, it does not in fact change the responsibility of taxpayers regarding proving the business reason behind transactions, although it explicitly puts the burden of proof on them.

Madagascar

Taxation of capital gain on the sale of shares

Where a profit is made from selling shares in an entity that realises value derived from assets in Madagascar, this profit is subject to 20% income tax. This applies whether or not the shareholders of that entity are individual or corporate and regardless of whether or not the person or entity selling the shares has a registered office or establishment in Madagascar.

The tax is payable when the deed of sale is filed for stamp duty. The tax is normally borne by the seller but effectively paid upfront by the entity whose shares are sold.

This represents a change in that prior to the 2016 Financial Act *(Loi de finances – LF 2016)*, the notion of capital gain was only limited to the sale of real estate by individuals. The gain realised from the sale of shares by foreign shareholders was indeed not taxed in Madagascar. Revenue realised by the sale of shares by resident shareholder are considered as normal business income of the seller subject to normal corporate income tax (CIT).

PwC observation:
The above new provision may encourage investors to set up a holding entity and sell the holding instead of the entity in Madagascar. However, for the time being, it is unclear whether the capital gain is also applicable on the shares of foreign holding companies. As a matter of fact, since such holdings' value includes value derived from assets in the Madagascar-based entities, tax authorities may state that profit from selling those shares may be taxable in Madagascar.

Dora Mathe
Budapest
T: +36 1 461 9767
E: dora.mathe@hu.pwc.com

Gergely Juhasz
Budapest
T: +36 1 461 9359
E: gergely.juhasz@hu.pwc.com

Andriamisa Ravelomanana
Madagascar
T: +261 32 07 005 24
E: andriamisa.ravelomanana@mg.pwc.com

Lanto Ralison
Madagascar
T: +261 20 22 217 63
E: lanto.ralison@mg.pwc.com

Irina Rabarijohn
Madagascar
T: +261 20 22 217 63
E: irina.rabarijohn@mg.pwc.com

Panama

Panamanian Free Trade Zone changes

Panama on April 4, 2016, published Law No. 8, which reorganises the Colón Free Trade Zone (FTZ) and approves other amendments, in the Panamanian Official Gazette. This law expands the types of activities that qualify for the Colón FTZ and allows companies operating under a multinational company (MNC) headquarters regime to do business in the Colón FTZ. The law also introduces a special immigration regime for investors in companies in the Colón FTZ and non-resident employees hired to work in the Colón FTZ. In addition, the law obligates the Colón FTZ operator to meet the country's anti-money laundering regulations.

Law No. 8 also introduces various amendments to the Panamanian Tax Code that affect companies in the Panama-Pacific FTZ. As main amendments, companies established in this FTZ are now subject to the annual operations notice tax (0.5%) or to withholding tax (WHT) on dividends (if engaged in specific business activities), except for companies registered in the FTZ before December 31, 2016.

PwC observation:
Multinational enterprises should consider how these amendments could affect their investments or operations in Panama. Additionally, they should consider the potential benefits of a Panamanian FTZ for their activities in the region.

Poland

The GAAR was entered into force in Poland

In June 2016, Polish President approved a legislation introducing a general anti-avoidance rule (GAAR) into the Polish Tax Law. On June 14, 2016, the clause was published in the official Journal of Laws and came into force as of July 15, 2016. 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.

According to the act, 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 above 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' transaction 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 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.

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

The new regulations came into force on July 15, 2016. According to the act, GAAR clause is applicable to transactions carried out before the GAAR provisions come into force in case 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.

