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
Australia

Australian government releases Exposure Draft for a Diverted Profits Tax

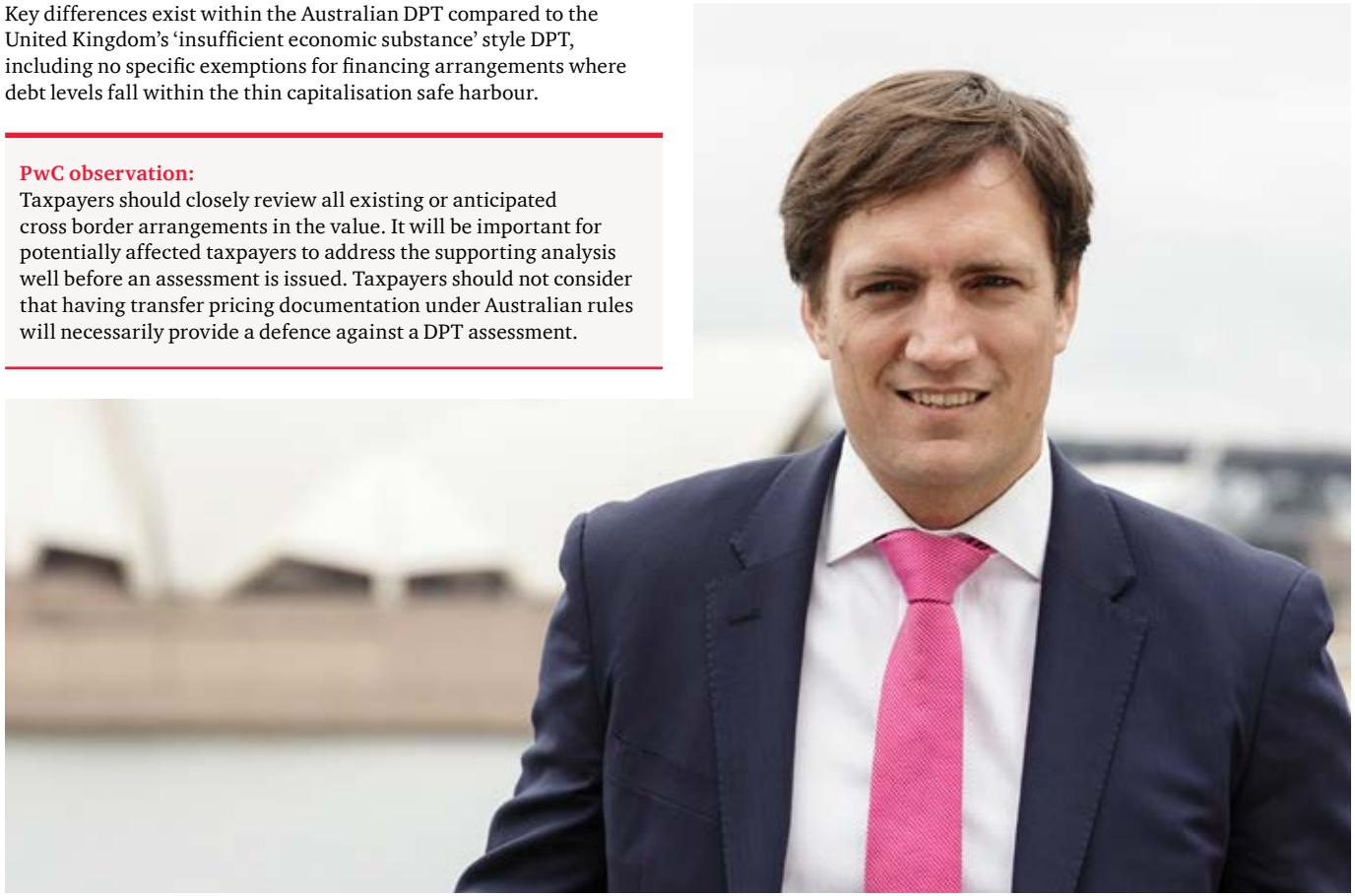
The Australian Diverted Profits Tax (DPT) will apply to multinational groups with more than 1 billion Australian dollars (AUD) global group wide revenue. The DPT imposes a penalty tax rate of 40% to Australian tax benefits obtained in tax years beginning on or after July 1, 2017 whether or not the scheme was entered into, or was commenced to be carried out, before that day.

The 40% DPT penalty tax rate will apply to the amount of an Australian tax benefit where it is reasonable to conclude that the arrangement was entered into for a principal purpose, or for more than one principal purpose, to obtain an Australian tax benefit, or to both obtain an Australian tax benefit and reduce foreign tax liabilities. The DPT will not apply, even if the principal purpose test is satisfied, if it is reasonable to conclude that one of the following carve out clauses applies:

- Australian turnover does not exceed AUD 25 million. Taxpayers will not be eligible for the exception if Australian turnover has been artificially booked offshore, or
- the 'sufficient foreign tax test' is satisfied, requiring an increase in foreign tax liabilities from the arrangement to be equal to, or to exceed, 80% of the corresponding reduction in the Australian tax liability, or
- the 'sufficient economic substance test' is satisfied, requiring the income derived, received, or made by each entity connected with the arrangement to 'reasonably reflect the economic substance' of the entity's activities in connection with the arrangement.

Key differences exist within the Australian DPT compared to the United Kingdom's 'insufficient economic substance' style DPT, including no specific exemptions for financing arrangements where debt levels fall within the thin capitalisation safe harbour.

