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Editor:
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PREFACE

This is the seventh edition of *Global Legal Insights – Corporate Tax*. It represents the views of a group of leading tax practitioners from around the world.

One consistent trend across each jurisdiction is the evolving nature of tax rules which impact cross-border arrangements, and the ongoing uncertainty that this creates. BEPS implementation is now well into the domestic implementation phase and transfer pricing is now a mainstream aspect of tax planning. We also see renewed effort to reach an international consensus on taxation of the digital economy, with increasing concern that further delay will prompt unilateral domestic action across the OECD.

This has prompted reaction from the US government in particular, at a time when US tax reform is still causing issues for inbound and outbound investors. It also coincides with information reporting entering a new phase, as DAC 6 will be implemented across the EU. All of the above are examples of why tax compliance continues to reach new heights of complexity.

Authors were invited to offer their own perspective on the tax topics of interest in their own jurisdictions, explaining technical developments as well as any trends in tax policy. The aim is to provide tax directors, advisers and revenue authorities with analysis and comment on the chosen jurisdictions. I would like to thank each of the authors for their excellent contributions.

Sandy Bhogal
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Overview of private funds in the UK last year

Daniel Lewin & Jake Fleming
MJ Hudson

The following information is accurate as at 1 July 2019.

Private equity

General trends

The private equity market remains buoyant in the first half of 2019; despite concerns over growth prospects for the global economy and rising political risk in a number of markets, European fundraising in 2018 was only slightly down on 2017. Despite this, the level of "dry powder" – unused capital in funds – grew to record highs in 2018. There was just over $2 trillion of dry power in private capital funds in 2018, of which $1.1 trillion was in private equity funds.[1]

The UK remains a significant presence in the European private funds space, with 948 fund managers located in the UK as of Q2 2019, which is just over a quarter of all fund managers across Europe.[2]

Fundraising

Globally, private equity funds raised $457 billion in commitments in 2018. Fundraising in the first quarter of 2019 has continued at a broadly similar pace, with $100 billion closed in Q1 2019,[3] and a further $109 billion in Q2 2019. A total of 244 funds reached a final close globally in Q1 and Q2 2019, respectively. In the UK in 2018, private funds raised €49.4 billion, a level of fundraising that has remained relatively stable since 2016 (in 2016, €48.6 billion was raised and in 2017, €47.3 billion).[4] In 2018, the number of new funds raising capital was 94.[5]

In 2019, the fundraising market has become even more intensely competitive and concentrated around a number of mega funds. As of Q2 2019, the top five largest funds currently marketing are between them seeking $175 billion in capital, around 18% of the total capital targeted. One consequence of this is that the lower end of the market is becoming more crowded. As of June 2019, globally 46% of funds have fundraising targets at or below the $100 million mark, competing for just 4% of all capital targeted. Comparing figures from January 2018 and June 2018 indicates quite how acute this increasing competition has become. In January 2018, 2,296 funds were in market, targeting capital of $744 billion, whereas in June 2019 there were 3,951 funds targeting $981 billion. There has therefore been an increase of 72.1% in the number of funds but only a 31.9% increase in the total capital targeted.[6] Looking to the UK, this trend of concentration of capital is also present. In 2018, seven UK-managed funds had targets of over £1 billion; together they raised over £22 billion in incremental funding. By contrast, similar to the situation in other leading PE markets, there were more funds at the small-cap end of the UK market, with an increase in the number of funds seeking less than £100 million rising from 60 funds in 2017 to 67 in 2018[7] – while overall fundraising at this level has remained broadly stable.

Hedge funds

Globally, Q4 2018 was a difficult quarter for hedge funds, with losses of 4.78%. However, Q1 2019 saw significant improvement, with a net return of +5.4% over the course of the quarter.[8]

The year 2018 also saw challenges for Europe-focused hedge funds, caused by political uncertainty, volatile currencies and general international market slowdowns. Europe-focused hedge funds saw losses of 4.22% in 2018, with Europe-based assets under management ("AUM") decreasing to €560 billion – a drop of 8.7% from 2017.[9]

The UK remains a significant player in the hedge fund space within Europe. As of Q2 2019, there were 494 hedge fund managers in the UK, which is over half of all hedge fund managers located in Europe. UK-based funds, as of figures released in July 2019, were faring better than their European counterparts, with three-year annualised returns of +5.1%, compared to an average across continental Europe of +2.59%.[10] Globally, two of the top 10 largest hedge funds by AUM are based in the UK: the Man Group with $80.5 billion AUM; and Marshall Wace with $33.5 billion AUM. The UK is the sole European country among this top 10, as the remainder are US-based funds.[11]

The number of hedge funds launched also appears to be in decline from the highs of the past few years. In 2018, 191 Europe-focused hedge funds launched, with 170 being liquidated in the same period. This continues the slow decline in numbers from the peaks of 2010–2015, where in excess of 300 hedge funds were launched each year – in 2016, 303 funds were launched and 243 in 2017.

Venture capital

The year 2018 saw a very high volume of venture capital deals, both in numbers and aggregate value – in 2018, the aggregate value of all deals globally was $266 billion.[12] This trend, however, does not appear to have continued into 2019 as, in the first half of the year, both the number and value of venture capital deals has declined. In the second quarter of 2018, 3,263 deals were announced globally, worth a total of $52 billion – a stark decline from the 4,356 deals worth $77 billion announced in Q2 2018.[13] Nevertheless, deal levels are still high when compared to historical levels.

In Europe, the aggregate value of deals in the period from 1 January 2018 to the end of Q1 2019 was €25.7 billion, of which €9.1 billion derived from UK-based deals.[14]

Mega-funds remain a significant presence in the venture capital space. SoftBank's Vision Fund, the world's biggest technology investor with $100 billion in capital commitments, has been involved in many billion-dollar deals since it began investing, including the $1 billion raise by FlexPart in Q1 2019.[15] Venture capital-backed investment into the UK increased in the first six months of 2019, rising 37% to £4.4 billion ($5.5 billion) compared to the same period in 2018. There were 603 deals in the first half of 2019.[16] Mature UK businesses appear to be the focus for investment in 2019 so far, with only £21.5 million of angel or seed investment into UK companies in Q2 2019.[17] Significant venture capital-backed investments in 2019 to date include London-based Deliveroo's latest round of fundraising, which raised $575 million in May 2019,[18] and Mitsubishi Corporation investing over £215 million into Bristol-based electric vehicle and energy storage company OvoEnergy.[19]

Brexit

Brexit continues to play a significant role in fuelling uncertainty in European markets.

Reports suggest that some £62 billion of hedge fund investments by UK investors have been placed offshore following the outcome of the Brexit referendum in 2016. The bulk of this (~£42 billion) has gone to Dublin, with the remainder going to Luxembourg.[20]

Private equity-backed investment into UK-based portfolio companies has also dropped due to Brexit uncertainty persisting. The year 2018 saw a 12% drop in investments into UK-based companies but a 13% rise in investment into the rest of Europe, perhaps indicating investors are looking elsewhere in Europe.[21]

Key developments affecting the taxation of the UK asset management sector

The below section on UK tax law developments reflects a summary of the key developments affecting the UK asset management sector in 2018, but it is not a comprehensive or detailed discussion of all tax measures in the past year. The legislation, case law and information stated below are accurate as at July 2019.

Overview

Compared to previous tax years, 2018/19 saw fewer UK domestic legislative measures directly targeting or impacting the UK asset management industry. However, the combination of recently introduced anti-avoidance legislation, new European Union ("EU") developments, HM Revenue and Customs ("HMRC") challenges of asset managers and potential Brexit implications, meant that the asset management sector remained under considerable tax pressure in 2018/19.

Offshore substance

A major development in the treatment of UK asset managers with operations or investment funds established in offshore jurisdictions such as Jersey, Guernsey, the Cayman Islands and the British Virgin Islands are the economic substance requirements initiated by the EU Code of Conduct Group and the introduction of the EU's list of "non-cooperative tax jurisdictions". In connection with these European policy measures, legislation was introduced for accounting periods commencing on or after 1 January 2019 which aims to ensure that legal entities established in these jurisdictions have real economic presence (or "substance") – targeting the widespread use of offshore vehicles and the perceived tax avoidance and evasion that came with it.

While the legislation applies to (and is enacted by) the offshore jurisdictions, the potential impact on UK based asset managers is significant. To name two examples, the use of offshore management companies and offshore general partner vehicles for limited partnership funds are commonplace in the hedge and private equity fund sectors, respectively.

Although the relevant legislation is technically distinct in each offshore jurisdiction and subject to local interpretation by the relevant authorities, there are strong similarities between the rules in each jurisdiction. It is expected that respective Revenue Authority guidance will also be similar. Considering one example, Guernsey, Jersey and the Isle of Man (i.e., the Channel Islands) jointly issued formal "*Guidance on aspects in relation to the economic substance requirements as issued by Guernsey, Isle of Man and Jersey*" in April 2019, outlining application of the rules on substance across these islands.

The Channel Islands guidance requires that a local company:

- is directed and managed on the relevant island;
- has an adequate number of (qualified) employees proportionate to the level of activity carried out on the island;
- has adequate expenditure proportionate to the level of activity carried out on the island;
- has an adequate physical presence on the island; and

- conducts core income-generating activity ("CIGA") on the island.

The "directed and managed" test is separate from the English common law "central management and control" test used in determining the UK tax residence of non-UK incorporated companies. Differences between the tests include that under the directed and managed test, the board of directors must meet *on the island* at an adequate frequency given the level of decision-making required, and have a quorum during the meeting *physically present on the island* (conversely, the central management and control test does not mandate physical presence in the foreign jurisdiction – it is only necessary that board meetings take place outside the UK).

The practical meaning of "adequate" for the number or level of employees, expenditure and office space is unclear at present, but should become known as market practice develops. Further, the CIGA rules pose potential difficulty, as they require that a company established in the Channel Islands must generate any CIGA income it receives itself by performance of the relevant CIGAs *on the relevant island*. In relation to fund management, the guidance identifies the following as CIGAs:

- taking decisions on the holding and selling of investments;
- calculating risk and reserves;
- taking decisions on currency interest fluctuations and hedging positions; and
- preparing reports and returns to investors and the relevant financial services regulator.

Non-CIGA activity can be outsourced to jurisdictions outside of the relevant island – so that a UK based asset manager can act as investment advisor to an offshore manager so long as the actual investment decision is taken by the offshore company. Where an activity falls within CIGA, however, it can only be outsourced to an entity on the island – and the outsourcing company must still be able to demonstrate that it has adequate supervision of the outsourced activities. This creates an obvious problem for existing fund structures where investment decisions are delegated to, and taken by, a UK manager.

For asset managers based in the United Kingdom, some commonly used structures in offshore jurisdictions are coming under pressure: for example, UK hedge fund managers with Cayman Islands parents acting as "offshore manager"; and private equity funds set up as limited partnerships with a Jersey or Guernsey-based General Partner.

As mentioned above, despite guidance issued by the relevant jurisdictions, the practical application of the new legislative measures remains unclear and further clarification is expected as discussions between Government Authorities and industry continue. Advice provided by advisors has, unsurprisingly, been contradictory. It is also unknown whether affected offshore jurisdictions will generally follow a similar approach to the interpretation of the legislation (e.g., what specific activities are included in "CIGA", and when are local employees and office arrangements "adequate"), or if some will be more prescriptive than others.