John A Salerno
New York
T: +1 646 471 239
E: john.salerno@us.pwc.com

Francisco Barrios
Panama
T: +36 1 461 9359
E: francisco.barrios@pa.pwc.com

Jose Leiman
Miami
T: +1 305 381 7616
E: jose.leiman@us.pwc.com

Agata Oktawiec
Warsaw
T: +48 502 18 48 64
E: agata.oktawiec@pl.pwc.com

Weronika Missala
Warsaw
T: +48 502 18 48 63
E: weronika.missala@pl.pwc.com

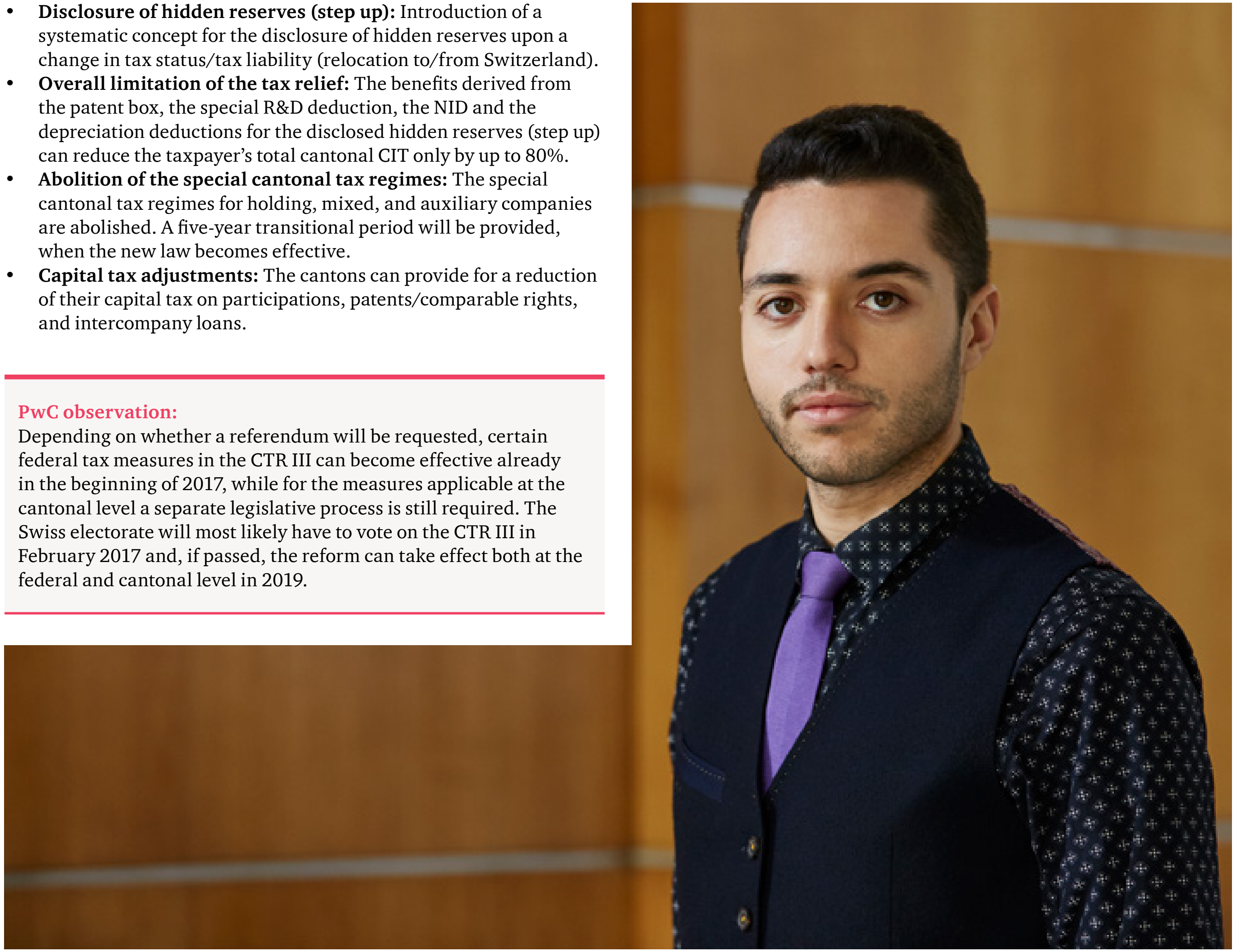
Switzerland

Switzerland adopts the final corporate tax reform III package

On June 17, 2016, the Swiss parliament adopted the final Corporate Tax Reform III package (CTR III) to strengthen Switzerland's competitiveness as a business location. The CTR III includes several notable tax reform measures related to federal and cantonal tax laws. The key changes are summarised below:

- **Cantonal corporate income tax (CIT) reduction:** Many cantons have already communicated their overall target effective tax rates ranging from 12.5% to 14%, while others expect to communicate their target tax rates within the next few months.
- **Introduction of a Cantonal patent box:** The cantons can exempt from the cantonal CIT the qualifying income derived from patents and similar intangibles property rights up to a maximum of 90%. This measure applies the residual profit approach in line with the Organisation for Economic Co-operation and Development's (OECD's) modified nexus approach.
- **Optional Cantonal research and development (R&D) deduction:** An optional cantonal deduction of up to 150% with respect to R&D expenditures incurred in Switzerland is introduced.
- **Introduction of a notional interest deduction (NID):** An interest deduction calculated on the 'surplus' equity, i.e. equity exceeding a certain threshold, is introduced for all the businesses at the federal level (and optionally at the cantonal level).
- **Disclosure of hidden reserves (step up):** Introduction of a systematic concept for the disclosure of hidden reserves upon a change in tax status/tax liability (relocation to/from Switzerland).
- **Overall limitation of the tax relief:** The benefits derived from the patent box, the special R&D deduction, the NID and the depreciation deductions for the disclosed hidden reserves (step up) can reduce the taxpayer's total cantonal CIT only by up to 80%.
- **Abolition of the special cantonal tax regimes:** The special cantonal tax regimes for holding, mixed, and auxiliary companies are abolished. A five-year transitional period will be provided, when the new law becomes effective.
- **Capital tax adjustments:** The cantons can provide for a reduction of their capital tax on participations, patents/comparable rights, and intercompany loans.

PwC observation:
Depending on whether a referendum will be requested, certain federal tax measures in the CTR III can become effective already in the beginning of 2017, while for the measures applicable at the cantonal level a separate legislative process is still required. The Swiss electorate will most likely have to vote on the CTR III in February 2017 and, if passed, the reform can take effect both at the federal and cantonal level in 2019.



Stefan Schmid
Zurich
T: +41 58 792 4482
E: stefan.schmid@ch.pwc.com

Proposed Tax Legislative Changes
Korea

Tax Reform Proposals

Tax reform proposals were announced by the Korean government on July 28, 2016. The main corporate tax proposals included in the government's bill that Korean inbound investors should be aware of are summarised below.