PwC observation:
Taxpayers should closely review all existing or anticipated cross border arrangements in the value. It will be important for potentially affected taxpayers to address the supporting analysis well before an assessment is issued. Taxpayers should not consider that having transfer pricing documentation under Australian rules will necessarily provide a defence against a DPT assessment.



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Belgium

Transfer pricing documentation – forms and guidance published

Belgium on December 2, 2016, published in the Belgian Official Gazette the Royal Decree containing the various models of the forms that need to be used to submit the Master File, Local File and Country-by-Country Report (CbCr). The Royal Decree provides guidance on how to use and complete the forms. The publication of the Royal Decree is the closing step in the formal introduction of transfer pricing documentation requirements into Belgian tax law.

Together with the transfer pricing documentation forms, Belgium has also published the CbCr notification to identify the reporting entity for CbCr purposes. The Belgian tax authorities have decided to postpone the first formal notification to identify the reporting entity for CbCr purposes from December 31, 2016 to no later than September 30, 2017 for accounting periods that begin on or after January 1, 2016.

PwC observation:
Companies required to file formal transfer pricing documentation should keep track of the reporting requirements and assess the availability of the necessary information and data collection tools as soon as possible to fully prepare for the transfer pricing documentation requirements.

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Belgium

Belgium gazettes bill to implement changes to the Parent-Subsidiary Directive and amend exit tax provision

Belgium on December 8, 2016, published in the Belgian Official Gazette an act containing the following two measures:

Implementation of the amendments to the Parent-Subsidiary Directive

The act implements two amendments to the European Union Parent-Subsidiary Directive (EU PSD) legislation: (i) a so-called anti-hybrid measure and (ii) the introduction of a general anti-abuse rule (GAAR), which would apply to income granted or made payable as from January 1, 2016.

The anti-hybrid rule provides for an exclusion of the use of the dividends received deduction (DRD) if and to the extent that the dividend paying entity, including a permanent establishment (PE) of the distributing entity, can deduct the dividend distributions from its taxable basis.

In addition to the existing Belgian GAAR, the act implements a new EU PSD GAAR which claims that the benefits of the EU PSD as implemented in Belgian law - such as the use of the DRD and withholding tax (WHT) exemptions - will not be granted in case of a legal act or series of legal acts, having been carried with the main purpose, or one of the main purposes, of obtaining a tax advantage that defeats the object or purpose of the EU PSD and which is not genuine, considering all relevant facts and circumstances. A legal act or series of legal acts will be regarded as not genuine to the extent that it is not carried out for valid business reasons that reflect economic reality.

Amendments to the exit tax regime

In view of bringing the Belgian tax law in line with the freedom of establishment, the second tax measure implements - in an EU/European Economic Area (EEA) context and for specifically defined transactions - the option to pay exit taxation either as a direct payment or spread over five years in equal instalments. A taxpayer would be allowed to explicitly opt to spread payment of the exit taxation provided that the assets are maintained within a company or a foreign establishment located in another EU or EEA Member State.

When a taxpayer explicitly opts for a spread payment of the exit tax, the taxpayer is, in principle, required to complete an annual form with information about the assets concerned. The taxpayer, however, has the option to repay the remaining amount at any given time in the five year period. In addition, the Belgian tax authorities could request for a guarantee during the five year period if there is a risk of future non-recovery. This regime would apply beginning in tax year 2017 for transactions occurring on or after the act's publication date.

PwC observation:
Companies should assess the impact of these measures on their business going forward.

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Hungary

Hungary modifies the definition of controlled foreign company (CFC)

Pursuant to the new definition of controlled foreign companies (CFCs), a foreign entity may be considered a CFC in Hungary if the following conditions are met:

- a Hungarian taxpayer directly or indirectly holds more than 50% of a company's shares or registered capital or is entitled to more than 50% of its after-tax profit, and
- the corporate tax paid abroad by the foreign entity is less than half of the corporate tax that would have been due in Hungary.

A foreign branch of a Hungarian resident company may also qualify as a CFC along the same lines. The aforementioned provisions are not applicable if the taxpayer can prove that the entity or the branch operates with real economic substance. Also, the amended Hungarian CFC rules provide for a recognised stock exchange listing exemption for foreign entities.

PwC observation:
The amended definition is partly based on the Anti-Tax Avoidance Directive (ATAD) but is not identical to those rules. Since the ATAD's wording itself contains uncertainties, the interpretation of the newly-introduced Hungarian CFC definition is also not without uncertainties. Therefore, at this point, no conclusions can be drawn in terms of the effects of the new regulation, other than the fact that it seems stricter than the CFC legislation that Hungary applied previously. As a result, Hungarian taxpayers that hold, directly or indirectly, a foreign entity or permanent establishment (PE) with an effective tax rate lower than 5% are recommended to consult on this issue.

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Poland

Amendment to the Polish CIT law restricting exemptions available to investment funds

Poland on November 29, 2016, published an act amending the Polish corporate income tax (CIT) law in the official Journal of Laws. The amendment takes effect beginning in January 2017, leaving little time for the investors to prepare for the changes.

The amendment excludes the CIT exemption for close-ended investment funds (Polish close-ended investment funds [FIZ] and similar European Union [EU]-based investment funds) with respect to income generated through tax transparent partnerships, disposal of interest or shares in such partnerships, and other income related to participation in such partnerships, including interest. This means that rental income and capital gains from disposal of real properties accruing to Polish and foreign investment funds through tax transparent partnerships will be subject to Polish CIT at 19%. Income related to real property held directly by the fund may still be tax exempt.