For larger fund managers, compliance should at least not be financially difficult; the impact may well be more difficult for smaller managers. One pragmatic view would be to consider that these new substance rules simply mean increased compliance costs for fund managers using offshore fund structures, but not all market participants will be able to afford them. Many fund managers have so far taken a restrained approach to the new rules, maintaining the *status quo* and accepting the risks until the direction of the relevant authorities becomes clearer. However, some UK-based groups have already begun winding down offshore management operations.

Sanctions for non-compliance with substance legislation include: (1) exchange of information with authorities in other jurisdictions; (2) financial penalties; and (3) striking off the companies register.

Entrepreneurs' relief

Entrepreneurs' relief ("ER") is a relief from capital gains tax which applies to the first £10 million of qualifying capital gains over an individual's lifetime. Where it is claimed, it allows an individual to reduce the rate of capital gains tax applicable from 20% to 10%. ER is intended to encourage entrepreneurialism in the UK and is frequently relied on by entrepreneurs selling their venture capital-backed companies. Naturally, the availability of ER is of significant interest to investors and fund managers in the venture capital space. The year 2019 saw a number of changes to the ER rules.

Under the legislation, qualifying capital gains are those arising on disposals by individuals of shares in a "personal company" of theirs. Until recently, a "personal company" was defined as a trading company (or holding company of a trading group) where the taxpayer has been an officer or employee of the company (or group) throughout the period of one year before the disposal, holding at least 5% of the ordinary share capital, allowing him to exercise at least 5% of the voting rights.

Since 6 April 2019, the qualifying period has been increased to two years, and there are additional requirements for the taxpayer's shareholding to entitle him to 5% of distributable profits and 5% of the company's assets available to equity holders on a winding up (or 5% of the disposal proceeds in the case of a disposal of the whole company – designed to include growth shares). Effectively, the revised legislation in the Finance Act 2019 doubled the qualifying holding period and introduced an economic ownership condition to the qualifying test.

The most recent 2019 changes also included two industry concessions:

- As an alternative to the new 5% economic ownership conditions, an individual also qualifies for ER if the individual is simply entitled to at least 5% of the proceeds available to the ordinary shareholders on a disposal of the company. This particular test was aimed at growth shares – which must have been held for the 24-month period.
- The revised legislation tackles a perverse incentive that existed previously, whereby managers were discouraged from supporting further investment if it meant their own shareholding would be diluted below the 5% threshold(s). The Finance Act 2019 provides that where a company issues shares to raise funds for genuine commercial reasons, and the share raise would result in a manager's shareholding falling below the necessary 5% to qualify for ER, that manager can choose to lock in ER for the gains made to date by treating their shares as having been disposed of for market value immediately before the dilution, and subsequently acquired again for market value immediately after the dilution. Provided ER would have been available for the initial disposal, the relief can then be claimed on any chargeable gain arising as a result of the deemed disposal. For any future disposals, the market value then forms the base cost of the shares – although no ER would be available for the subsequent gain (so that the normal 20% capital gains tax rate is likely to apply). Payment of the 10% ER tax for the deemed initial gain can be deferred until an actual disposal of the shares to avoid the manager having to pay tax on the initial gain without actually receiving any monies (i.e., to avoid a dry tax charge). Credit is also available against the initial ER gain to the extent the ultimate share disposal results in a loss, so that a manager will not be out of pocket (the credit arises in the same year as the tax for the held-over gain would be payable).

IR35 and personal service companies

Draft legislation impacting off-payroll working rules was published on 11 July 2019. The proposals, to be introduced with effect from April 2020, will shift the burden of compliance with the so-called "IR35" tax rules to employers (or end clients) in the private sector –

echoing the public sector changes. This could have significant implications for fund managers and portfolio companies that use the services of consultants.

The off-payroll working rules, commonly known as "IR35" (a reference to the original Inland Revenue budget press release announcing the rules), are the body of tax rules aimed at countering tax avoidance strategies that involve the use of personal service companies ("PSCs") by individual workers. Where IR35 does not apply and an end client engages an individual through a PSC instead of employing them directly, the individual avoids paying income tax and National Insurance Contributions ("NICs"). Instead, the PSC pays corporation tax and the individual pays tax on dividends – which results in more take-home pay for the individual.

In broad terms, the IR35 rules apply where an individual worker is engaged by an end client through a PSC and the circumstances are such that, if the PSC were not involved, the relationship between the worker and end client would be an employee-employer relationship. Where the IR35 rules apply, the PSC is required to account for income tax and NICs. HMRC is currently litigating a significant number of cases.

In determining whether the relationship would amount to employment (from a tax law perspective), the tribunal first imagines a hypothetical contract between the individual and the end client and then undertakes an analysis of that hypothetical agreement to determine whether the relationship is one of services or employment – considering control over work, place and hours of work, substitutability of consultant and other factors.

The burden of compliance with IR35 originally fell on the PSC, but under the new legislation, analogous to the position in the public sector, liability now shifts to the end client in the private sector as well. This raises significant practical concerns over the end client's potential liability for the consultant's taxes, agreeing the tax treatment (potentially against sustained resistance from the consultant where contrary views are taken or uncertainty of treatment exists) or indeed being indemnified if HMRC later challenges the consultancy.

To aid small businesses, the legislation excludes small companies from the changes. The definition of "small" mirrors that used in the Companies Act 2006; *i.e.*, a small company will be one that has at least two of the following: (1) turnover of no more than £10.2 million; (2) balance sheet value of no more than £5.1 million; and (3) no more than 50 employees.

Helpfully, HMRC has indicated that it does not intend to undertake targeted investigations into past IR35 determinations by PSCs where the new regime leads to employment treatment. However, there is no guarantee that the new rules will not cause problems for individuals (and their PSCs) who have been incorrectly treating IR35 as not applicable to their working arrangements.

The obvious difficulty for businesses with workers currently operating via PSCs is that where end clients have to date been able to take a relaxed approach, knowing that the tax risk lay with the PSC, this will no longer be possible. Even assuming that acceptable indemnities exist (which may well be an issue), end clients will not be keen to bear the 13.8% employer's NICs, or become the subject of HMRC investigations. One additional challenge is the practical difficulty in determining employment or consultant status notwithstanding HMRC's online tool, as evidenced by two 2019 tribunal decisions, *Albatel v HMRC* and *Christa Ackroyd Media Ltd. v HMRC*, where the tribunals came to opposite conclusions in reasonably similar circumstances.

Some businesses may choose not to change anything about their employment/consultancy arrangements, but doing so entails accepting the risk that the business may later have to account for unpaid taxes and NICs as well as interest on those payments and any penalties for non-compliance. It is also important to note that in any exit event, this tax risk can be expected to be picked up as an issue during due diligence. Alternatives to this approach

include: (1) changing consultants to employees; (2) maintaining the *status quo* but accepting that IR35 applies; (3) adjusting working arrangements to ensure that IR35 does not apply; or (4) engaging consultants via agencies. In any event, the prudent approach is to have difficult conversations with consultants now, and resolve any conflict upfront.

Cryptocurrency transactions

While investment in cryptocurrencies and other digital assets such as digital tokens continues to increase globally at some speed, many questions over the UK tax treatment remain unresolved. Cryptocurrencies and digital tokens may be commercially regarded as equivalent to dealings in currencies or transactions in securities in a number of ways; however, it does not follow that these are currencies or securities for UK tax purposes.

The uncertainty includes the treatment of transactions by UK asset managers in non-UK based crypto funds, particularly where the cryptocurrencies or digital tokens are traded. Accordingly, the first question to determine is whether the activity is treated as an "investment" or "trading" for UK tax purposes. It is generally only the latter that creates a tax risk for non-UK investment funds (or investors in such funds where the fund vehicle is tax transparent); pure investment activity by a UK manager will generally not subject the fund or any non-UK investors (in tax transparent funds) to UK tax risk. Under existing UK tax law, important categories of crypto assets such as most cryptocurrencies, including Bitcoin, cannot normally be traded by a UK asset manager directly on behalf of a non-UK based crypto fund without attracting UK tax for the fund.

Generally, where a non-UK fund engages in trading activity on the basis of investment decisions taken by a UK asset manager, the fund and UK manager commonly rely on the investment manager exemption ("IME") to avoid bringing the fund into the UK tax network. The IME is a long-standing statutory concession which provides that a UK investment manager will not constitute a UK permanent establishment, branch or agency of a non-UK fund in respect of the trades it carries on, so long as certain conditions are complied with.

The IME includes a relatively broad list of permitted investment transactions – the so-called "white list" – that UK asset managers may engage in on behalf of the fund without causing tax risk to the fund – including currency, foreign currency, securities and contracts for difference. For the time being, the white list does not include cryptocurrencies or other digital assets as a permitted investment category in their own right.

It will generally be necessary to look at the facts of each case in order to decide on the tax treatment – but many transactions, such as currency transactions including Bitcoin, can simply not be traded by a UK investment manager without causing UK tax risk to the fund (except where treaty protection is available, or the ultimate trading decision is, for UK tax purposes, taken outside the UK). The fact that cryptocurrencies are not "currency" (or foreign currency) for the purposes of the IME was confirmed by HMRC in April 2019, when it issued new guidance regarding the treatment of individual investors in cryptocurrencies.

Depending on the specific nature of the cryptocurrency or digital asset in question, some crypto transactions may fall into permitted categories such as transactions in "securities" – e.g., which could, depending on the circumstances, be the case for specific initial coin offerings ("ICOs"). ICOs are a recent but increasingly popular method of crowdfund-raising for start-ups and other companies. However, the form of ICOs, including rights and powers represented by each initial "coin" or "token", can vary greatly leading to difficulty of interpretation.

Detailed submission to HMRC was made by the Alternative Investment Management Association in July 2018 about the significant commercial benefits for cryptocurrencies and other crypto assets to be included in the list of permitted IME transactions. As at the date of this publication, the HMRC response remains outstanding.

Limited liability partnerships and salaried members

The taxation of UK limited liability partnerships ("LLPs") came under unexpected challenge in 2018, owing to a surprising number of HMRC enquiries into, among others, large asset managers established as LLPs, and their treatment under the "salaried member" legislation, a body of anti-avoidance rules. In summary, the tax (and financial) concern for HMRC was the absence of the 13.8% employer's NICs that apply to payment of salary and other employment income, but not allocation of partnership profit.

The salaried member rules were enacted in 2014 to counter what HMRC perceived as abuse of partner status by individuals who, for non-tax purposes, could not be truly considered as partners, yet the LLP benefitted from the absence of the 13.8% employer's NICs. Broadly, a "salaried member" is an individual LLP partner (termed "member" by the LLP legislation) who fails to meet certain statutory conditions and is therefore, for tax purposes, treated as an employee.

Under the salaried member rules, an individual partner will be treated for tax purposes as an employee of the partnership if three conditions are met: the individual: (a) receives at least 80% of his compensation as "disguised salary"; (b) does not have "significant influence" over the affairs of the LLP; and (c) contributes less than 25% of the total amount of disguised salary as partnership capital. Failing any one condition results in the member being treated as a partner for tax purposes.

A particular industry concern when the legislation was introduced was the significant uncertainty of the salaried member rules without much meaningful statutory guidance. In consequence, and against the objection of the legal industry that lobbied for better legislation, HMRC published written guidance with multiple (at times contradictory) examples of how these rules are to be applied.

In the HMRC enquiries, HMRC challenged primarily the "disguised salary" and "significant influence" conditions (the third condition, the 25% capital contribution, is rarely relied on by investment management LLPs).