- **Qualified corporate mergers:** Under current tax law, a merger between Korean companies qualifies for deferral of capital gains tax only if certain prescribed conditions are satisfied. To facilitate corporate restructuring, it is proposed that mergers between wholly owned Korean subsidiaries of a common parent company will qualify for tax benefits irrespective of whether the conditions for a qualified merger are satisfied. Certain other changes have also been proposed to the qualifying conditions to obtain tax benefits in respect of other types of corporate restructuring transactions.
- **Research and development (R&D) tax credits:** The R&D tax credit regime will be restructured so that it has an increased focus on emerging growth-engine industries such as future-generation motor vehicles and next-generation software and security etc. and increasing the rate for eligible non-small and medium sized entity's (SME) businesses from 20% to 30%. No change is proposed to the existing 30% rate for SMEs.
- **High-tech foreign investment tax incentives:** A comprehensive reform of the existing tax incentives available for foreign invested high-technology businesses is proposed so the scope of businesses eligible for the incentives is focused on new growth-engine industries (to be aligned with those that qualify for the reformed R&D tax credits). There will also be changes to the calculation of the eligible tax exemption amount and new minimum levels of foreign investment in order to be eligible for the incentives.
- **Tax on excess corporate earnings:** To motivate corporations to spend corporate retained earnings on certain qualifying items including investments in facilities, wage increases, and dividend payments, a 10% additional tax on excess corporate earnings was introduced in January 2015 and applies if the use of corporate earnings for qualifying expenditure falls short of certain threshold amounts computed using one of two methods:
  - Method A: (Adjusted taxable income for a year x 80% – the total amount of investment, wage increases, and dividend payments) x 10%, or
  - Method B: (adjusted taxable income for a year x 30% – the total amount of wage increases and dividend payments) x 10%
  - Certain changes have been proposed including allowing companies to change its election from Method B to Method A in calculating whether the qualifying expenditure thresholds are met (previously, a company could not revoke its election for three years), a weighting of 150% will be given for the amount of payroll increases provided the number of regular employees has increased during the year, and a weighting of 80% will be given to the amount of dividends paid.
- **Limitation on utilisation of tax losses:** Under changes to the tax law effective from January 1, 2016, tax losses carried over from prior years that can be utilised by a Korean company in a year are limited to 80% of the company's current year taxable income. It is proposed that the same restriction will apply to Korean branches of foreign companies.

Henry An
Seoul
T: +82 2 3781 2594
E: henry.an@kr.pwc.com

Sang-Do Lee
Seoul
T: +82 2 709 0288
E: sang-do.lee@kr.pwc.com

Robert Browell
Seoul
T: +82 2 709 8896
E: robert.browell@kr.pwc.com

Luxembourg

Luxembourg proposed 2017 tax measures

On July 26, 2016, the Luxembourg government introduced a bill on the proposed 2017 tax measures for corporations and individuals. The proposed changes are in line with the announcements made during the State of the Nation address on April 26, 2016. The changes announced for corporations are detailed hereafter:

Reduction in the corporate income tax (CIT) rate

The proposal is to reduce the CIT rate from 21% to 18% over the next two years. The proposals do not include any changes to the 'solidarity surcharge' on the CIT rate or to the rate of municipal business tax payable by companies. The overall CIT rate for companies with a net tax base of more than 30,000 euros (EUR) would be reduced to **19%** for **FY 2017** and **18%** for **FY 2018**, leading to an overall tax rate of **27.08%** for companies in Luxembourg City for **FY 2017** and **26.01%** for **FY 2018** (taking into account the 7% solidarity surcharge on the corporate income tax rate and including the 6.75% municipal business tax rate).

In addition, the bill introduces a reduced CIT rate of 15% applicable as of financial FY 2017 for companies with a tax base of less than EUR 25,000. For companies with a tax base of between EUR 25,000 and EUR 30,001, the CIT would be EUR 3,750 plus 39% of the tax base above EUR 25,000 (for FY 2017) or 33% of the tax base above EUR 25,000 (for FY 2018).

Sami Douénias
Luxembourg
T: +352 49 48 48 3060
E: sami.douenias@lu.pwc.com

Sandrine Buisseret
Luxembourg
T: +352 49 48 48 3124
E: sandrine.buisseret@lu.pwc.com

Increase in the minimum net wealth tax charge

A minimum Net Wealth Tax (NWT) charge was introduced on January 1, 2016 for all corporate entities having their registered office or central administration in Luxembourg. The measures imposing this new charge are very similar to the previous provisions for a minimum CIT charge, which were abolished with effect from the same date. For holding and finance companies whose sum of fixed financial assets, transferable securities, and cash at bank (as reported in their commercial accounts presented in the standard Luxembourg form) exceeds 90% of their total gross assets and EUR 350,000, the minimum NWT would increase from EUR 3,210 (including the solidarity surcharge) to EUR 4,815 (including the solidarity surcharge) as of FY 2017. The minimum NWT applicable to all other corporations having their registered office or central administration in Luxembourg would remain unchanged.

Restrictions on the use of future losses

The use of losses generated as of FY 2017 will be limited. Losses generated during and after FY 2017 would only be able to be carried forward for a maximum period of 17 years. Losses that arose before FY 2017 are not affected by this time limit. Contrary to what the government initially announced, the deduction would not be limited to 75% of the net taxable profit of each subsequent year.