Full exemption for open-ended funds

Full tax exemption will be available to Polish open-ended (FIO) and specialist open-ended (SFIO) investment funds, except SFIO applying investment principles and limitations relevant FIZ. Comparable EU-based investment funds meeting certain criteria will also retain CIT exemption. In particular, this exemption will be applicable if the EU-based collective investment institution (i) raises funds by public offering of participation titles (ii) may invest only in securities and money market instruments, and (iii) carries out its activities based on permit of the relevant financial market supervision authority.

Limited exemption for close-ended funds

Polish FIZ and SFIO applying investment principles and restrictions relevant for FIZ, as well as EU-based close-ended collective investment institutions (under certain conditions), are subject to a more limited exemption.

This exemption will not be available with respect to (i) income from participation in tax transparent entities (ii) capital gains from sale of securities issued by such entities and shares thereof (iii) interest on loans and other receivables owed by these entities to the fund (also on securities issued by these entities), and (iv) certain other income related to participations in such tax transparent entities.

In case of this exemption, EU-based collective investment institutions may invest in securities, money market instruments, as well as other property rights and it will be sufficient if carrying out of their activities requires notification of the relevant financial market supervision authority.

PwC observation:
The act is one of the actions that the Polish authorities took up in order to limit the tax avoidance. The amendment targets structures involving Polish FIZ and income-tax transparent partnerships, as they are frequently used for tax avoidance purposes. Therefore, affected stakeholders, including investors holding or considering investment fund structures, should seriously consider the implications of the act.

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Spain

Spanish CIT reform

The Spanish government on December 3, 2016, passed Royal Decree Law 2/2016 amending certain provisions of the Corporate Income Tax (CIT) Act. The main highlights are:

- Net operating losses (NOLs): Large taxpayers (entities with revenues of at least 20 million euros [EUR] in the previous year) will be able to offset NOLs up to 50% or 25% of the taxable income in contrast to the general limitation of 70% of the taxable income (60% in 2016).
- Tax credits: Large taxpayers can apply tax credits, but, jointly, these must not exceed 50% of the annual tax due. This measure applies from January 1, 2016.
- Impairments: Shareholding impairments that were tax deductible before 2013 must be reverted on a straight-line basis over five years. This applies from January 1, 2016.
- Losses: Beginning January 1, 2017, losses from the transfer of a subsidiary or a foreign permanent establishment (PE) are not tax deductible. However, losses realised upon liquidation of a subsidiary or closure of a foreign PE continue to be tax deductible.
- Participation exemption: A full participation exemption continues to apply on dividends and capital gains from qualifying subsidiaries.

PwC observation:
Spain has approved revenue raising provisions that will particularly impact large taxpayers, but has maintained a full participation exemption on dividends and capital gains. Taxpayers should consider how the enacted amendments may impact their operations in Spain.

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Proposed Tax Legislative Changes
Brazil

Brazilian tax policy adopts international transparency standards

The Brazilian Tax Authorities (RFB), since June 2014, have closely followed the discussions of the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) project and adopted a series of measures related to the BEPS Action Plans' proposed minimum standards.

Multilateral Convention on Mutual Administrative Assistance (MCAA)
Although not strictly developed under the BEPS project, the MCAA, signed by Brazil and effective since October 2016, provides a platform for automatic and on-demand exchange of information between tax authorities in different jurisdictions.

Under the umbrella of the MCAA, Brazil has signed two multilateral competent authority agreements, which allow tax authorities to automatically exchange financial information (CRS MCAA) and country-by-country reports (CbC MCAA).

Common reporting standards (CRS)
The RFB recently released a public consultation related to the implementation of the CRS in Brazil. The public consultation defines the relevant information that should be exchanged, including information on financial assets, as well as the specific procedures that should be followed by the financial institutions that will present the report. The final regulations have been issued by the end of 2016.

Country-by-Country Reporting (CbCR)
The RFB released on November 4, 2016, a public consultation on CbCR, establishing the framework under which multinational enterprises (MNEs) will be required to disclose information in Brazil related to their economic activities worldwide. According to the public consultation, the information will be disclosed in a specific section of the Brazilian corporate income tax return (ECF). The ECF format has already been updated to incorporate this requirement. The RFB has issued the final regulations on December 29, 2016.

Mutual Agreement Procedures (MAP)
On November 9, 2016, after a public consultation, the RFB issued Normative Instruction (NI) 1669/2016, laying out the rules to allow taxpayers to access the MAP. Although Brazil had included Article 25 of the OECD Model Convention related to MAP provision in its double tax treaties (DTTs), there were no specific procedures to access this resource before NI 1669/2016.

Multilateral Convention to implement tax treaty related measures to prevent base erosion and profit shifting
The OECD recently released the final draft of the Multilateral Instrument (MLI) that could amend bilateral treaties to swiftly implement the tax treaty measures developed in the course of the BEPS Action Plans. The Convention is modular in alternatives and countries should opt in and out of the specific provisions that they wish to include in their agreements. Since Brazil has taken part in the negotiations, it is expected to sign the convention in the ceremony that will be held in Paris in June 2017.

Exchange of information of Brazilian Rulings
The RFB opened a public consultation on November 29, 2016 regarding the compulsory exchange of information (EoI) on tax rulings, which, according to the RFB, should include *'solução de consulta'*, *'solução de divergência'* and *'ato declaratório interpratativo'*. The EoI is expected to be restricted to transfer pricing, permanent establishment (PE), or the semiconductor sector (PADIS) tax benefit.

PwC observation:
Brazil is closely following BEPS action plans. Stakeholders should continue to monitor new developments and respond appropriately.

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Canada

Expansion of the back-to-back rules

The existing back-to-back loan rules for non-resident withholding tax (WHT) apply in certain situations where:

- a non-resident person (the funder) indirectly provides financing to a Canadian taxpayer through an intermediary and
- the interest paid by the taxpayer to the intermediary is subject to less WHT than would be imposed if the interest were paid directly to the funder.