Broadly, a "disguised salary" includes any amount which is fixed, a variable sum which is varied without reference to the overall amounts of the profits or losses of the LLP and a variable amount which is not, in practice, affected by the overall amount of those profits or losses. In their investigations, HMRC focused on the "overall LLP profit" and contended that an individual member who is entitled to a profit share based on a formula reflecting their own personal performance, but not the overall LLP profit, received disguised salary and should be taxed as an employee. HMRC's controversial and not wholly convincing view is that such a payment is disguised salary even where the LLP simply uses the formula to determine how much of the LLP profit is allocated to an individual member. In HMRC's view it must be demonstrated that individual profit is based on overall LLP profit. While one can conceive of examples where individual formulas are indeed indicative of "disguised salary", in other LLPs, especially larger ones, HMRC's approach can be out of line with how LLP members wish to share their profit.

Perhaps even more controversially, HMRC challenged the often difficult determination of when an individual has "significant influence" over the affairs of the LLP. For example, the 2014 HMRC guidance suggested that the members of an LLP management committee were likely to exercise "significant influence". In investigation, HMRC retreated and asserted that in practice only two or three members of such a committee could exercise "significant influence" for the purposes of the condition. The difficulty with HMRC's approach is that the question whether members of any executive or management committee have significant influence may well depend on the particular circumstances of such committee. However, taxpayers are entitled to certainty of legislation and interpretation, and having provided guidance on which members

relied, it appears that HMRC simply withdrew relevant parts of the 2014 guidance. In addition to the NICs (and PAYE) question, a partner being treated as an employee for tax purposes could mean that partnership interests, such as carried interest, then also fall under the employment legislation with additional potentially adverse tax consequences. Revised HMRC guidance has been promised for some time but, as at the time of writing, remains outstanding.

Anti-profit fragmentation

New anti-avoidance legislation in the form of the "fragmented profits tax" came into force in April 2019 for SMEs (broadly, businesses with fewer than 250 employees and either a turnover of less than €50 million or a balance sheet total of less than €43 million). The legislation focuses on the transfer of value or profit from a UK individual or entity to an overseas recipient where the tax paid overseas is less than 80% of the tax which would have been paid if the profits were taxed in the UK. The tax is primarily aimed at UK SMEs with an overseas subsidiary or parent company in low or no tax jurisdictions. This can include a UK asset manager with overseas operations.

Under the rules, value is treated as diverted as a consequence of increased costs having been attributed to the UK from overseas, or because UK profits have been reduced on overseas transactions.

For the rules to apply, two additional conditions must be met:

- the individual or beneficial owner of the businesses or someone "connected" with them is able to "enjoy" the transferred profits either now or in the future (a "relevant person"); and
- it is reasonable to conclude that the main purpose, or one of the main purposes, for which the arrangements were entered into was to obtain a tax advantage.

The new tax focuses on the actual tax paid overseas rather than the headline rate (although the latter may well also be indicative) so that it is not just low-tax jurisdictions with a tax rate of less than 80% of the UK rate that need to be considered; e.g., Ireland's 12.5%, but also jurisdictions which offer beneficial tax regimes for a particular stream of income, such as intellectual property income (e.g., 7% in the Netherlands).

The tax is payable via self-assessment, putting the onus on UK taxpayers including companies, partnerships and individuals to self-assess that their tax returns are prepared in accordance with the anti-profit fragmentation legislation. Effectively, adjustments under self-assessment must be made to the tax position of the UK transferor to counteract the tax advantage that would otherwise result.

To the extent a UK investment management group already complies with transfer pricing, it is not expected that the measures will be problematic. For example, private equity management groups often have robust transfer pricing policies in place. Equally, other tax provisions, such as the carried interest legislation for private equity managers, effectively ensure that the profit fragmentation rules should not be an issue. However, whether or not the rules are in point for private equity, hedge fund or venture capital fund managers will depend on their specific circumstances.

Brexit

In July 2018, an industry working group was organised by HMRC, HM Treasury and a number of representative bodies, including the British Private Equity & Venture Capital Association (representing the interests of private equity fund managers) and the Alternative Investment Management Association (the governing body of the UK hedge fund industry), to discuss the impact of Brexit on the UK financial services industry and assist industry. Subgroups were established for Asset Management, Banking, Insurance and VAT.

The purpose of the working groups was to discuss tax concerns arising for financial services

firms in connection with Brexit, specifically where business reconstructions are undertaken to address the effects of regulatory changes. To name one topic addressed by the asset management subgroup, a key regulatory Brexit concern for UK managers with EU-based alternative investment funds and EU-based investors was the inability of such managers to avail themselves of the marketing passport under the Alternative Investment Fund Manager Directive ("AIFMD") if the UK leaves the single market, as UK managers would no longer be permitted to manage such funds or be eligible for the passport. To deal with such scenario, some affected managers were, among other, considering transferring fund management operations to affiliated or third-party managers based in other EU jurisdictions, such as Ireland or Luxembourg. The EU fund would then terminate the investment management agreement with the UK manager which was previously acting as alternative investment fund manager ("AIFM") to the EU fund and instead appoint another EU-based AIFM. The existing UK manager could continue acting as investment advisor to the new AIFM and make investment recommendations (the actual investment decisions would then be taken by the EU-based AIFM). Under established UK tax practice, it should often be possible to arrange such change of investment manager without attracting UK tax, although the treatment will depend on the specific circumstances.

In consultation, HMRC queried some of the concepts and initially took a relatively defensive stance, adding that while the circumstances of Brexit were exceptional, any resulting business restructurings were to be treated no differently to any other corporate event or business change.

Ultimately, understanding was reached by the working group on many points, much depending on individual circumstances. HMRC subsequently made available a summary note of the direct tax and VAT issues discussed in the meetings.

DAC 6

Continuing the global reporting trend, Council Directive (EU) 2018/822 – commonly referred to as DAC 6 – came into force on 25 June 2018. DAC 6 imposes obligations on EU intermediaries to disclose certain information on cross-border transactions involving at least one EU Member State to their tax authority if certain "hallmarks" are met, such as a feature that indicates a potential risk of tax avoidance. The aim of the Directive is to tackle aggressive cross-border tax planning by requiring intermediaries to provide relevant information to their tax authority in order to enable the latter to take action (either itself or through information exchange with other authorities) and counteract relevant arrangements.

The scope of DAC 6 is extremely broad affecting potentially worldwide transactions, and it is anticipated that it will require disclosure of a wide range of arrangements. At present, there is uncertainty as to how the rules will apply, including how transactions involving private equity and hedge funds will be covered, as cross-border investment transactions could potentially be in scope. While the first disclosures under DAC 6 will only be required in July 2020, the disclosure requirements are retrospective and include reportable arrangements entered into in the previous two-year window starting on or after 25 June 2018. These rules therefore catch transactions which are being used now. In the UK, HMRC is currently consulting until 11 October 2019 on draft regulations to implement DAC 6 into UK law with effect from 1 July 2020. HMRC has confirmed that it will apply DAC 6 post-Brexit.

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Endnotes

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Andorra

Jose María Alfin Martin-Gamero & Marc Urgell Diaz
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Key developments

As the Andorran direct corporate tax system has been recently implemented (before January 1st 2011, Andorra did not have any corporate tax laws), we are going to summarise briefly the most important rulings that regulate the corporate tax system which entered into force in 2011.

The Andorran tax system depends on the definition of residence. Residence is based on the following criteria that must be considered globally: a corporation is resident in the Principality of Andorra if it: (i) is incorporated under Andorran law; (ii) has its corporate address there; or (iii) is effectively managed from there.

The effective general tax rate in Andorra is 10% over the tax profit, but there is a special tax rate for collective investment vehicles, which is 0%. Likewise, there is a special effective tax rate of 2% (this is the result of a deduction over the tax basis) for the companies as follows: (i) international trading companies; (ii) financial intragroup companies; and (iii) intellectual and industrial property management companies. Nevertheless, these special regimes have been amended or eliminated according to the Draft Bill of amendment of the Act 95/2010, December 29th, regulating the corporate income tax that was approved as law on April 19th 2018 by the General Council of Andorra. Actually, the international trading companies and financial intragroup companies regimes have been eliminated and they will be gradually reduced by the end of the financial year 2020.

The regime regulated for holding companies (the subsidiaries could be either resident or non-resident) is still very attractive, since the tax rate for profits distributed by the subsidiaries in the form of dividends or the capital gains arising out the sale of the shares of subsidiaries is 0%. Nevertheless, the new law establishes that the non-resident subsidiary must be subject to a tax rate of at least 40% of the Andorran corporate tax rate or must be resident in a country which has a double tax treaty in force with Andorra.

As a consequence of this efficient corporate tax system, we have seen certain movements of businesses or companies to Andorra, especially companies related to some specific sectors that do not need a significant physical presence or a factory for manufacturing activities, such as computer software companies, Internet-related companies, intellectual property or other similar businesses. Likewise, we have seen movements of individuals or executives with the aim of managing groups of operational companies located in several countries within the European Union through Andorran holding mother companies.

The introduction of the principle of tax neutrality ("*roll over regime*") in the Andorra tax system was approved by the Act 17/2017, October 20th on corporate restructuring amending partially the Corporate Income Tax Act, the Personal Income Tax Act, and the Capital Gains

Act in relation to real estate transactions. The aforesaid law is creating opportunities for local companies or individuals to take decisions about corporate reorganisations, contributions in kind, mergers, scissions, and acquisitions.

Andorra regulates the possibility of applying a tax credit to losses with future tax profits within 10 years after the losses were originated.

At present, Andorra has not yet introduced any "controlled foreign company's regime" for companies. That means that the profit not distributed to the Andorra mother company or to the individual shareholder by the subsidiaries is not taken into account when calculating the business profit and the taxable base.

Another important point to note is the internal treatment of the international double tax relief. The regime allows the application unilaterally of a total exemption over the tax withheld at the source up to the limit of the internal tax rate (10%).

Another important key feature of the Andorra corporate tax system is the Pyrenean country's definitive stance towards tax transparency. This is a development of the decision taken by Andorra to join the *common reporting standard* of the OECD for the automatic exchange of tax information in April 2014, which has been realised through an agreement executed with the European Union in February 2016 for the automatic exchange of tax information and the corresponding internal law, which entered into force on January 1st 2017.

The main domestic laws regulating the tax regime of the Andorran resident companies are as follows:

- **Corporate Income Tax Act, December 29th 2011** (*Llei de l'impost de societats, 10/95, de 29 de desembre*).
- **Decree developing the Corporate Income Tax, September 23rd 2015** (*Decret de 23 de setembre de 2015 del reglament de l'impost de societats*).
- **Act of October 20th 2017 approving the principle of tax neutrality on corporate reestructurings** (*Llei 17/2017, de 20 d'octubre, de règim fiscal d'operacions de reorganització empresarial I de modificació de les lleis de l'impost de societats; llei del impost sobre la renta de les persones fisiques; llei de societats anònimes i limitades i llei de l'impost sobre les plusvàlues en les transmissions immobiliàries*).
- **International treaty with the European Union implementing the automatic exchange of tax information by means of an amendment to the Tax Savings Agreement for payments in the form of interests executed between Andorra and the European Union dated February 26th 2016.**
- **Act on automatic exchange of Tax Information, November 29th 2016** (*Llei d'intercanvi automàtic d'informació fiscal de 29 de novembre de 2016*).
- **International Double Tax Treaty with Luxembourg, July 2nd 2014**.
- **International Double Tax Treaty with Spain, January 5th 2015**.
- **International Double Tax Treaty with France, July 1st 2015**.
- **International Double Tax Treaty with United Arab Emirates, 28th July 2015**.
- **International Double Tax Treaty with Portugal, September 27th 2015**.
- **International Double Tax Treaty with Liechtenstein, September 30th 2015**.
- **International Double Tax Treaty with Malta, September 20th 2016**.
- **International Double Tax Treaty with Cyprus, May 18th 2018**.