Other new tax measures

The following measures that would benefit companies were also announced in the bill:

- The scope of Article 54bis LITL (deferred taxation for foreign-exchange gains on certain assets denominated in a foreign currency) would be extended to all companies as of FY 2016.
- As of FY 2017, the tax returns for companies liable to CIT would no longer be allowed to be filed by post. The bill provides that it would be mandatory to file them electronically.
- The 0.24% registration duty due on transfers of claims would be abolished.
- Deferred depreciations would also be introduced: taxpayers could opt to defer the deduction given by the depreciation. These new measures would increase the CIT for a given year and may allow to reduce the NWT due (under conditions).
- In order to make inter-generational transfers of family businesses easier, capital gains linked to real-estate assets (both land and buildings) would benefit from tax-neutral treatment.
- R&D would be encouraged through the increase of investment tax credits. Complementary and overall investment tax credits would be increased from 12% to 13% and from 7% to 8% respectively (the tax credit for investments exceeding EUR 150,000 would remain at 2%). The investment tax credit for assets approved for the special depreciation regime would also be increased from 8% to 9% (the tax credit for investments exceeding EUR 150,000 would remain at 4%). In addition, the scope of eligible investments would be extended to include investments made with the European Economic Area (EEA).

PwC observation:
Implications for our clients to be confirmed on the law will be effectively voted.

United Kingdom

Amendments to draft hybrid mismatch rules

As previously reported, draft anti-hybrid legislation for inclusion in the UK Finance Bill 2016 was initially published on December 9, 2015 and later revised following the budget in March 2016. Further proposed amendments were issued on July 20, 2016, including amendments in relation to mismatches involving permanent establishments (PEs) and an extension of the hybrid payee deduction/non-inclusion mismatch provisions. The current draft of the legislation continues to follow closely the Organisation for Economic Co-operation and Development's (OECD's) Base Erosion and Profit Shifting (BEPS) Action 2 recommendations.

The anti-hybrid rules will apply to payments made on or after January 1, 2017 and there is no grandfathering of existing arrangements. The definition of payment is broad and includes, for example, interest, royalties, and cost of goods sold. The UK's existing anti-arbitrage legislation will be repealed.

PwC observation:
The proposed amendments are due to be considered in September at the Report Stage of the Bill's progress through the parliamentary process. Royal Assent of Finance Bill 2016 is expected in October 2016.

Groups should, therefore, ensure that they have considered the rules and the impact they may have on their financing arrangements and business models given the rules will be effective from January 1, 2017. We expect that Her Majesty's Revenue & Customs (HMRC) will publish further guidance on the application of the anti-hybrid rules later in 2016.

Uruguay

Proposed amendments for increasing tax transparency

Late in July, 2016, the Uruguayan government remitted to Congress consideration a bill of law that includes a set of provisions aimed to enhance the achievement of international standards on tax transparency.

The bill introduces a change from the 'exhaustive list' approach by which a jurisdiction is considered a tax haven (low or no-tax jurisdictions/regimes) towards a substantive criterion. The rules to be issued by the Ministry of Finance (MoF) will determine the conditions that countries, jurisdictions or entities must meet to be considered as tax havens.

Income derived from the transfer of shares or participations in entities from low or no-tax jurisdictions whose assets located in Uruguay exceed 50% of their total investments, is deemed to be Uruguayan sourced (thus taxable) for corporate income tax (CIT) purposes. Similar provisions apply to resident individuals and to non-resident taxpayers.

Discouraging the use of intermediary entities that reside in low or no-tax jurisdictions, when a resident individual participates in their capital, passive income and/or, capital gains received by these entities will be assigned as deemed dividend, thus, be taxed in the hands of the individual beneficiaries.

Finally, rates are increased from 12 to 25% for Uruguayan sourced income obtained by entities resident in low or no-tax jurisdictions.

PwC observation:
Corporate and individual taxpayers, as well as non-residents should follow up the progress of this bill of law, and review their structures in which low or no-tax entities are included.

Neil Edwards
London, Embankment Place
T: +44 20 7213 2201
E: neil.edwards@uk.pwc.com

Jonathan Hare
London, Embankment Place
T: +44 20 7804 6772
E: jonathan.hare@uk.pwc.com

Rosalind Z Burke
London, Embankment Place
T: +44 20 7804 5967
E: rosalind.z.burke@uk.pwc.com

Daniel Garcia
Uruguay
T: +59 8251 82828
E: garcia.daniel@uy.pwc.com

Eliana Sartori
Uruguay
T: +59 8251 82828
E: eliana.sartori@pwc.com.uy

Diego Tognazzolo
Uruguay
T: +59 8251 82828
E: diego.tognazzolo@uy.pwc.com

Tax Administration and Case Law
Netherlands

Landmark decision of the Supreme Court on the Dutch anti-base erosion rules

On July 8, 2016, the Supreme Court provided further clarity on the scope of the Dutch anti-base erosion rules, thereby answering some essential open questions on the Dutch base erosion rules in relation to the deductibility of interest expenses. It further raised questions to the European Court of Justice (ECJ) regarding the (in) compatibility of these rules with the European Union (EU) freedom of establishment.

To recap, the Dutch base erosion rules as laid down in Article 10a Dutch Corporate Income Tax Act 1969 (CITA) may limit the deductibility of interest expenses on inter-company debt that is connected to so-called tainted transactions. These rules do, however, not apply if the taxpayer demonstrates business reasons for both the transaction and the financing thereof. Also these rules do not apply if the corresponding interest income is sufficiently taxed according to Dutch tax standards, provided that the Dutch tax inspector cannot successfully demonstrate that:

- the transaction or its financing is based on non-business reasons, or
- the interest income is to be offset against existing future losses, or similar claims.

Hereinafter, reference is made to the aforementioned exceptions as 'counter evidence rules'. Tainted transactions include capital contribution, dividend distribution, and acquisitions.