Where these rules apply, the taxpayer is deemed to pay interest to the funder for non-resident WHT purposes.

The 2016 federal budget proposed a significant expansion of the back-to-back rules. These amendments were introduced on July 29, 2016, and were re-released in modified form on October 21, 2016 (the October Amendments). The new rules have been included in Bill C-29 (the Bill), which was introduced in Parliament on October 25, 2016, and is expected to be enacted by the end of the year. The key changes may be summarised as follows:

- The Bill clarifies the application of the back-to-back loan rules to arrangements with multiple intermediaries. The amended rules apply to certain arrangements in which one or more 'ultimate funders' indirectly provide funding to a Canadian taxpayer, by way of a chain of funding arrangements involving one or more intermediaries. The amount of deemed interest paid to each ultimate funder is based on the amount of net new funding provided by that ultimate funder, and the difference between the WHT rates on interest paid to that ultimate funder and on the actual interest paid to the direct creditor.
- The Bill includes new rules to address back-to-back arrangements involving rents, royalties, and similar payments. These 'back-to-back royalty' rules are modelled on the back-to-back loan rules, and apply in certain circumstances where one or more 'ultimate licensors' indirectly lease or license property to a Canadian taxpayer by way of a chain of 'relevant royalty arrangements' involving one or more intermediaries. The October Amendments provide an exception for certain arm's length royalty arrangements that do not have a main purpose of avoiding WHT.
- The Bill adds Character substitution rules. These rules prevent taxpayers from avoiding the back-to-back loan rules by substituting funding arrangements with economically similar equity or royalty arrangements between an intermediary and a non-resident. Similar rules prevent taxpayers from avoiding the back-to-back royalty rules by replacing royalty arrangements with economically debt or equity.
- The Bill includes new rules to address back-to-back loan arrangements in the context of the shareholder loan rules. These rules are similar to the back-to-back WHT rules. They apply in certain situations where one or more 'ultimate funders' indirectly provide funding to an 'intended borrower' by way of a chain of funding arrangements involving one or more intermediaries, and the shareholder loan rules would apply to a direct loan from an ultimate funder to the intended borrower. The rules deem the intended borrower to receive a loan from the ultimate funder. Where the intended borrower is a non-resident, this loan may be treated as a deemed dividend for WHT purposes if it is not repaid within one year after the end of the taxation year in which it arose. All or a portion of a deemed loan may be deemed to be repaid when the funding provided through the chain of funding arrangements is reduced.

The WHT changes apply to amounts paid or credited after 2016. The new shareholder loan rules generally apply to debts outstanding after March 21, 2016 for arrangements involving a single intermediary or after December 31, 2016 for arrangements with multiple intermediaries.

PwC observation:
These changes expand the scope of the existing back-to-back loan rules, creating a broader back-to-back regime. The new rules are complex, raise many interpretive issues, and could result in current year tax provision adjustments. The back-to-back rules generally operate mechanically, based on factual connections between funding or royalty arrangements, without regard for the purpose of these arrangements. As a result, the rules create significant uncertainty and could apply to many ordinary commercial transactions.

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United Kingdom

The UK Autumn Statement 2016 & Finance Bill 2017

The UK Chancellor of the Exchequer, Phillip Hammond, presented his Autumn Statement to Parliament on November 23, 2016 setting out the government's plans for the economy and how it intends to raise and spend public money over the course of the Parliament. He announced a number of measures relevant to business and international tax, principally those set out below, many of which have been expected. Draft legislation for inclusion in the UK Finance Bill 2017 and draft guidance for consultation has subsequently been issued (on December 5 and 9, 2016 respectively) related to some of these measures.

- **Corporation tax rate** - The government confirmed that the main corporate tax rate will be cut to 17% by 2020, as previously announced by Mr. Hammond's predecessor.
- **Tax deductibility of corporate interest expense** - As previously announced, new rules will take effect from April 1, 2017 to limit the tax deductions that groups can claim for UK interest expenses. Some of the legislation has now been published and the remainder will be issued for consultation in January 2017.
- **Corporate tax loss relief** - As expected, legislation will take effect from April 1, 2017 to restrict the use of a company's carried-forward losses to 50% of profits in excess of 5 million pounds (GBP). Some of the legislation has now been published and further clauses are expected in January 2017.
- **Bringing non-resident companies' UK income into the corporate tax regime** - Shortly after Budget 2017, the government will consult on bringing non-UK resident companies that are currently chargeable to income tax on their UK taxable income within the scope of corporation tax and subject to the rules which apply generally for the purposes of corporation tax.
- **Substantial shareholding exemption (SSE)** - Following a consultation, draft clauses have been published to effect a simplification of the SSE rules from April 1, 2017. The investing company will no longer need to be a trading company or a member of a trading group. The rules will also provide a more comprehensive exemption for companies owned by qualifying institutional investors.
- **Research & Development (R&D)** - The government will review the tax environment for R&D to look at ways to build on the introduction of the 'above the line' R&D tax credit to make the UK an even more competitive place to do R&D.
- **Hybrids and other mismatches** - Amendments to two aspects of the new rules, which take effect on January 1, 2017, were published and draft guidance (for consultation) on the operation of the regime as a whole.
- **Avoidance: sanctions and deterrents** - The government issued draft legislation imposing a new penalty on individuals and entities who enable the use of tax avoidance arrangements which Her Majesty's Revenue & Customs (HMRC) later defeats.

The Chancellor also stated that from 2017 there will be one fiscal event each Autumn, rather than the current two.