BEPS

Andorra assumed the BEPS commitment on October 15th 2016 and has already implemented the relevant actions through Act 6/2018, amending Corporate Income Tax, approved by the General Council (Andorran Parliament) on April 19th 2018.

The commitment to these minimum standards determines that Andorra has given its consent to the following points:

- Meeting the minimum standards on tax treaty shopping.
- Implementing a country-by-country reporting system on transfer pricing.
- Imposing limits on the benefits of preferential tax regimes.
- Implementing the mutual agreement procedure in its tax treaties.
- The inclusion of Andorra in the BEPS Project will be subject to a peer-to-peer review process in order to commit to the implementation of the BEPS minimum package in Andorra.

This minimum package encompasses the following BEPS Actions:

- Action 1: address the tax challenges of the digital economy.
- Action 2: neutralise the effects of hybrid mismatch arrangements.
- Action 3: strengthen controlled foreign company rules.
- Action 4: limit base erosion via interest deductions and other financial payments.
- Action 5: counter harmful tax practices more effectively, taking into account transparency and substance.
- Action 6: prevent treaty abuse.
- Action 7: prevent the artificial avoidance of permanent establishment status.
- Actions 8–10: assure that transfer pricing outcomes related to intangibles are in line with value creation.
- Action 11: establish methodologies to collect and analyse data on BEPS and the actions to address it.
- Action 12: require taxpayers to disclose their aggressive tax planning arrangements.
- Action 13: re-examine transfer pricing documentation.
- Action 14: make dispute resolution mechanisms more effective.
- Action 15: develop a multilateral instrument.

In essence, Andorra will have to: (i) develop standards in relation to the remaining BEPS issues; (ii) review and be reviewed during the implementation of these standards; and (iii) support developing countries with the implementation of the same.

Holding companies (foreign securities holding companies)

The Andorra tax regime for holding companies is quite attractive for several reasons, which can be summarised as follows:

- The domestic tax rate for holding companies, whose corporate purpose is participation in the capital of subsidiaries, is 0%, both for income coming from dividends, or capital gains arising from the sale of shares of subsidiaries. Nevertheless, the non-resident subsidiary must be subject to a minimum tax rate of at least 40% of the Andorran ordinary tax rate or must be resident in a country with a double tax treaty in force with Andorra.

- There is neither a minimum threshold of participation nor a minimum period of holding, which is a major difference compared to neighbouring countries.
- Andorra is currently signing double tax treaties with many relevant jurisdictions. This means that Andorra will not be discriminated against in the future with high withholding rates applicable to countries which do not have double tax treaties in force.

Industry sector focus

The tax industry has been focused on the following:

- Banking, investment entities, portfolio management companies and financial advisors.
- Tobacco manufacturing and distribution.
- Property and real estate.
- Asset financing.
- Familiar groups of companies.
- Intellectual and industrial management companies.
- Software, computer and internet companies.

The year ahead

Andorra is very advanced in the negotiations for a potential agreement of association with the European Union. The European Union has already communicated that they will respect the low tax rates of Andorra due to its particularities, and the VAT harmonised system will not be applied to Andorra. That means that Andorra will continue to be an attractive jurisdiction with very low tax rates. Likewise, Andorra will benefit from the application of the most important principles of the European Union, such as: the freedom of movement of companies and individuals; principle of freedom of movement of capital; freedom of movement of individuals and workers; and the other freedoms regulated in the Treaty of the European Union.

In principle, we do not expect significant tax reforms in the year ahead after the implementation of the "rollover tax regime" and the implementation of BEPS into the internal tax system.

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Overview of corporate tax work over last year

Types of corporate tax work

Much of corporate tax work in the year 2018–19 continues to be in advising and assisting corporates with their tax reporting obligations and international tax arrangements.

The Australian Taxation Office's ("**ATO**") review and audit of the Australian subsidiaries of significant global entities (groups with a global turnover of more than A$1 billion) as part of its Top 100 programme and its review and audit of large public and multinational groups with a turnover of more than A$250 million continues through the 2018–19 year as part of its Top 1,000 programme. The focus of this review and audit activity is on transfer pricing, the application of the multinational anti-avoidance law ("**MAAL**") and thin capitalisation. In this review, the ATO has also placed special attention on a group's tax governance frameworks, including its approach to corporate tax disclosure.

Following audit or risk review activity, or as a result of more guidance issued by the ATO, Australian subsidiaries of multinational enterprises ("**MNE**s") applying for Advanced Pricing Arrangements ("**APAs**") also continued through 2018–19. These applications have become more involved than they once were, requiring the applicant subsidiary to devote not insignificant resources to complying with the significantly greater information and economic pricing analysis burden that an APA process now requires.

There continues to be significant corporate tax work from the private sector's involvement in delivering Federal and State Government's infrastructure programmes, whether in road and public transport investment or social infrastructure investment.

Significant deals and themes

Transfer pricing

Since the Senate Committee Hearing on Multinational Tax Avoidance and the Government's adoption of a range of integrity measures aimed at significant global entities ("**SGEs**"), the ATO continues to gather industry information from its review of SGEs. In 2018–2019, the ATO released the following guidance.

Embedded royalties

The ATO has also provided its view on the related issue of embedded royalties in payments under cross-border supply contracts. Through TA 2018/2, the ATO indicated two main concerns:

1) That arrangements between related parties were not being conducted in accordance with the arm's length principle, meaning that Australian entities were gaining a tax advantage through inflated deductions or the reduction of profit by not recognising the value added to transactions by Australian counterparties.

2) That withholding tax on royalties was being avoided by entities disguising royalty payments as mere payments paid solely for a tangible good or service.

Inbound distributors

In March 2019, the ATO released its view on the profit mark-ups for certain related party transactions pursuant to inbound distribution arrangements. PCG 2019/1 is a guide for Australian entities predominantly involved in the distribution of goods purchased from related foreign entities for resale. The ATO recognises four categories of inbound distributors: life sciences; information and communication technology; motor vehicles; and a general distributors category.

An entity's earnings before interest and tax ("**EBIT**") will be compared to its sales to calculate a profit percentage. This profit percentage is then compared to ATO profit markers for the relevant category of entity. An entity will then be classed into either a high, medium or low-risk zone.

Under the 'general distributors' category, low-risk entities will have an EBIT margin of above 5.3%, medium-risk entities between 2.1–5.3% and high-risk entities below 2.1%. A high-risk zone inbound distributor can expect the ATO to apply increased compliance activities through audits or risk reviews. The ATO warns no 'safe harbour' is created by the low-risk zone, and entities must still apply appropriate transfer pricing methodologies.

Demergers

We have recently seen some high-profile demergers within Australia, including the Coles/Wesfarmers demerger (see CR 2018/59) and AMA Group's proposed restructuring (which subsequently fell through after demerger relief was refused).

In March 2019, the ATO released a draft TD 2019/D1 which sets out what constitutes 'restructuring' for the purposes of subsection 125-70(1) of the *Income Tax Assessment Act 1997* (Cth) ("***ITAA 1997***"). The recent TD 2019/D1 has indicated a broader interpretation of 'restructuring' than previously indicated.

Of particular note is an example provided by the ATO which contradicts its previous stance on the availability of demerger tax relief where the demerger involves the 'sale of new interests via a sale facility' ("**Post-Demerger Sale Facility**"). Although ATO ID 2003/1053 (which dealt with this) was withdrawn on 19 February 2010, it found that the use of a Post-Demerger Sale Facility was consistent with sections 125-70(1)(c) and 125-70(2) of the *ITAA 1997*. Despite the ATO's reasoning that this withdrawn publication was a 'straight application of the law', a similar facility is used in Example 5 of TD 2019/D1 which is deemed to be inconsistent with these conditions.

Although TD 2019/D1 provides guidance on how the ATO will award demerger relief, the inconsistency justifies cautionary restructuring if the relief is sought.

Private equity

There is significant potential for high aggregate deal value in the private equity ("**PE**") sphere for the 2019–2020 financial year. Factors contributing to this prediction include high levels of cash reserves held by PE houses and the Australian central bank's decision to implement a record-low cash rate in July. However, in addition to the other changes discussed, the following two significant changes in tax legislation will impact PE transactions from 1 July 2019.

Existing tax exemptions for foreign pension funds and sovereign wealth funds will be limited to passive income and portfolio investments (typically interests of less than 10%).

As discussed below, a minimum 30% withholding tax on trading income converted to passive income distributed by a managed investment trust and as part of a stapled structure.

Key developments affecting corporate tax law and practice

Domestic case law developments

*Federal Commissioner of Taxation v Resource Capital Fund IV LP [2019] FCAFC 51 ("**RCF IV**")*

The much-anticipated decision in *RCF IV* has clarified the tax treatment of corporate limited partnerships in Australia, whilst also addressing a number of other complex international tax issues. The decision overturns the first-instance decision which held that certain gains made by two limited partnerships from a sale of shares in an Australian company should not be taxable in Australia on the basis that limited partnerships are not taxable entities.

RCF IV confirms that limited partnerships are to be treated as companies for Australian income tax purposes and are liable to pay income tax as an entity. Whilst limited partnerships are entitled to rely on treaty benefits, it is somewhat unclear how these benefits can be accessed.

The decision also confirms that a key consideration for determining the source of a gain by an offshore limited partnership fund will be the place of contract formation for the disposal, and that a disposal effected through a scheme of arrangement implemented pursuant to an Australian order will have an Australian source.

*Commissioner of State Revenue v Placer Dome Inc [2018] HCA 59 ("**Placer Dome**")*

On 5 December 2018, the High Court of Australia ("**HCA**") delivered its decision in *Placer Dome* which confirms the approach taken when ascertaining what constitutes an entity's 'goodwill'.

Placer Dome concerned Barrick Gold Corporation's acquisition of Placer Dome Inc ("**Placer**"). In the event that the unencumbered value of Placer's land was equal to more than 60% of the value of all its property, it would fall within the definition of a 'listed land-holder corporation' under Division 3b of part IIIBA of the *Stamp Act 1921* (WA) (now repealed and replaced with the *Duties Act 2008* (WA)), and *ad valorem* duty would be payable.

The HCA held that Placer had 'no material property comprising legal goodwill' and consequently met the 60% threshold. Goodwill for legal purposes extends 'to those sources which generate or add value (or earnings) to the business by attracting custom'.

*Glencore International AG & Ors v Commissioner of Taxation of the Commonwealth of Australia & Ors (S256/2018) ("**Glencore**")*

Glencore has been reserved for judgment by the HCA. In October 2014, the plaintiff engaged a Bermudian law firm to provide legal advice. In November 2017, the law firm had numerous client documents leaked to the media (known as the 'Paradise Papers'). As a result of the leak, the ATO came into possession of documents belonging to the Plaintiff. The issue before the Court is whether client legal privilege extends to restraining the ATO from using the documents, as opposed to the conventional use of legal professional privilege in blocking the compulsory production of such documents.

*Commissioner of Taxation v BHP Billiton Limited [2019] FCAFC 4 ("**BHP**")*

On 29 January 2019, the Full Federal Court handed down its decision in *BHP* which considered the meaning of 'associate' in section 318 of the *Income Tax Assessment Act 1936* (Cth) ("***ITAA 1936***") by reference to what constitutes sufficient influence. Section 318(6)(b) of the *ITAA 1936* states a company will be sufficiently influenced by another entity if the company, or its directors, is under an obligation (whether formal or informal), or might reasonably be expected to act in accordance with the other entity's directions.