In the case at hand, the Supreme Court had to decide whether sound business reasons are available in respect of a capital contribution made by a Dutch taxpayer into an Italian acquisition vehicle that was used to finance the buyout of a publicly traded Italian company. The Court of Appeal has previously argued that the taxpayer would not have undertaken such a transaction if it had not been possible to deduct interest expenses in the Netherlands and the participation exemption was not available. As such, the Court of Appeal concluded that the transaction was not based on sound business reasons but was, rather, entirely tax driven.

In addition, the Court of Appeal had argued that when assessing whether the corresponding interest income is sufficiently taxed according to Dutch tax standards, one should look at the direct creditor of such loan unless the creditor is legally bound to on-pay this income to another creditor.

The Dutch Supreme Court rejected both decisions of the Court of Appeal and extensively substantiated its decision. The following key points can be derived therefrom:

- A Dutch taxpayer is free in its choice how to structure a transaction. Making use of advantages of the Dutch tax system as such is irrelevant when determining whether a transaction is based on sound business reasons.
- If one relies upon sufficient taxation of the corresponding interest income when applying the counter-evidence rules, the Dutch Supreme Court made clear that this test should be performed in line with the economic reality (i.e. in a back-to-back situation, one should not perform this test at the level of the direct creditor, but look at the underlying creditor).
- The above statement seems to imply that if debt is ultimately attracted from a third-party creditor and subsequently on-lent via another company to a Dutch taxpayer under the same conditions, the Dutch taxpayer should entirely fall outside the scope of Article 10a CITA (without having to worry about demonstrating sound business reasons for the transaction as such), although this may be interpreted differently.
- Capital contributions within a Dutch fiscal unity are not considered 'tainted transactions' for purposes of Article 10a CITA.

In addition to these points, the Dutch Supreme Court requested the ECJ to clarify whether the 'per-element approach' as applied in the Groupe Steria case (C-386/14) does also impact Article 10a CITA. As stated above, if a Dutch taxpayer would have formed a fiscal unity with a subsidiary, the capital contribution would not have been considered a tainted transaction for purposes of Article 10a CITA, resulting in non-applicability of this interest deduction limitation rule. The Dutch fiscal unity regime is (generally) restricted to Dutch resident subsidiaries, resulting in the fact that this method of avoiding the applicability of the interest deduction limitation rule can only be achieved in Dutch domestic situations. The Supreme Court requested the ECJ to clarify whether this is an infringement to the EU freedom of establishment.

PwC observation:
The Dutch Supreme Court stated that Dutch taxpayers are free in their choice how to structure a transaction. In addition to its statement in the so-called Mauritius court case (ECLI:NL:HR:2015:2167) in which it was decided that Dutch taxpayers are in principle free in their choice how to finance a transaction (with debt or equity), this may provide more flexibility towards multinationals in the context of debt-financing in the Netherlands.

Jeroen Schmitz
Amsterdam
T: +31 88 79 27 352
E: jeroen.schmitz@nl.pwc.com

Ramon Hogenboom
Amsterdam
T: +31 88 79 26 717
E: ramon.hogenboom@nl.pwc.com

Pieter Ruige
Amsterdam
T: +31 88 79 23 408
E: pieter.ruige@nl.pwc.com

OECD

OECD continues BEPS implementation

The Organisation for Economic Co-operation and Development (OECD) continues to move forward with the implementation of its Base Erosion and Profit Shifting (BEPS)-related deliverables. Recent OECD announcements provide both an update and insight into its progress, as well as anticipated areas of future work — e.g. profit splits, attribution of profits to permanent establishments (PEs), and financial transactions guidance. These announcements occurred at the 2016 OECD International Tax Conference held in Washington, DC on June 6-7, 2016. The first meeting of a new inclusive framework to implement BEPS was held in Kyoto, Japan on June 30-July 1, 2016.

BEPS implementation

The BEPS project now has entered the implementation stage, with the OECD having an increased focus on an 'inclusive framework', i.e. on having more countries participate in the BEPS work on an equal footing, including non-OECD countries.

To start this process, on June 30-July 1, 2016, the OECD's Committee on Fiscal Affairs held its first meeting of the new inclusive framework to implement BEPS. The gathering represented 82 countries and tax jurisdictions. Of those, 36 have already formally joined the new inclusive framework and have committed to implement the BEPS package, while the OECD has announced that another 21 are likely to join the framework in the coming months.

Substantively, the participants began their efforts at standard-setting on remaining issues, including transfer pricing and interest deductibility, as well as developing practical guidance to support consistent, global implementation of their commitments to the BEPS package. More specifically, they will focus on ensuring implementation of the four minimum standards arising from the BEPS Project — on harmful tax practices, tax treaty abuse, Country-by-Country reporting (CbCR), and dispute resolution mechanisms — which will be subject to a peer review process, alongside ongoing monitoring of the other elements of the package.

Attribution of profits to PEs

After the finalisation of BEPS Action 7 concerning the PE threshold, the OECD undertook to examine whether its 2010 rules on attribution of profits to PEs, or the Authorised OECD Approach (AOA), require updating. The OECD issued a Public Discussion Draft (the paper) on July 4, 2016, soliciting comments by September 5, 2016, to be followed by a public consultation on October 11-12, 2016.

As widely expected, the OECD did not conclude that wholesale changes are needed to the AOA, but instead focused on providing additional guidance to Part I (General Considerations) of the AOA. It is acknowledged that since the AOA is not applied by all states, this guidance may not be applicable in a number of cases. The OECD has not directly provided any additional guidance on Parts II, III, and IV concerning the application of the AOA to certain Financial Services businesses; however, the additional guidance to Part I likely will be helpful for many Financial Services businesses looking to understand how as a practical matter the OECD expects profit attribution to be carried out.