PwC observation:
The new Chancellor's commitment to his predecessor's target 17% corporate tax rate by 2020 and the 2016 tax road map sends an early signal that the government intends to keep corporation tax competitive and recognises that business likes certainty and stability.

Removing the requirement for an investing group to be trading to benefit from SSE is favourable for corporate groups and the government's plans to build on the R&D credit regime are also welcome. A review of this regime could lead to increases in rates of relief for larger businesses, which are currently entitled to less relief than smaller firms.

While the transition to the new fiscal timetable will require adjustments to the normal tax policy-making process, it will ultimately enable greater Parliamentary scrutiny of budgetary measures.

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United States

US election results may provide opportunities for major tax law changes in 2017

Republican candidate Donald J. Trump has been elected to serve as the 45th President of the United States. Republicans will also retain control of the next Congress, but with reduced majorities in both the US House of Representatives and the US Senate.

President-elect Trump has stated that one of his top priorities is a comprehensive tax reform to significantly lower individual and business tax rates. Under his proposed plan, the top individual tax rate would be lowered from 39.6% to 33%, and the US corporate tax rate would be lowered from 35% to 15%. Owners of partnerships, S corporations, and other 'pass-through' business entities would be able to elect to be taxed on their pass-through business income at a flat rate of 15%, rather than under the regular individual tax rates. US-based manufacturers also would be allowed to elect full expensing of plant and equipment (with no deduction for interest expense). Trump also has proposed a 10% 'deemed' repatriation tax on the foreign earnings of US-based companies.

Trump's call for action on comprehensive tax reform is expected to receive strong support from Republicans in Congress, but the divisive nature of the 2016 elections means that there may be no 'honeymoon' period for the new president.

House Republicans have been drafting statutory language to advance the tax reform 'blueprint' that they released earlier this year, which differs in some important respects from Trump's tax proposals. House Speaker Paul Ryan (R-WI) has said a Republican-controlled Congress could advance tax reform in 2017 by using 'budget reconciliation' procedures that allow legislation to be approved in the Senate with a simple 51-vote majority, instead of the 60 votes generally needed to advance legislation.

The House Republican tax reform plan would lower the top corporate tax rate to 20% and would replace the current six individual tax brackets with three brackets, with rates set at 12%, 25%, and 33%. The plan also would create a new 25% pass-through business tax rate, and provide full expensing for business costs (with no deduction for net business interest expense). In addition, the plan would move the United States from a worldwide international tax system to a 'territorial' dividend-exemption system, and impose a mandatory 'deemed' repatriation tax (8.75% for cash or cash equivalents and 3.5% for other accumulated foreign earnings).

PwC observation:
The results of the 2016 elections for control of the White House and Congress will have a significant impact on the direction of tax reform over the next four years. President-elect Trump and the Republican-controlled Congress are expected to push for action on comprehensive tax reform that would lower both individual and business tax rates. Still, prospects for the enactment of such legislation remain in question, given differences between the two political parties on how much tax should be paid by upper-income individuals.

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Uruguay

Tax amendments under Congress consideration

The Executive Power submitted a bill of law (the Bill) for congressional consideration that establishes the tax treatment applicable to derivative financial instruments (DFIs), an issue that currently lacks specific tax regulation.

The Bill clarifies that the source of the income is determined by the place of residence of the person or entity to which the income belongs. In this regard, when contracts are subscribed by Uruguayan income taxpayers, income derived from DFIs is deemed Uruguayan sourced. On the other hand, when such income is obtained by non-residents, it shall not be considered Uruguayan sourced, and thus not subject to this tax.

Other important aspects of the Bill include:

- the results obtained from DFI shall be regarded as existent at the time of the settlement
- losses derived from the DFI are included on the list of deductions allowed for corporate income tax, provided that the counterpart is not an entity resident in a country with low or no taxation, or that benefits from a special regime of low or no taxation, and
- Income derived from the DFI shall not be considered for the calculation of value-added tax (VAT).

For the calculation of net wealth tax (NWT), only the assets and liabilities resulting from the settlement of DFI shall be considered. In case of a debit balance, when the counterpart is a non-resident, it shall be considered as an exempt asset for NWT purposes and thus not subject to withholding.

PwC observation:
Multinational enterprises (MNEs) operating in Uruguay, as well as individual taxpayers and non-residents, should consider the impact of these expected tax amendments on their respective structures.

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Tax Administration and Case Law
Australia

Tax residence of a company determined by where central management and control of company actually abides

*The High Court of Australia on November 16, 2016, in **Bywater Investments Limited v. Commissioner of Taxation; Hua Wang Bank Berhand v Commissioner of Taxation [2016]** HCA 45 unanimously dismissed appeals by four companies and held that, notwithstanding the overseas location of the formal operations of each company, the real business decisions of the companies were carried on by an Australian resident without the involvement of the directors of the appellants.*

For Australian income tax purposes, if a company is not incorporated in Australia it can nonetheless be a tax resident of Australia if it carries on business in Australia and has either its central management and control in Australia or its voting power controlled by shareholders who are residents of Australia. The key question in this case was whether the central management and control of the companies was located in Australia. The High Court confirmed that it is a 'question of fact and degree to be answered according to where the central management and control of the company actually abides…not by reference to the formal constituent documents of the company, but upon a scrutiny of the course of business and trading'.

The High Court unanimously held that, notwithstanding the taxpayers were overseas incorporated companies whose directors were located outside of Australia, and who held board meetings outside of Australia, the companies' actual central management and control was in Sydney, Australia. This was because there was no occasion for the actual directors to exercise any measure of independent judgment with respect to the transactions or direction and policy of the company. Instead, the substantive direction and control by an Australian resident individual, as an advisor to the businesses, amounted to an abrogation of the powers of management of the foreign directors and a usurpation of the functions of the board which rendered the companies Australian tax residents.