The definition of 'associate' in section 318 of the *ITAA 1936* is used widely in Australian tax and, accordingly, this decision will have widespread application.

Recent domestic legislation and guidance changes

Corporate residency

An Australian tax-resident company can be incorporated in Australia, or not be incorporated in Australia if it carries on business in Australia with either central management and control in Australia or its voting power is controlled by shareholders who are residents of Australia. Most of Australia's tax treaties include a tie-breaker rule for dual-residency, usually by reference to the place of effective management, though this will be modified/removed for some treaties pursuant to the OECD Multilateral Instrument ("**MLI**").

The ATO has updated its guidance on the meaning of these tests in TR 2018/5 and PCG 2018/9, following the HCA decision in *Bywater Investments Limited v Commissioner of Taxation* (2016) 260 CLR 169.

Consolidation regime

In March 2018, the Federal Government introduced amendments to Australia's tax consolidation regime. The new laws provide certainty to multiple-entry consolidated groups in relation to how the integrity measures affect the tax cost-setting rules and calculation of allocable cost amounts for entities that join or leave the group.

Hybrid mismatch rules

This year, Australia joined the United Kingdom and New Zealand with the commencement of Australia's hybrid mismatch rules.

Australia's hybrid mismatch rules apply to certain payments made after 1 January 2019 and to income years commencing on or after 1 January 2019, irrespective of whether the underlying arrangement was entered into before or after that date. Whilst the existence of a 'payment' underpins the operation of Australia's hybrid mismatch rules, the term is deceptively narrow. In addition to capturing transfers of cash and non-cash benefits, the decline in value of an asset, an amount which represents a share in the net loss of a transparent entity (such as a partnership) and accrued amounts can also be caught.

Broadly, the rules seek to neutralise deduction/non-inclusion and deduction/deduction outcomes. It also applies to neutralise 'imported hybrid mismatches', whereby a deductible payment made by an Australian taxpayer is shielded from tax directly or indirectly by a hybrid arrangement entered into elsewhere within the corporate group. Neutralising a mismatch can involve a deduction being denied in Australia. However, and perhaps more alarmingly, the measures can result in amounts being deemed to be included assessable income.

These rules pose significant challenges for both private and in-house tax practitioners. Not only do the rules require knowledge about the operation of foreign tax regimes, but also an intimate knowledge of intra-group arrangements which exist within a corporate group, even if there is no obvious direct link with Australia. The latter may prove to be a particular challenge for Australian companies in foreign multinational groups as the rules assume a level of knowledge and intimacy with the rest of the group's tax affairs which, in practice, may not exist. Perhaps the only respite, albeit a temporary one, is that Australia's imported hybrid mismatch rule will only apply to non-structured arrangements from income years commencing on or after 1 January 2020 (which is intended to align with the European Union's introduction of hybrid mismatch rules).

Finally, whilst Australia's hybrid mismatch rules generally follow the OECD model which came out of BEPS, with measures including amendments that deny imputation (i.e. franking)

benefits on distributions which are deductible in a foreign jurisdiction and denying access to Australia's participation exemption for distributions that are deductible in a foreign jurisdiction, there is one uniquely Australian feature to the Australian hybrid mismatch rule.

The unique feature (and key departure from the OECD model) is the inclusion in Australia's hybrid mismatch rules of a targeted integrity measure which will have a significant impact on intra-group financing arrangements within a multinational group. Very broadly, the integrity rule has the potential to deny deductions on interest payments (or amounts in substitution for interest) and payments under derivative financial arrangements which are not subject to foreign income tax in at least one jurisdiction at a tax rate of more than 10%. Accordingly, groups with special purpose financing vehicles in low-tax jurisdictions will need to carefully analyse their existing funding structures.

Thin capitalisation

The thin capitalisation rules have been amended to deny foreign investors from taking advantage of 'double-geared' structures which seek to convert active business income to interest income (subject to a lower withholding tax rate). These structures were achieved by 'layering' multiple flow-through entities, each of which issued debt against the same underlying asset allowing investors to gear higher than the thin capitalisation limits intended.

The 'associate entity' provisions in subdivision 820-I of the *ITAA 1997* were intended to prevent these double-gearing arrangements by requiring the grouping of associate entities when working out each entity's debt limit. Prior to 1 July 2019, an entity would only be an 'associate' if the interest held in an underlying trust or partnership was 50% or more. Since 1 July 2019, however, an entity will be an associate if the other entity holds 10% or more in the underlying trust or partnership.

An integrity measure has also been included through the operation of sections 820-905(2B)(b) and 820-905(2C) of the *ITAA 1997*, which treat the holdings of two or more related entities holding less than 10% to be associates if it is reasonable to conclude that one of the entities did so for the principal purpose of ensuring the other entity or entities would not be an associate.

Foreign citizen stamp duty

States generally

Foreign buyers (depending on how foreign person is defined) may pay the following foreign surcharge duty in addition to transfer duty in respect of the purchase of mainly residential property:

- 8% (in New South Wales);
- 7% (in Victoria, Queensland, Western Australia and South Australia);
- 3% or 0.5% (in Tasmania, depending on whether the property is residential or primary production property); or
- 0% (in the Australian Capital Territory and Northern Territory).

New exemption in New South Wales

From 1 July 2019, there is an exemption from the foreign person surcharge duty if a retirement visa (subclass 405 or 410) is held. This is significant because retirement visa holders are merely temporary visa holders.

Similar business test

On 1 March 2019, the similar business test was introduced with the effect of increasing the ease of which companies can access their previously incurred tax losses. As a result,

company tax losses incurred throughout previous income years can now be carried forward and deducted in future income years if they, throughout the relevant test period, continue to carry on a 'similar business' to previous income years.

Generally, the regime now permits tax losses from prior income years to be deducted against the assessable income of a company in a later income year if:

1) the continuity of ownership test ("**COT**") is satisfied; or
2) where a company fails the COT, the business continuity test ("**BCT**") is satisfied. In general terms, the BCT will be satisfied if the company either:
   (a) carries on the same business as it carried on immediately before the test time ("**Same Business Test**"); or
   (b) carries on a business that is similar to the business it carried on before the test time ("**Similar Business Test**").

LCR 2019/1 echoes section 165-211 of the *ITAA 1997* and sets out four mandatory factors to be considered when ascertaining whether a current business is a 'similar business' to the former business. These factors to consider include:

1) the extent to which the assets (including goodwill) used in the current business were also used in the former business to generate assessable income;
2) the extent to which the activities and operations of the current business were also the activities and operations from which the former business generated assessable income;
3) the identity of the current business compared to the former business; and
4) the extent to which any changes to the former business resulted from development or commercialisation of assets, products, process, services or marketing or organisation methods of the former business.

Importantly, practitioners should note that the Similar Business Test can only be used to access tax losses, net capital losses, or bad debts incurred on or after 1 July 2015.

Stapled structures

As communicated by TA 2017/1, the ATO was concerned that stapled structures may be used to re-characterise trading income into more favourably-taxed passive income. Under a stapled structure, income that may be subject to company tax can be diverted to a related trust where, on distribution from the trust, that income is subject to no tax or a lesser rate of tax than the corporate tax rate.

In an effort to limit access to concessions available to foreign investors for passive income, the *Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Act 2019* (the "**Stapled Structures Act**") was introduced.

Under Schedule 1 of the Stapled Structures Act, the managed investment trust ("**MIT**") withholding rate on fund payments that are attributable to non-concessional MIT income was increased to 30%.

This increased withholding rate applies from 1 July 2019.

BEPS

BEPS and OECD Multilateral Instrument

Australia remains committed to the BEPS Action Plan and has now implemented recommendations from BEPS Actions 2, 5, 8–10, 13, 14 and 15.

Australia ratified the MLI on 26 September 2018 and, by virtue of domestic legislation that received royal assent and became law on 24 August 2018, the MLI entered into force in Australia on 1 January 2019.

It is expected that the MLI will modify 32 of the 45 bilateral tax treaties currently in force with Australia. Key MLI positions Australia has adopted include the fiscally transparent entity provisions, the principal purpose test and the mandatory binding arbitration articles (subject to certain conditions).

Tax climate in Australia

Consistent with global trends, Australia's economy has been slowing. As a result, the Federal Government continues to implement corporate tax relief and tax concessions, while simultaneously working to reduce the tax gap and achieve an operating surplus of approximately A$7.1 billion for the 2019–20 year. The ATO estimates that the net income tax gap for large corporate groups was A$1.8 billion in 2015–16, which is equivalent to 4.4%. By comparison, the ATO estimates that the net tax gap for individuals not in business is A$8.76 billion, equivalent to 6.4%. Due to the community perception of large MNEs and pressure to build confidence in the community, MNE tax compliance remains high on the ATO's agenda. The ATO is also turning greater attention to the black (or cash) economy to reduce the small business income tax gap, estimated at approximately A$10 billion.

Corporate tax relief

Australia continues to implement its plan to gradually lower the corporate tax rate for corporate entities who meet the aggregated turnover threshold and have no more than 80% base rate entity passive income. The plan commenced from the 2016 income year, before which time all corporate entities were subject to a tax rate of 30%. For this income year, the corporate tax rate for entities with aggregated turnover under A$50 million, and no more than 80% base rate entity passive income, is 27.5%. By the 2022 income year, this rate will be down to 25%. All other corporate entities remain subject to a corporate tax rate of 30% in Australia.

Instant asset write-off

In the days following the announcement of Australia's 2019 Federal budget ("**2019 Budget**"), the *Treasury Laws Amendment (Increasing and Extending the Instant Asset Write-Off) Act 2019* was passed to expand the availability of instant asset write-offs for small businesses under the *ITAA 1997*. The instant asset write-off provisions allow small businesses to write off assets in the first year in which they are used or installed ready for use. The legislation extends the operation of the provisions by 12 months to 30 June 2020. The legislation also expands the scope of the concession to cover assets costing less than A$30,000 and to include medium-sized businesses with an aggregated turnover from A$10 million up to A$50 million for assets acquired after 7.30pm AEDT on 2 April 2019. Business with an aggregated turnover of up to A$10 million can also access the instant asset write-off for assets costing less than A$25,000 and acquired from 29 January 2019 until before 7.30pm (AEDT) on 2 April 2019, and assets costing less than A$20,0000 and acquired from before 29 January 2019.

ATO Tax Avoidance Taskforce

As part of the 2019 Budget, the Government announced it will provide additional funding of A$1 billion over four years from 2019/20 to extend the operation of the ATO's Tax Avoidance Taskforce. The Tax Avoidance Taskforce was established in 2016 and undertakes compliance activities targeting MNEs, large public and private groups, trusts and high wealth individuals. The Government has noted that the funding will allow the Taskforce to expand its activities, including increasing its scrutiny of specialist tax advisors and intermediaries that endorse tax avoidance schemes and strategies. The Government estimates that the additional funding for the Taskforce will result in a fiscal gain of A$3.6 billion over the forward estimates period.

Black economy: strike approach and TRPS expansion

It has been estimated that the black (or cash) economy costs the broader community an estimated A$50 billion. Common practices contributing to the problem include not declaring income, not recording all income, and not reporting income from weekend sales. To address the problem, the ATO is implementing a 'mobile strike approach' that will see it visit up to 10,000 businesses around Australia each year for the next three to four years, and expanding the taxable payments reporting system ("**TPRS**") under which certain businesses need to report the payments they make to contractors for services. Since 1 July 2019, businesses in IT, road freight and security and investigative services industries have been required to start reporting through the TPRS.

As part of another initiative to combat the black (or cash) economy, since 1 July 2019, businesses wanting to tender for Commonwealth Government contracts over A$4 million (including GST) have also needed a statement of tax record from the ATO.