The paper considers five examples – four relating to Dependent Agent PEs (DAPE), and one relating to Fixed Place of Business PEs in the context of warehousing (FPOB PE). For each of these examples, it provides suggested guidance and asks for comments.

Unlike most BEPS discussion drafts, this paper does not introduce any new rules, nor does it purport to do so. Rather, it seeks to apply principles already established for the attribution of profits to a PE in the context of the lower thresholds for determining the existence of a PE by way of examples. The paper declares that the changes to significantly lower the PE threshold under BEPS Action 7 did only that – lower the PE threshold, and did not modify the nature of the deemed PE. The paper then states that there is no difference in attributing profits to a PE under the pre-BEPS PE rules versus attributing profits to a PE under the post-BEPS PE rules. As a result, it concludes no additional guidance is required in relation to the attribution of profits.

Interest deductibility

A July 11, 2016 discussion draft from the OECD deals with elements of the design and operation of a group ratio rule to determine limits on interest and payments economically equivalent to interest under Action 4 of the BEPS Action Plan.

In October 2015, the BEPS Action 4 Report *Limiting Base Erosion Involving Interest Deductions and Other Financial Payment* set out a common approach to agree limits to the deductibility of interest and payments economically equivalent to interest. This included a 'fixed ratio rule' which limits an entity's net interest deductions to a set percentage of its taxable earnings before interest income and expense, depreciation and amortisation (tax-EBITDA) calculated using tax principles. The limitations would apply to related and unrelated party interest expense.

Tim Anson
Washington, D.C.
T: +1 202 414 1664
E: tim.anson@us.pwc.com

Michael Urse
Cleveland
T: +1 216 875 3358
E: michael.urse@us.pwc.com

Bernard E. Moens
New York
T: +1 646 471 6787
E: bernard.moens@us.pwc.com

Recognising that groups may be leveraged differently for non-tax reasons, the Report also recommended that countries consider introducing a 'group ratio rule' to allow an entity to claim higher net interest deductions, based on a relevant financial ratio of its worldwide group.

To arrive at a workable version of this common group ratio rule, further analysis was to be carried out on the working party's most detailed approach and, partly by implication, on comparing alternative allowable methods.

The items which should be taken into account are, the draft suggests, interest or income/expenses that are economically equivalent to interest as defined in Chapter 2 of the Action 4 Report. It also suggests that a country may require or allow an entity to adjust the figure for net third party interest expense to reflect specific policy goals. In particular, the draft recommends that the calculation should include: capitalised interest, interest included within other categories of income or expense in the consolidated income statement, and interest income on financial instruments carried at fair value. It also recommends that the calculations should exclude: fair value gains or losses on financial instruments, foreign exchange gains or losses, and accrued interest on accounting provisions, etc.

PwC observation:
Taken collectively, these developments reflect continuing and significant progress in implementing the BEPS recommendations.

The OECD paper on attribution of profits to PEs provides taxpayers with additional guidance that can be used to evaluate existing intercompany arrangements in light of BEPS Action 8-10 and to understand what additional profits, if any, would be allocated to PEs arising following the lowering of the PE threshold. A number of questions remain to be answered through the consultation process, and a number of areas of subjectivity within the AOA are not addressed in this guidance. The OECD also notes that the AOA is not universally accepted; given the lowering of the PE threshold, this fact is likely to lead to an increased number of disputes. Comments on this paper are due by September 5, 2016, to be followed by a public consultation on October 11-12, 2016.

The discussion draft on interest deductibility does not change any of the conclusions agreed in the October 2015 Action 4 Report. Nor does it address many of the issues we previously raised as regards the practical operation of those recommendations and the likely double taxation which will arise. It does examine alternative approaches to applying a group ratio rule to increase deductibility limits for various group situations. The options included in the draft do not yet represent the consensus view of the Committee on Fiscal Affairs (CFA) or its subsidiary bodies, but are intended to provide stakeholders with substantive options for analysis and comment.