PwC observation:
This decision should be a red flag to foreign incorporated entities whose decisions are made via consultation with Australian advisors and other personnel located in Australia. Boards and key management personnel located overseas should ensure that they are making the substantive decisions and not merely rubber-stamping or mechanically implementing the decisions made by personnel located in Australia.

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Belgium

EU Advocate General provides opinion on fairness tax

A request for annulment of the Belgian fairness tax regime is currently pending before the Belgian Constitutional Court. On January 28, 2015, the Belgian Constitutional Court requested a preliminary ruling from the European Court of Justice (CJEU). On November 17, 2016, Advocate General Kokott issued her opinion in this regard.

Under the Belgian implementation of the Parent-Subsidiary Directive (the Dividends Received Deduction [DRD]), 95% of qualifying dividends received are exempted from (non-resident) corporate income tax (CIT). The remaining 5% is in principle subject to tax (implementation of article 4[3] of the directive). The fairness tax, introduced in 2013, is only applicable if, generally speaking, the following conditions are cumulatively met during a taxable period: (i) the company has distributed dividends during the taxable period and (ii) the company's taxable profit has been partly or fully offset against notional interest deduction or carried forward tax losses. The tax rate is 5.15% and applies to Belgian companies and to Belgian branches of foreign companies.

In the typical case of an intermediary holding company, however, the complexity of the taxable basis leads to situations where the fairness tax applies to more than 5% of qualifying dividends received and redistributed by the intermediary holding. In such case, the Advocate General considers that the fairness tax infringes article 4(3) of the Parent-Subsidiary Directive.

The next step in the procedure is a decision by the CJEU. When the CJEU renders its decision on the EU law cause for action, the Constitutional Court will then still need to rule on the other arguments. The case may still take some time before being settled.

PwC observation:
Based on the above, Belgian companies and Belgian establishments of foreign companies previously subject to the fairness tax should consider safeguarding their administrative rights through filing a tax appeal.

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Brazil

Brazilian tax authorities released amend Normative Instruction on controlled foreign corporation rules

The Brazilian tax authorities (RFB) on November 29, 2016, published Normative Instruction (NI) 1,674/2016, updating NI 1,520/2014 related to certain regulations for Brazilian controlled foreign corporation (CFC) rules under Law No. 12,973/2014.

In broad terms, NI 1,674/2016 includes amendments that update rules regarding the disclosure and electronic filing of foreign profits, the definitions of sub-taxation regime and eligibility for the presumed tax credit. NI 1,674/2016 also clarifies the impact of transfer pricing adjustments and additional ancillary filing obligations.

Sub-accounts

The Brazilian CFC rules require that the foreign profits of each entity, directly or indirectly controlled by the Brazilian shareholder, be disclosed individually. According to NI 1,520/2014, this was to be disclosed in sub-accounts in the Brazilian controller's statutory books – specifically, in a sub-account of the main investment account. Pursuant to NI 1,674/2016, a Brazilian CFC must now include the amounts in an auxiliary sub-account specifically for Brazilian CFC purposes. It should therefore not impact the main investment account. The updates also make it clear that the values should be reversed in the following year.

Electronic filing of results

Where a controlled company is located in a jurisdiction with which Brazil does not have a treaty or act with a clause specifically for the exchange of tax information, it may still be eligible to consolidate its results for Brazilian CFC purposes if it provides its financial information to the Brazilian tax authorities in the prescribed electronic format.

The changes provide certain details around the format of such electronic filing.

NI 1,674/2-16 also clarifies that it is only necessary to complete the forms relating to active and passive income where the entity intends to utilise one of the specific benefits contemplated by the law – specifically, consolidation of results, the presumed tax credit, or deferral of tax payable in relation to its CFCs.

Impact of transfer pricing adjustments

In order to prevent double taxation, the Brazilian CFC rules specifically allow a deduction, for Brazilian CFC purposes, for additions arising as a result of transfer pricing adjustments and application of the thin capitalisation rules. The deduction is subject to certain limitations, such as limiting the deduction to the additional tax in Brazil due to the relevant adjustment. While this limitation has not been removed from the law, NI 1,674/2016 has now removed it from NI 1,520/2014. Further, the additional limitation that the RFB introduced in NI 1,520/2014 - that is, any deduction should be limited to the calculation base of the tax due in Brazil related to transfer pricing or thin capitalisation adjustments - remains in effect.

Definition of sub-taxation regime

The Brazilian CFC rules introduced a new concept of 'sub-taxation regime', which, in addition to the existing tax havens (black list) and privileged tax regime (grey list), disqualified certain entities from benefits and other favourable treatment under the rules. The rules defined a sub-taxation regime as one that taxes the profits of the foreign company at a nominal rate of less than 20%. NI 1,674/2016 appears to have broadened the definition by including tax havens and privileged tax regimes within the definition of sub-taxation regimes.

Presumed tax credit

In addition to taxes actually paid by controlled companies - both corporate income tax (CIT) and withholding taxes (WHT) - companies that pass certain requirements and perform certain activities may be eligible for an additional 9% presumed tax credit. This list of activities has been amended several times since the original law was introduced. NI 1,674/2016 extended the definition of extraction of minerals and ores to include other extraction industry.