Client legal privilege

In recent years, the ATO has become increasingly sceptical about CLP claims. At the Australian Tax Institute's 34th National Convention, held in March 2019, Commissioner Chris Jordan stated that the ATO '[will] be taking a tougher stance in the future' due to rising concerns that CLP is being relied on to 'cheat the system' and conceal contrived tax arrangements.

At the National Tax Liaison Group held on 30 November 2018, the ATO provided supplementary materials exploring its key concerns with purported CLP claims. These broadly concerned claims made with reckless disregard as to satisfying the elements of a CLP claim or possible waiver, advice being prepared by non-lawyers but rubber stamped by lawyers, and claims being made over non-privileged commercial/entrepreneurial advice. Once again, these were all underpinned by an apprehension of tax avoidance.

In addition to CLP, the ATO offers administrative concessions such as the Accountant's Concession and Corporate Board Advice Concession which largely preserve confidentiality for tax compliance advice received from qualified accountants or to corporate boards. Currently, the ATO maintains that such concessions will only be lifted in 'exceptional circumstances'.

APAs and MAPs

The ATO continues to encourage taxpayers to enter in APA and mutual agreement procedures ("**MAPs**") in respect of the international tax arrangements with their related parties. However, there also continues to be criticism of the administration of these programmes by the ATO.

All of Australia's treaties in its treaty network contain a MAP provision. On 30 August 2018, the Stage 1 MAP Peer Review Report for Australia was published (as part of the BEPS Action 14 peer review and monitoring process, which was launched by the OECD in December 2016). The report found that Australia's treaty network was not yet fully compliant with the BEPs Action 14 minimum standards. The report also observed that there is limited guidance on the availability of MAP in Australia.

Taxpayers have reported experiencing problems when negotiating APAs with the ATO, including long delays, numerous and onerous information requests and indecisiveness by the ATO. Some APAs remain unresolved after three or four years of negotiation. In recent times, the number of active APAs has been declining significantly. Since the 2012 income year, the number of active APAs has decreased by 30%.

Disclosure requirements and tax governance

Tax Transparency Code

In February, the Board of Taxation released a consultation paper which provided a post-implementation review of the Tax Transparency Code ("**TTC**"), as well as some proposed changes to the current framework. These included changes to minimum standards and best practice, the inclusion of a 'basis of preparation statement' and reconciliation between reports produced under the TTC and the ATO annual corporate tax transparency disclosures. The Board accepted external views on the proposed changes until late March – no update has been provided as yet.

Justified Trust Program and risk ratings

The ATO continues to employ the Justified Trust Program to the top 100 and top 1,000 taxpayers simultaneously. The year of 2019 is the final one in which the ATO will apply risk categorisations to the top 100. The three tiers of categorisation are (from low to high): key taxpayer; key taxpayer with significant concerns; and higher risk. The ATO will provide further guidance on the 2020 approach to top 100 risk ratings later in the year.

*Reportable Tax Position ("**RTP**")*

Since 30 June 2019, the ATO no longer issues notifications to taxpayers required to lodge an RTP. The task of assessing the necessity of lodgement now rests with the taxpayer. In most cases, satisfying all of the following criteria means lodgement of an RTP is required:

- having a public company or a foreign owned company;
- having total business income of A$25 million or more in the current tax return; and
- being part of a public or foreign owned economic group with a total business income of A$250 million or more in the current or immediately prior year.

*Country-by-country ("**CbC**") reporting*

The ATO continues to enforce obligations on SGEs as a means to successfully implement CbC reporting (Action 13 of the BEPS Action Plan). The obligations include providing a CbC report, Master file and Local file.

Tax authorities sharing information globally

In addition to standard information-sharing practices, the ATO has played a significant role over the past year as part of J5. J5 is a team of tax authorities from Canada, USA, the Netherlands, the UK and Australia that aims to combat international tax evasion and money laundering. A media release published in June 2019 outlined that J5 is currently involved in more than 50 investigations. The sharing of intelligence and data in real time plays an integral role in J5's success.

Developments affecting attractiveness of Australia for holding companies

Australia has three key measures in its domestic tax law which are intended to make Australia a more attractive jurisdiction for holding companies. These have not changed.

First, non-deductible dividends derived by Australian tax resident companies obtain the benefit of a participation exemption where the Australian tax resident company holds at least 10% of the foreign resident company.

Second, Australia has a participation exemption in respect of capital gains derived from capital gains tax events with respect to shares held by Australian tax resident companies in foreign resident companies where the Australian tax resident company holds at least 10%

of the foreign tax resident company. The participation exemption is reduced to the extent that the foreign tax resident company is not carrying on active business.

Third, Australian domestic tax law provides 'conduit foreign income' rules (or "**CFI rules**"). Under the CFI rules, dividends paid out of profits sourced from dividends and capital gains that obtain the benefit of the participation exemptions are not subject to Australian dividend withholding tax.

Industry sector focus

E-commerce/digital economy

Digitalisation and e-commerce are increasingly enabling firms to play a significant economic role in Australia despite having a limited physical presence within the jurisdiction. In an attempt to address this evolving business practice, a Treasury Discussion Paper titled 'The digital economy and Australia's corporate tax system' was released in October 2018. Amongst other things, the paper indicates that legislative and policy changes are required to address the nature of this industry through mechanisms such as the recent introduction of BEPS reporting.

Concurrently, MAAL, which took effect from 1 January 2016, acts as another form of integrity measure within Part IVA of the *ITAA 1936*. MAAL only applies to foreign entities that are considered significant global entities that have significant activity in Australia and seeks to prevent artificial structures and arrangements that result in the avoidance of a taxable presence in Australia. The 'look through' provisions which allow for the assessment of the intent behind certain arrangements as well as the expanding of the definition of significant global entity, effective from 1 July 2018, are particularly noteworthy.

Pharmaceutical

The ATO is currently engaged in a review of the tax compliance and transfer pricing practices of the pharmaceuticals industry. This is focused on related party financing, thin capitalisation, intellectual property migration, consolidation, business restructures and research and development.

Diverted profits tax came into effect on 1 July 2017, ultimately imposing a tax rate of 40% on amounts of diverted profits. It is aimed at arrangements where profits made in Australia are diverted to a tax jurisdiction where the tax rate is less than 24%. Businesses need to consider their status as significant global entities as well as the structuring of their arrangements to determine whether these provisions would apply.

Energy and resources

In Australia, the tax landscape in the energy and resources industry is heavily influenced by the Energy and Resources Working Group. This is a group comprised of representatives of tax professional bodies, resource industry associations and the Australian Taxation Office.

In Australia, there exists a regime of fuel tax credits which allows businesses to claim credits for the fuel tax, whether it be excise or customs duty that is inherently included in the price of fuel used in business activities. This is caveated by certain requirements under the scheme, including that the business must be registered for GST and that it does not apply to fuel used by light vehicles on public roads. The amount of fuel tax credit available is calculated by multiplying the number of eligible litres of fuel by the applicable rate. This applicable rate changes twice a year in both February and August based on the consumer price index.

The Petroleum Resource Rent Tax ("**PRRT**") is a tax on profits generated from the sale of oil and gas products which are referred to as Marketable Petroleum Commodities ("**MPCs**"). PRRT arises in situations in which a project has recovered all eligible expenditure including

certain exploration costs resulting in a certain threshold rate of return on these outlays. The amount of PRRT paid is reduced by the amount of royalties and excise paid in the relevant State and Federal jurisdictions. From 1 July 2019 changes will be made to this regime, including removal of onshore projects from its hold. Note that these projects will still be subject to the applicable State Royalties. Given the volatility of commodity prices, the ATO have flagged an intention to enter into Annual Compliance Arrangements ("**ACAs**") and APAs.

Financing arrangements

Following an Australian Full Federal Court's decision in *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* (2017) 251 FCR 40, the ATO has published further guidance setting out its views on the transfer pricing issues associated with financing arrangements. Recently, the ATO has issued:

1) PCG 2017/4 in relation to cross-border related party financing arrangements and related transactions. An updated version of this PCG has been issued as a draft for public comment until 31 August 2018;
2) PCG 2017/8 in relation to the use of internal derivatives by multinational banks;
3) TD 2018/D6, concerning the interaction between Australia's transfer pricing provisions in subdivision 815-B and debt/equity characterisation rules in Division 974 of the *ITAA 1997*; and
4) TR 2019/D2, which provides updated guidance on the 'arm's length debt test' in the thin capitalisation provisions, including discussion on how the arm's length debt test interacts with the transfer pricing rules.

Hubs

Offshore hubs remain a key focus of the ATO in the context of transfer pricing and international risk. On 11 October 2018, the ATO updated PCG 2017/1 by publishing a new Schedule focused on Australian tax risk assessment for offshore non-core procurement arrangements. PCG 2017/1 was originally released in January 2017 with initial guidance focusing on marketing hubs.

The year ahead

In the 2019 Budget, the Federal Government forecast a budget surplus of A$7.1 billion for 2019/20. This would be Australia's first surplus in 12 years. However, this is a modest surplus and, in the year ahead, the Government will continue to employ tax incentives as a stimulus for a slowing economy (such as the expansion of the instant asset write-off outlined above).

In July 2019, the Federal Government was able to pass personal income tax cuts which will phase in over three stages over the period 1 July 2018 to 1 July 2024. By 1 July 2024, the income tax scales applying to the taxable income of individuals will be streamlined. The four tax brackets which currently apply will be reduced to three tax brackets with the 37% bracket being abolished, leaving taxable income in the range of A$41,000 to A$200,000 being subject to a 32.5% tax rate.

* * *

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Belgium

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Overview of corporate tax work over last year

Types of corporate tax work

The Belgian market is not structured in a way that it is possible to detect (and have an overview of) the main types of corporate tax work that are done.

However, at present, three particular trends are noticeable in the Belgian corporate tax market. First, one of the focus areas of the tax authorities remains transfer pricing, and the tax authorities recently initiated a new wave of transfer pricing audits. In this respect, the tax authorities are investing in additional manpower and in the effectiveness of such audits. Second, there has been an increase in work (including litigation work) related to corporate reorganisations, including capital reductions and dividend distributions, and corporate migrations. Third, there has been an increase in litigation regarding the deductibility of costs of a company.

Significant deals and themes

The Belgian market is not organised in a way that information regarding the corporate tax market is readily available or in the public domain.

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

(a) Cases

Case law in Belgium is very extensive. However, not all case law is published in a systematic manner. Moreover, judgments do not have a precedential value. There are a few exceptions to the aforementioned rule. First, annulment judgments of the Belgian Constitutional Court have an *erga omnes* effect. Second, judgments of the Constitutional Court on a preliminary ruling *de facto* also have an *erga omnes* effect. Third, judgments of the Court of Cassation or Supreme Court often have, in practice, the same value as a precedent.

Over the past year, there were several important judgments in the context of corporate reorganisations. Below, we highlight three of them.

- **Limitation of tax losses in case of tax-neutral merger (or (partial) demerger)**

  In case of a tax-neutral merger, Belgian tax law provides that the carried-forward tax losses of both the absorbed and the absorbing company are subject to a limitation (a so-called "loss limitation rule"). Pursuant to this limitation rule, the carried forward tax losses of the companies involved are reduced based on the proportionate net fiscal value of the absorbed company (before the restructuring) compared to the sum of the net fiscal values of both the merging entities (before the restructuring).[1]

The Belgian tax authorities traditionally took the viewpoint that this loss limitation rule also applied to current year tax losses, while Belgian doctrine often took the position that the loss limitation rule only applied to prior year tax losses.[2] In addition, it was highly debated whether the net fiscal value of the absorbing company needed to be calculated prior to or post the merger.