EU Law
Belgium

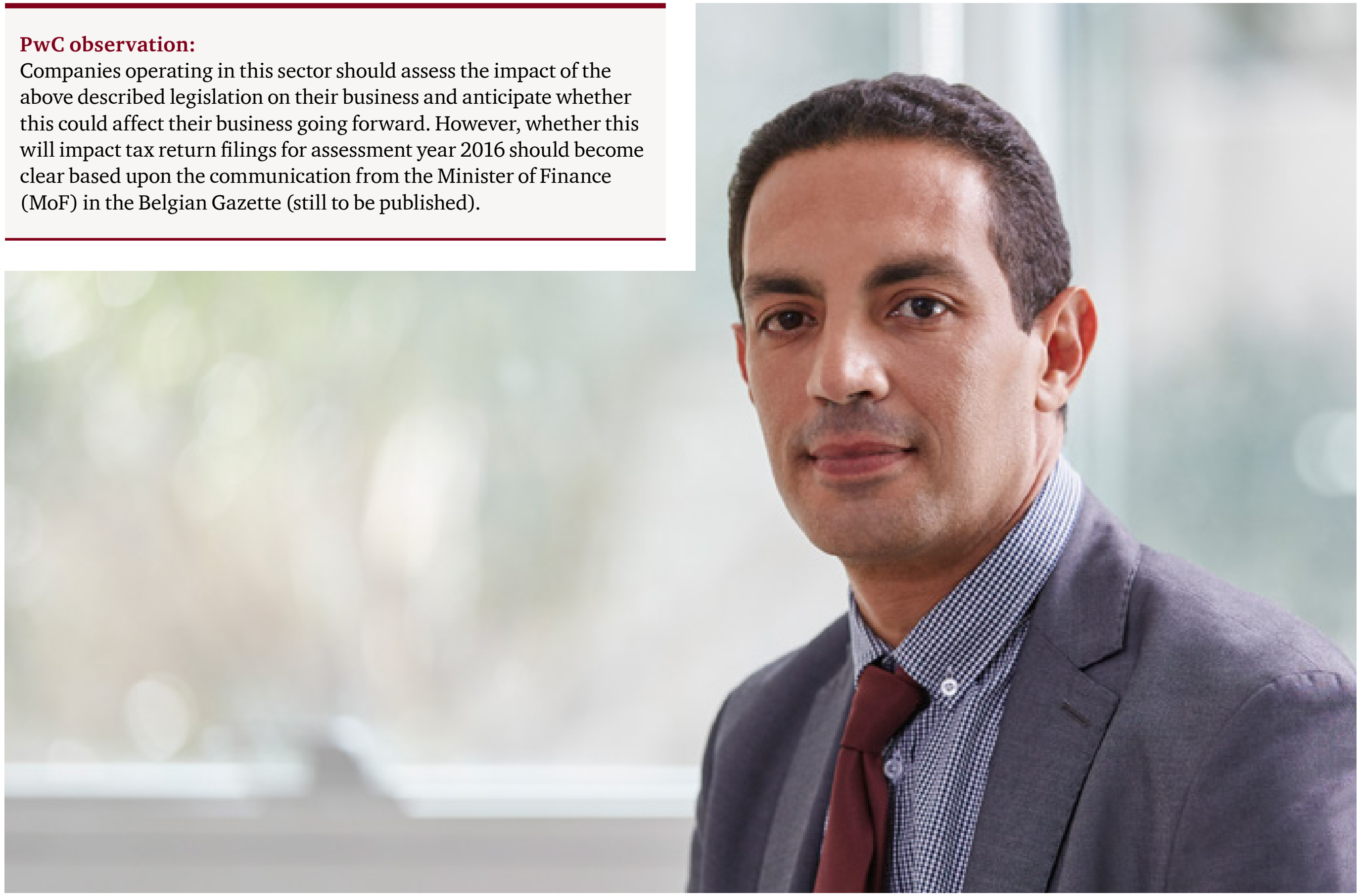
State aid: Commission authorises alternative income tax regime for wholesale diamond sector in Belgium

In 2015, Belgium introduced a specific income tax regime for diamond traders (the 'Diamond Regime') to address difficulties in the application of the general income tax regime to the sector. Under the new Diamond Regime, the calculation of a trader's gross profit is based on a fixed percentage of turnover, which also results in a fixed calculation of the value of stones purchased and the variation in the inventory during the accounting period (cost of goods sold). This new regime was approved and published in the Belgian Gazette. However, it would only come into force if the European Union (EU) Commission concluded that the new regime did not constitute State aid.

As a result, the Commission assessed this measure under EU State aid rules to ensure that it does not unduly favour diamond traders over other businesses that are subject to the normal income tax regime in Belgium. The Commission also assessed whether the scheme favours certain diamond traders within the wholesale diamond sector in Belgium.

On July 29, 2016, the European Commission published its conclusion, stating that the Diamond Regime is in line with EU State aid rules and that the provisions do not selectively favour certain companies and, therefore, do not constitute State aid within the meaning of EU rules.

PwC observation:
Companies operating in this sector should assess the impact of the above described legislation on their business and anticipate whether this could affect their business going forward. However, whether this will impact tax return filings for assessment year 2016 should become clear based upon the communication from the Minister of Finance (MoF) in the Belgian Gazette (still to be published).



Pascal Janssens
Antwerp
T: +32 3 259 3119
E: pascal.janssens@be.pwc.com

Maarten Temmerman
Antwerp
T: +32 3 259 3166
E: maarten.temmerman@be.pwc.com

Treaties
China

The Double Tax Treaty (DTT) between China and Russia and its protocols entered into force

China and Russia signed a new DTT and an accompanying protocol on October 13, 2014. In May 2015, another protocol was signed to revise the interest article in the DTT. In July 2016, China's State Administration of Taxation (SAT) announced that the new DTT and protocols entered into force on April 9, 2016 and will be applicable to the income derived on and after January 1, 2017. The SAT also clarifies that the term of 'recognised stock exchange' in the DTT refers to Moscow Exchange in Russia.

PwC observation:
After the effectiveness of the DTT and protocols, the reduced withholding tax (WHT) rates on dividends, interest, and royalties will be welcomed by relevant investors. Meanwhile, they also need to consider the limitation of benefits article introduced in the DTT to avoid any challenge of treaty shopping.

Matthew Mui
China
T: +86 10 6533 3028
E: matthew.mui@cn.pwc.com

China

Agreement between China and Poland on the VAT Exemption of International Air Transportation Services came into effect

On June 20, 2016, China and Poland signed an Agreement to commit that international air transportation services provided by an air transport enterprise established in either country should be exempt from value-added tax (VAT) or any tax of a similar nature in the other country. The Agreement entered into force on July 1, 2016.

PwC observation:
Besides this stand-alone agreement with Poland on VAT exemption for international air transportation services, China has also recently signed protocols to double tax treaties (DTTs) with certain countries/regions (e.g. Indonesia, Hong Kong) to provide VAT exemption for international air transportation services.