Further, NI 1,674/2016 appears to have clarified an error in NI 1,520/2014 by limiting the additional conditions eligible for the presumed credit with a requirement that the entity not be subject to a sub-taxation regime and the entity not have less than 80% active income. Notably, the requirement that the entity is not controlled, directly or indirectly, by an entity that is subject to a sub-taxation regime or privileged tax regime or located in a tax haven has been removed.

Accrual regime for affiliates

NI 1,674/2016 confirms that the Brazilian taxpayer may elect on an annual basis to treat the profits of affiliates that would otherwise meet the conditions to be treated on a cash basis, on an accruals basis. NI 1,674/2016 goes on to provide details for how such election should be made and provides confirmation that, if made, the election applies to all relevant affiliates and is irrevocable.

PwC observation:
Although a Normative Instruction does not have the force of law, it represents the Brazilian tax authority's interpretation of the relevant legislation and how it is likely to administer the relevant rules. Therefore, Brazilian entities with investments abroad should consider how the changes introduced by NI 1,674/2016 may impact their structure.

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OECD

OECD publishes multilateral instrument for implementing BEPS in double tax treaties

The Organisation for Economic Co-operation and Development (OECD) on November 24, 2016 published the 49-page Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS) and its accompanying 86-page Explanatory Statement. The Convention (MLI) has two main aims:

- to transpose a series of tax treaty measures from the OECD/ G20 BEPS Package into existing bilateral and multilateral tax agreements and
- to set a new standard for mandatory binding arbitration in relation to resolving double tax disputes.

Implementation of the October 2015 Final BEPS Package requires changes to the OECD and United Nations (UN) model tax conventions, as well as to the bilateral tax treaties based on those model conventions. The OECD has determined that there are more than 3,000 bilateral treaties, making separate updates burdensome and time-consuming, and thus limiting the effectiveness of multilateral efforts to restrain BEPS.

The Action 15 Report 'Developing a Multilateral Instrument to Modify Bilateral Tax Treaties' concluded that an MLI to enable countries to swiftly modify their bilateral tax treaties was desirable and feasible, and that negotiations for such an instrument should be convened quickly. The Action 15 Report was developed with the assistance of specialists in public international law and international tax law. The procedural questions to address, given that the substantive content was already addressed in Action Steps (and 'model outcomes'), relate to:

- Action 2 on hybrid transactions
- Action 6 on treaty abuse
- Action 7 on permanent establishments (PEs), and
- Action 14 on dispute resolution and the mutual agreement procedure (MAP).

An ad hoc group of interested states quickly formed. The OECD states that, in a period spanning little more than 12 months, 99 countries participated as members (plus, as observers, four non-State jurisdictions that are covered by another jurisdiction's bilateral treaty that extends to the non-State jurisdiction, and seven international or regional organisations).

The OECD's aspiration was that having over 100 states, territories and jurisdictions indicating their interest in the work of the ad hoc group negotiating the MLI would facilitate the process of implementing the treaty-based aspects of the October 2015 BEPS report recommendations. These aspects include the 'minimum standards' (treaty abuse and basic dispute resolution/ compensating adjustment rules) which are mandatory (albeit with some optionality), and all other changes (including arbitration) which are essentially optional. One could reasonably expect that the 27 countries that have apparently been involved in developing the arbitration standard will generally adopt it. This, in turn, may bring swifter relief for many cross-border business tax disputes.

The MLI could enable the signatory parties to make many changes to their existing treaties, whether based on the OECD or UN model convention. However, the flexibility included in the MLI suggests that some of the parties do not intend to implement, or fully implement, some of those recommendations. While the recommendations included some options and the MLI needs to reflect them, part of the flexibility is designed to enable parties to opt out of particular recommendations altogether, or to disapply them for individual treaties ('to accommodate specific tax treaty policies' per the OECD press release). Unfortunately the OECD could not ensure a greater level of application, thus giving rise to greater uncertainty. The parties' provisional notifications of their intentions to sign the MLI this year will better indicate the level of consistency in applying the BEPS measures and whether the MLI will effectively achieve its goals.

PwC observation:
The MLI's many options will make its application highly complex, both for the countries that sign it and for practitioners and businesses who have to interpret it. In some cases, a country can choose to selectively apply an option on the condition that its treaty partners have made the same option. In other cases, the application of some rules will be asymmetrical. One treaty partner could apply one rule while the other treaty partner applies a different rule.

The minimum standard for access to MAP should help businesses resolve cross-border disputes more timely and efficiently. A wide range of businesses will welcome the optional mandatory arbitration standard. In states that adopt the arbitration process, there could be a more certain route to resolving the most difficult disputes.

The range of options available under the MLI means, however, that uncertainty will remain until states, jurisdictions, and territories clarify their intentions. The capacity negotiated in the ad hoc group for states, jurisdictions, and territories to opt out for particular provisions or individual existing agreements, suggests that despite the efforts, the treaty-related BEPS measures may be inconsistently applied. Frequent references in the MLI to parties 'endeavouring to resolve' different views suggest that the MLI will not be the panacea the OECD had hoped for in aligning tax measures.

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United States

IRS Notice targets repatriation of offshore earnings

The internal revenue service (IRS) on December 2, 2016 announced that it intends to issue regulations under Section 367 that would modify the rules regarding cross-border triangular reorganisations and certain inbound non-recognition transactions. The Notice is the sixth set of rules that the government issued in the last decade regarding these transactions, and is the latest salvo in its campaign against repatriation of offshore cash.

The announcement (Notice 2016-73) targets triangular reorganisations involving foreign target corporations by making them more difficult to execute in a tax-free manner by, for example, requiring gain to be recognised on the target shares. The Notice also causes taxpayers to recognise a larger 'all earnings and profits amount' upon the domestication or inbound liquidation of certain foreign corporations, even when the domesticating or liquidating corporation itself has earnings and profits. The changes are intended to prevent taxpayers from repatriating untaxed earnings.