By the judgment of 25 January 2019,[3] the Belgian Supreme Court decided that the carried forward tax loss limitation only applies to prior year tax losses (i.e. the losses existing at the last financial year-end before the tax-neutral reorganisation). Therefore, all tax losses realised during the financial year in which the merger took place are to be entirely maintained. The Belgian Supreme Court also clarified that the net fiscal value of the absorbing company is the value existing at the last financial year-end before the tax neutral reorganisation.

The reasoning of the Belgian Supreme Court could also be applied to other reorganisations where the tax loss limitation rule is applicable, such as in case of partial demergers.

- **No tax deductions in abnormal economic circumstances**

  On 24 May 2019,[4] the Belgian Supreme Court judged in two cases that the special anti-abuse rule, whereby a number of deductions cannot be applied if the Belgian company receives so-called abnormal or gratuitous advantages, also applies with respect to the notional interest deduction ("NID"). The Court traditionally defines these "abnormal or gratuitous advantages" as advantages that are received under abnormal circumstances in the framework of transactions that cannot be explained by economic reasons, but solely by tax reasons. It thus does not suffice that the transactions are carried out at arm's-length conditions.[5]

  Both cases involved a Belgian financial vehicle that was incorporated in order to benefit from the Belgian NID regime when foreign acquisitions were made. From the facts, it appears that the Belgian financing vehicles apparently did not have much substance.

- **Deductibility of interest in relation to equity decrease**

  The Belgian tax authorities tend to contest the deductibility of interest related to a decrease of the equity of a company by way of a capital decrease and by way of a distribution of a "*superdividend*". Both the court of appeal of Ghent (judgment of 9 January 2018) and the court of appeal of Antwerp (judgment of 16 May 2018) refused the deductibility of interest made in the context of a so-called "leveraged dividend distribution" (paid on a loan contracted to proceed to the distribution of a superdividend). This position is highly debatable. According to our information, an appeal before the Belgian Supreme Court was filed in both cases. Up to date, there is no judgment of the Belgian Supreme Court as of yet.

(b) Legislation

Over the past few years, international movements have led to a shift in the corporate tax landscape.

Indeed, in the aftermath of the BEPS project, substantial changes have occurred at the EU level, which also had an impact in Belgium. Reference can be made to the recent modifications to the Parent-Subsidiary Directive, the Anti-Tax Avoidance Directives and the decisions of the European Commission regarding state aid and the excess profit rulings. The main changes in Belgian tax law that were influenced by BEPS or EU developments will be

discussed below (see section *(b) Leglislation* under "European – CJEU cases and EU law developments" below).

In addition to the changing legal framework in the context of international developments, 2017–2019 was also a timeframe during which a number of (purely) domestic changes to corporate tax law occurred, the most important one being the major corporate income tax reform. The purpose of the Belgian corporate income tax reform was mainly to preserve the Belgian competitive tax regime and to provide a favourable entrepreneurial environment. With the goal of limiting budgetary losses expected from these positive tax measures, several measures to broaden the corporate tax base were introduced as well. This was mainly achieved by transposing into domestic tax legislation the anti-BEPS provisions of the European Union (EU) Anti-Tax Avoidance Directives I and II.[6]

The main changes to Belgian corporate tax law, pursuant to the Belgian corporate income tax reform, are as follows:[7]

- **Reduction of the Belgian corporate income tax rate**

  A reduction of the Belgian corporate income tax rate has been under consideration for years, but could so far never be achieved due to budgetary constraints. In the framework of the Belgian corporate income tax reform, Belgium has now reduced its corporate tax rate (including Belgium's temporary crisis surtax) from 33.99% to 29.58% (for assessment years 2019 and 2020)[8] and to 25% (as of assessment year 2021).[9] Provided that certain conditions are fulfilled, SMEs can benefit from lower rates.[10]

  A specific anti-abuse rule ("SAAR") refuses the new, lower tax rates in case of taxable reversals of tax-exempt provisions or reserves that have been recorded in a taxable period closing at the earliest on 1 January 2017 and at the latest on 30 December 2020.[11] Exempt investment reserves and capital gains on trucks, barges and sea vessels and deferred capital gains which have become taxable, prior to reinvestment, pursuant to non-compliance with the intangibility condition due to lack of timely reinvestment, fall within the scope of this SAAR, as well as tax-exempt provisions.[12]

- **Improved holding tax regime**
  - Changes to the dividends received deduction ("DRD")
    Traditionally, Belgium's DRD for qualifying shareholdings (i.e., representing at least 10% of the share capital or with an acquisition value of at least €2.5m) was limited to 95% of the gross dividend received. In 2018,[13] the DRD was increased to a 100% deduction.[14]
  - Changes to the capital gains exemption
    Up to 2017, capital gains on qualifying shareholdings were exempt from ordinary corporate income tax but were subject to a special corporate tax of 0.412% (except for SMEs), irrespective of the size of the shareholding. This special levy was abolished with effect from 2018.[15] Therefore, non-SMEs can also benefit from a full tax exemption for capital gains on qualifying shareholdings.
    The 100% capital gains exemption is now subject to the minimum holding requirement that also applies to the DRD.[16] This implies the application of (i) a minimal participation of 10% or €2.5m,[17] (ii) a minimum holding period of one year,[18] and (iii) a subject-to-tax condition at the level of the subsidiary.[19] The 100% capital gains exemption will only be allowed "to the extent" of the DRD entitlement. In case of proportional DRD, the capital gains exemption will also be proportional.[20]

- Changes to the dividend withholding tax exemption
  Belgium applies the dividend withholding tax exemption under the EU Parent Subsidiary Directive for shareholdings of 10% or more to dividends paid to qualifying parent companies established either in the EU, EEA or in the United States or other qualifying tax treaty countries (i.e., any country outside the EEA that has a tax treaty with Belgium containing an adequate exchange of information clause). In line with the *Tate & Lyle* case law of the Court of Justice of the European Union,[21] a reduced withholding tax rate of 1.6995%[22] was introduced in 2015 for Belgian-sourced dividends paid to a qualifying foreign company holding a participation of less than 10% but having an acquisition value of at least €2.5m. In line with the extension of the 95% DRD to a full 100% deduction, this reduced dividend withholding tax rate was accordingly replaced by a full exemption from dividend withholding tax (effective since 1 January 2018).[23]

- **Tax consolidation regime**

  As of 2019, Belgian tax law contains an optional tax consolidation regime inspired by the so-called Scandinavian style of group contribution regime.[24] It does not constitute an actual tax consolidation. Each company involved in the tax consolidation remains a separate corporate taxpayer that is required to file its own annual corporate tax return and to report its own individual corporate tax base. Companies can benefit from the tax consolidation regime as of assessment year 2020.

  Under this regime, Belgian companies or Belgian permanent establishments ("PEs") of non-resident companies established in the EEA that are part of a group are allowed, subject to certain conditions, to transfer taxable profits to their loss-making group company (or PE) with which they have a direct relationship in terms of capital of at least 90% via a group contribution agreement.[25] To compensate the transferee for receiving the taxable result, the transferor must pay compensation equal to the saved taxes. The compensation is a non-deductible cost for the transferor and qualifies as exempt income for the transferee.[26]

  This tax consolidation regime only applies to profits and losses of the concerned taxable year. It does not apply to losses carried-forward or other tax assets. One of the conditions required for the optional consolidation regime is that the participation must be held for an uninterrupted period of five years. This five-year period commences on 1 January of the fourth calendar year, for the calendar year on which the assessment year is based. Consequently, new entities would not be able to benefit immediately from the consolidation regime.

  Simultaneously with this new group contribution regime, Belgium introduced another rule that has a consolidation-like effect, as part of Belgium's new EBITDA-based interest deduction limitation rules.[27] Under these rules, excess interest deduction capacity can be transferred between affiliated companies. The affiliation required for such interest deduction capacity transfers is much more flexible than the 90% direct participation requirement for the group contribution regime: as a rule, a mere majority of shares held during the entire tax year concerned suffices.[28] If applicable, both the group contribution regime and the interest deduction capacity transfer agreement can be combined.

- **Limit on the NID**

  The Belgian NID regime has always been very successful in increasing foreign direct investments in Belgium. However, the regime has been heavily criticised over the last

few years. Pursuant to this criticism, the NID regime was modified in the framework of the corporate income tax reform.

The NID regime consists of the deduction from the corporate tax base of a notional interest determined as a percentage of an equity-related calculation basis.[29] Traditionally, the deduction was calculated on the company's total accounting equity. Since 2018,[30] the deduction has been limited to a deduction calculated on the "incremental (i.e., the increase in) net equity" (capital increases plus retained earnings) of a company over a period of five years.[31] The incremental equity is equal to ⅕ of the positive difference between the net equity at the end of the tax year concerned minus the equity at the end of the fifth preceding year.

As a consequence of the new rule and the current low rate of the NID (for assessment year 2020: 0.726%; and 1.226% for SMEs), the impact of the NID significantly decreased.

- **Limitation carry-forward for tax losses**

  Up until the end of 2017, Belgian tax law contained an unlimited carry-forward of tax losses (in terms of both amount and timing).

  As of assessment year 2019 (for taxable periods starting as of 1 January 2018), the use of certain tax assets (like tax losses carried forward) is limited for any taxable year to €1m plus 70% of the taxable income above €1m, leading to a "minimum taxation" of the remaining 30%.[32] Expenses which cannot be deducted due to the minimum taxable income limitation may, however, be carried forward to the following years.[33] The minimum taxable income limitation is not applicable to tax losses incurred by small and medium-sized enterprises during the first four financial years post incorporation.[34]

- **Capital reimbursements**

  Until 31 December 2017, a capital reimbursement could, for tax purposes, be entirely imputed on the paid-up capital of a company, even if the company had reserves. Since 1 January 2018, capital reimbursements have been imputed proportionally on the paid-up capital and the existing reserves, leading to a (taxable) dividend to the extent that the reimbursement is imputed to the existing reserves.[35]

- **Entry into force of new measures aiming to prevent tax fraud and tax evasion with respect to movable withholding tax**

  Over the past year, movable withholding tax abuse was a highly-debated topic in the European press.[36] By the Law of 11 January 2019 (which entered into force on 22 January 2019),[37] various measures were introduced in this respect. The measures aim to prevent tax fraud and evasion and correspond to the aspirations that were set forward in the press.

  Some measures that were introduced by the Law of 22 January 2019 were modified by the Law of 28 April 2019.[38]

  The main changes following the Laws of 22 January 2019 and 28 April 2019 can be described as follows:

  - In case of artificial constructions, no withholding tax exemption, credit or reimbursement can be claimed. A rebuttable presumption is introduced for dividends received by pension funds with regard to short-term participations. Following the new rule, if the pension fund has held the securities from which the dividend originates for less than 60 days, the transaction will be deemed to be artificial. In such case, the pension fund will need to prove that, despite the short

holding period, the transaction is not artificial. In the absence of such proof, no withholding tax exemption, credit or reimbursement can be applied.[39]

- In order to be able to offset the movable withholding tax, a taxpayer must have had the *full ownership* of the underlying securities on the date on which the beneficiaries of the dividend are identified.[40]
- A movable withholding tax exemption for dividends in kind (listed corporate actions or shares) received by Belgian tax residents from listed companies pursuant to a spin-off transaction is introduced.[41] This modification aims to eliminate the previous different treatment of spin-off transactions and partial demergers.
- Pursuant to the Laws of 22 January and 28 April 2019, the beneficiary of distributed dividends is to be considered as the debtor of the movable withholding tax if (i) an unlawful movable withholding tax exemption was granted or when movable withholding tax was wrongly refunded, or (ii) to the extent that the unlawful exemption or the incorrect refund derives from an "incorrect statement" made by the beneficiary.[42] This is a confirmation of a rule that existed already before the Law of 22 January 2019.