Matthew Mui
China
T: +86 10 6533 3028
E: matthew.mui@cn.pwc.com

Ecuador

Ecuador limits availability of income tax treaty benefits

Effective June 14, 2016, the benefits under any of Ecuador's tax treaties apply 'automatically' only up to a maximum amount equivalent to 223,400 dollars (USD) for 2016.

For the tax treaty benefits to apply automatically, the withholding tax (WHT) agent must obtain a certificate of tax residence for the foreign payee issued by the relevant tax authorities. The limit applies to the sum of payments made by a WHT agent to a non-resident entity in the same tax year. Once the total amount of payments exceeds this limit, payments will be subject to domestic income tax withholding at a 22% rate from the time the limit is exceeded through December 31. If payments made from January 1 to June 14, 2016 already exceeded the 2016 limit, the WHT agent must apply the domestic WHT rate beginning on June 14. To the extent that lower income tax withholding rates should apply pursuant to the relevant income tax treaty, non-resident entities may file for tax refunds beginning in September 2016.

PwC observation:
Multinational enterprises (MNEs) with operations or investments in Ecuador should consider how these new measures may affect them. The rule should not affect the payment of dividends to tax treaty countries, since, as a general rule, dividends to non-resident non-tax haven entities should not be subject to income tax withholding in Ecuador under Ecuadorian domestic tax laws. However, other income payments are subject to a 22% income tax withholding rate.

Hong Kong

Hong Kong-Russia double tax treaty enters into force

The Hong Kong-Russia double tax treaty (DTT) entered into force on July 29, 2016. The DTT will take effect in Hong Kong from April 1, 2017. Accordingly, the article in the existing air services agreement, which was signed between Hong Kong and Russia in 1999, dealing with avoidance of double taxation of the air services (i.e. Article 12) will cease to have effect from April 1, 2017.

PwC observation:
The conclusion of a DTT with Russia may help in promoting a closer economic tie between Hong Kong and Russia. Given that Hong Kong does not currently impose any withholding tax (WHT) on dividends and interest paid to non-residents, one of the major benefits under the Hong Kong-Russia DTT for Russian resident corporations is the reduced WHT rate of 3% (as opposed to the domestic rate of 4.95%) on royalties derived from Hong Kong.

John A Salerno
New York
T: +1 646 471 2394
E: john.salerno@pwc.com

Pablo Aguirre
Ecuador
T: +593 2 382 9351
E: pablo.aguirre@ec.pwc.com

Jose Leiman
Miami
T: +1 305 381 7616
E: jose.leiman@pwc.com

Fergus WT Wong
Hong Kong
T: +852 2289 5818
E: fergus.wt.wong@hk.pwc.com

Portugal

Update on Portuguese tax treaties

There following updates on Portuguese tax treaties should be considered:

Treaty with the Sultanate of Oman is approved and ratified
On July 1, 2016, it was published in the Official Gazette that the Double Tax Treaty (DTT) signed between Portugal and the Sultanate of Oman has been approved and ratified. This DTT will limit the tax withheld at source to 15% on dividends (10% or 5% under certain conditions), to 10% on interest, and to 8% on royalty payments. The entrance into force of the above DTT is pending on the completion of all formalities required by both States.

Treaty with the Kingdom of Saudi Arabia is approved and ratified
On July 18, 2016, it was published in the Official Gazette that the DTT signed between Portugal and the Kingdom of Saudi Arabia has been approved and ratified. This DTT will limit the tax withheld at source to 10% on dividends (5% under certain conditions), to 10% on income from debt-claims, and to 8% on royalty payments. The entrance into force of the above DTT is pending on the completion of all formalities required by both States.

Treaty with the Socialist Republic of Vietnam is approved and ratified
On July 27, 2016, it was published in the Official Gazette that the DTT signed between Portugal and the Socialist Republic of Vietnam has been approved and ratified. This DTT will limit the tax withheld at source to 15% on dividends (10% or 5% under certain conditions), to 10% on interest, to 10% on royalty payments and to 7.5% on technical fees. The entrance into force of the above DTT is pending on the completion of all formalities required by both States.

Jorge Figueiredo
Lisbon
T: +35 12135 99618
E: jorge.figueiredo@pt.pwc.com

Catarina Nunes
Lisbon
T: +35 12135 99621
E: catarina.nunes@pt.pwc.com

Treaty with the Republic of São Tomé e Príncipe is approved and ratified
On August 5, 2016, it was published in the Official Gazette that the DTT signed between Portugal and the Republic of São Tomé e Príncipe has been approved and ratified. This DTT will limit the tax withheld at source to 15% on dividends (10% under certain conditions), to 10% on interest, and to 10% on royalty payments. The entrance into force of the above DTT is pending on the completion of all formalities required by both States.

PwC observation:
The approval of the above treaties is another step taken by Portugal in order to facilitate foreign investment and the investment of Portuguese entities abroad, as the extension of the treaty network allows for an increase of the withholding tax (WHT) reductions available. Following recent treaties concluded by Portugal, these DTTs also establish the foundations to the procedures of cooperation and exchange of information regarding tax matters, increasing the effectiveness of the fight against tax fraud and tax evasion.

Contact us

For your global contact and more information on PwC's international tax services, please contact:

Anja Ellmer
International tax services

T: +49 69 9585 5378
E: anja.ellmer@de.pwc.com

Worldwide Tax Summaries:
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