The Notice also adds an anti-abuse rule to the regulations in order to address transactions undertaken with a view to avoid the purpose of the rules applicable to inbound non-recognition transactions. The anti-abuse rule allows for making of adjustments, including disregarding the effects of transactions.

PwC observation:
Companies engaged in cross-border restructurings, inbound liquidations, or domestications should consider the Notice's potential application to their transactions, as the Notice states that future regulations will be effective as of December 2, 2016. Further, taxpayers should remain aware of the potential for additional Treasury and IRS guidance in these contexts.

Given the impending change in Administrations as well as President-Elect Trump's commitment to comprehensive tax reform, it is possible that the regulations described in the Notice will not be issued. The rules may be irrelevant in a post-tax reform world. Similarly, Trump has campaigned on withdrawing rules issued by the Obama administration. Given the uncertainty surrounding the future taxation of offshore earnings, taxpayers would be well advised to monitor these rules closely in 2017.

United States

IRS releases final and temporary regulations under Section 987

The Treasury and internal revenue service (IRS) on December 7, 2016 issued final and temporary regulations under Section 987. The final regulations implement an accounting regime based largely on proposed regulations issued on September 6, 2006, to account for income earned through a qualified business unit (QBU) that operates with a functional currency different than that of its owner (Section 987 QBU). One significant feature of the new rules is that unrealised Section 987 gains and losses existing as of the transition date for the new regime will largely disappear under a mandatory 'fresh start' transition method.

The new temporary regulations also include significant new limitations on taxpayers' ability to cause the recognition of Section 987 losses through terminations of QBUs. These limitations can apply to terminations occurring on or after December 7, 2016, and apply to all entities that determine Section 987 gain or loss under Section 987(3), even those excluded from the scope of the final Section 987 regulations. Taken together, these provisions make it likely that much of the existing unrealised Section 987 losses of US-based multinationals will never be tax affected. Because the US dollar is near historic highs against many currencies, these unrecognised Section 987 losses can be very large. To the extent that companies have recorded a deferred tax asset on their financial statements with respect to such unrealised Section 987 losses, they may be required to reverse such amounts through continuing operations in the current quarter.

PwC observation:
Multinational companies (MNCs) that conduct business activities through QBUs will need to assess the effect of the regulations for the financial statement period that includes the date the Regulations were enacted (i.e. December 7, 2016). In addition, companies should ensure that their financial reporting processes and controls are designed effectively to address the requirements of the new regulations.

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United States

IRS releases temporary and proposed regulations under Section 901(m)

The internal revenue service (IRS) on December 6, 2016 issued temporary and proposed regulations under Section 901(m) addressing when companies can claim a foreign tax credit (FTC) after buying and selling certain types of assets.

Section 901(m) was enacted as part of anti-abuse legislation in 2010 with the intent of preventing companies from manipulating the FTC through transactions referred to as 'covered asset acquisitions'. The regulations define three new types of transactions that would be considered covered asset acquisitions, including transactions involving partnerships. In general, the regulations address taxpayers that buy foreign assets in specific transactions and then claim FTCs on the associated income.

The IRS is targeting transactions in which a taxpayer's purchases are treated as taxable asset acquisitions under US tax law, but are treated as either stock acquisitions or completely ignored by the foreign country when it imposes its own income tax. Section 901(m) states that taxpayers cannot count the disqualified portion of foreign income tax when claiming the FTC. The regulations provide rules for computing that disqualified portion.

PwC observation:
The temporary regulations generally apply to covered asset acquisitions occurring on or after July 21, 2014. The proposed regulations generally would apply for covered asset acquisitions occurring on or after the date final regulations are published in the Federal Register. Taxpayers may rely on the proposed regulations prior to that date pursuant to the requirements specified in the proposed regulations. Comments on the proposed regulations must be received by March 7, 2017.

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United States

Final US research credit regulations on internal-use software make limited changes to proposed rules

The internal revenue service (IRS) on October 3 released final regulations (TD 9786) addressing various issues regarding the treatment of research related to internal-use software (IUS) for purposes of the Section 41 research credit. The regulations finalise, with certain changes, the proposed regulations released in January 2015. The IRS recognises that the role computer software plays in business activities today is very different than it was when the general exclusion for IUS from the definition of qualified research under Section 41(d) was enacted in 1986.

The final regulations, like the proposed regulations, are favourable overall for taxpayers engaged in third-party-facing software development. Taxpayers should carefully review their software development activities in light of this guidance to analyse whether they are properly claiming research credit eligible expenditures.

PwC observation:
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Treaties
Canada

Canada-Madagascar Tax Treaty

The Convention between Canada and the Republic of Madagascar for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (the Convention) was signed on November 24, 2016.

The new Convention limits the withholding tax (WHT) rate on dividends to 5% where the beneficial owner of the dividends is a resident of the other state and a company that controls directly or indirectly at least 25% of the voting power of the company paying the dividends. The WHT rate on dividends is 15% in all other cases.

The new Convention limits the WHT rate on interest and royalties to 10% where the beneficial owner is a resident of the other state. However, the reduced WHT rate is available only with respect to the portion of interest or royalties determined absent any special relationship between the payer and beneficial owner or between both of them and some other person.

Lastly, the new Convention contains provisions reflecting the standard developed by the Organisation for Economic Co-operation and Development (OECD) for the exchange of tax information.

PwC observation:
The new Convention will enter into force once Canada and the Republic of Madagascar have completed mutual notification procedures.

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