- **Reporting and withholding tax obligations for Belgian employers and companies**

  As of 1 March 2019, Belgian employers will need to withhold and report professional withholding tax if foreign companies that are linked with a Belgian company grant taxable income to employees or company directors that work for the Belgian company.[43]

- **Changes with regard to tax rulings**

  Tax rulings can no longer be issued on transactions or situations related to a tax haven that is not cooperative with the OECD or to a country mentioned in the list of States with low or no taxation (except if the country exchanges information with Belgium).[44]

- **Changes in tax procedure**
  - Late payment interest

    Until the end of 2017, late payment interest in favour of the taxpayer and late payment interest in favour of the tax authorities were both 7%. As of 2017, the late payment interest has been linked to the 10-year government bond, and the late payment interest to be paid to the Belgian State is double the interest to be received from the Belgian State. For 2018 and 2019, this leads to an interest of 4% if due by the taxpayer, and 2% if due by the tax authorities.[45] The Constitutional Court ruled on 29 November 2018 that the new law is not contrary to the principle of equality.[46] According to the Constitutional Court, it is justified for a taxpayer to pay a higher interest. It is also justified that the taxpayer is only entitled to interest that is 2% lower than the person himself has to pay to the tax authorities. Reference is made to the capacity of the State representing the public interest. For the interest due by the tax authorities to start running, a notice of default is required, whereas before interest started running automatically.[47]
  - New tax dispute resolution mechanism for cross-border tax disputes

    Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union provides for a more effective procedure for resolving cross-border tax disputes. The Directive was implemented into Belgian law by the Law of 2 May 2019. Under the new regime, the competent authorities of EU Member States have the obligation to solve taxation that is not in accordance with the applicable double income tax treaties in an efficient and

conclusive manner. The new procedure is possible as from 1 July 2019 for taxable periods starting at the earliest on 1 January 2018.[48]

- **No digital service tax (so far)**

  Belgium follows the discussions at both EU and OECD levels on proposals for comprehensive digital taxation measures with genuine interest, but is concerned about the potential impact on both digital and traditional businesses if such new fiscal measures are not applied on a sufficiently large international scale.

  At the EU level, proposals for a digital services tax[49] have been advocated since 2018 by the EU Commission and certain specifically interested EU Member States. The proposals are, however, unlikely to be adopted at the EU-level in the short term (even after a substantial reduction of the scope of the tax compared to the initial proposals). This prompted certain EU Member States to pursue or initiate their own digital services taxation measures at the national level. Belgium has abstained thus far from introducing new taxes on digital services or digital products at its own national level, as it fears that national divergent measures are likely to increase the existing problems.

European – CJEU cases and EU law developments

(a) Cases

- **Fairness tax**

  From 2013 to 2017, a fairness tax of 5.15% was applicable on the amount of dividend distributed out of current profits that have been offset by carry-forward losses. The Constitutional Court and the CJEU held certain aspects of the fairness tax to be incompatible with Belgian and EU law.[50] With effect from 2018, the fairness tax was therefore abolished. For 2013 to 2017, the effects of the abolished tax are maintained as far as the tax does not concern the situation of a Belgian company redistributing a dividend, as this was considered incompatible with EU law.

- **Excess profit rulings**

  On 14 February 2019, the General Court annulled the European Commission's state aid decision of 11 January 2016 on Belgian excess profit rulings.[51] Under the excess profit rulings, the corporate tax base was reduced for excess profits that resulted from being part of a multinational group.[52] According to the General Court, the European Commission[53] wrongly qualified the Belgian excess profit ruling system as a general state aid "scheme" rather than examining the 66 tax rulings individually. However, the General Court did not address the arguments addressing the findings of the European Commission of selectivity and of an advantage. On 24 April 2019, the European Commission brought an appeal against the judgment of the General Court.[54]

- **Danish cases on "beneficial ownership" and "tax abuse"**

  On 26 February 2019, the CJEU issued its landmark judgments in *T. Denmark and Y Denmark vs. the Danish Ministry of Taxation*[55] and in *N Luxembourg 1, X Denmark A/S, C Denmark I and Z Denmark ApS vs. the Danish Ministry of Taxation*.[56] The first case relates to the dividend withholding tax exemption as provided for in the Parent-Subsidiary Directive (the "Dividend case"), whereas the second case deals with the interest withholding tax exemption provided for in the Interest and Royalties Directive (the "Interest case").

  The underlying issue was whether dividend and interest payments were exempt from withholding tax when the payments were made from a Danish company to a company

resident within the EU, which then fully or partially passed on the payments to an ultimate parent company residing in a third country.

The CJEU stated that the application of the principle of abuse of rights is a general EU law principle and offered guidance on its application as well as the related burden of proof in case of intermediary holding companies. In this regard, the CJEU stated that the taxpayer cannot rely on primary EU law if the withholding tax exemption was denied due to the abusive nature of the transaction. Moreover, the CJEU also provided clarity on the "beneficial ownership" concept referred to in the interest-royalty directive. The judgments trigger the re-evaluation of the interposition of conduit companies, i.e. companies where the activity is limited to the receipt of interest or dividends and the transmission thereof to the beneficial owner or to other conduit companies. The absence of an economic activity must be inferred from an analysis of all relevant factors, e.g. the management of the company, the balance sheets of the company, the cost structure and expenditures incurred by the company, the staff that it employs and the premises and equipment that it has. Based on these factors, a company should be able to evidence its actual economic activity in order to benefit from the withholding tax exemptions.

As in other European countries, these cases may have an impact on international group structures.

(b) Legislation

In the aftermath of BEPS, the European Union is trying to create a "fair, efficient and growth-friendly taxation in the EU with new measures to tackle corporate tax avoidance".[57] One of the main examples thereof is probably the EU Anti-Tax Avoidance Package.

The EU Anti-Tax Avoidance Directives ("ATAD")[58] contain various measures regarding thin cap, controlled foreign corporations ("CFCs"), general anti-abuse rules and exit taxation, which have been implemented into Belgian law.

- **Anti-Avoidance Rules (ATAD)**
  - Interest deduction limitation
    - ***30% EBITDA or €3m***

      As of assessment year 2020 (financial years starting on or after 1 January 2019),[59] Belgian domestic law contains an interest limitation rule in line with the interest limitation rule provided in the ATAD (2016/1164).[60] According to this rule, the "exceeding borrowing cost" (net interest expense) is only deductible up to the maximum 30% of the taxpayer's fiscal EBITDA (taxpayer's earnings before interest, taxes, depreciation and amortisation).[61] Up to €3m, the net borrowing costs remain fully deductible. This *de minimis* will have to be divided between Belgian group entities. The excess can be carried forward. The Belgian International Trade Centre ("ITC") provides for several exceptions to the applicability of the rule, such as for certain financial enterprises, stand-alone entities and companies involved in public-private cooperation projects.

      In the course of 2019, the Belgian EBITDA interest deduction limitation rule has been subject to various technical modifications, amongst others with regard to the calculation of the fiscal EBITDA. It is to be expected that the Belgian EBITDA rule will be subject to subsequent modifications in the course of the upcoming year.

- ***5:1 thin-cap rule***
  The existing 5:1 thin-cap rule[62] has been abolished, except with respect to arm's-length interest payments for interest paid to beneficial owners located in tax havens. Moreover, intra-group interest paid pursuant to a loan agreement, of which it has been demonstrated that it has been concluded prior to 17 June 2016, is subject to grandfathering.[63] For these loans, the current 5:1 debt-to-equity thin-cap rule remains applicable.

- General anti-abuse rule
  Belgian tax law currently contains a general anti-abuse rule that allows the tax authorities to requalify a legal act (or a series of legal acts) provided that a number of specific requirements are met, including that they can demonstrate the existence of tax abuse.[64] This is generally the case if the taxpayer carries out transactions that are contrary to the (legislative) intent of the tax provisions, without other business reasons being present.
  The ATAD also provides for a general anti-abuse rule. This rule should have been implemented by EU Member States by 1 January 2019. As Belgium has already had a general anti-abuse rule since financial year 2013, there is no need to implement the ATAD general anti-abuse rule.

- Controlled foreign corporations
  Until recently, Belgian tax law contained no real CFC rules. In 2015, Belgium implemented for the first time a CFC-like rule known as the "Cayman Tax" for individual taxpayers and non-profit entities. In short, the Cayman Tax implies a look-through taxation for income received by Belgian individuals and non-profit entities from qualifying legal constructions, like trusts and low-taxed entities.
  Apart from this rule, Belgian law contains a rule that allows the disregard of a transfer of ownership of assets by a Belgian tax resident to a non-EU taxpayer, whose income derived from these assets is taxed substantially more favourably than under the ordinary Belgian tax regime if made without business reasons.
  In 2016, the Council of the European Union adopted a CFC rule as part of the ATAD (arts 7 and 8). Following this CFC rule, the Member State of a taxpayer will treat an entity (or a PE of which the profits are not subject to tax or are exempt from tax in that Member State) as a controlled foreign company if certain conditions are met. Taking into account that a CFC rule which applies independently of the substance of a subsidiary would be incompatible with the current case law of the CJEU, the Directive provides for a substance exclusion. The CFC rule needed to be implemented in Belgian legislation by 2019.
  As of 2019, an ATAD-compliant CFC regime applies in Belgium.[65] The Belgian regime is based on a so-called transactional approach and goes in certain respects beyond the minimal protection provided in the ATAD.
  The Belgian CFC regime applies to income generated by controlled companies and PEs located in jurisdictions that do not levy a corporate income tax, or at a rate which is less than half of the corporate income tax which will be due in Belgium on the CFC income.[66] The Belgian company is taxed on the non-distributed profits of a foreign CFC subsidiary, which arise "from an artificial structure that has been set up for the essential purpose of obtaining a tax advantage".[67] To determine whether or not a structure is artificial, a transactional approach is followed.[68] Accordingly, an artificial structure is upheld if and to the extent that revenue-generating assets and/or risks are transferred to the CFC, while the related main

business-relevant key decisions continue to be made within the Belgian parent company.

A foreign company qualifies as a CFC for Belgian tax purposes if the Belgian parent company holds a direct or indirect participation of more than 50% of the capital or the voting rights, or is entitled to a profit share of at least 50%, and the foreign entity is either not subject to income tax in its country of residence or is subject to an income tax of less than one half of the Belgian corporate tax which would be due if the company was established in Belgium.[69]

A similar treatment applies to profits attributable to a foreign CFC-treated PE of a Belgian company.[70]

- Exit taxation

  From 2019, the existing Belgian exit taxation rules have been defined more comprehensively to apply generally to any outbound internal dealing, i.e. transfer of assets or businesses from a Belgian head office or a Belgian PE to a foreign head office or a foreign PE within the same entity.[71] The exit tax due on outbound internal dealings is, as a rule, eligible for an optional deferral over a five-year period.[72] Belgian tax authorities can request a guarantee if there is a risk of non-recovery of the exit tax. In line with the introduction of the lower ordinary corporate tax rate (see above), the special exit tax rate was also decreased from 16.95% to 12.75%[73] with effect from 1 January 2019, but will increase to 15% as from tax year 2020 (assessment year 2021).[74]

  With effect from 1 January 2019, the rules related to inbound transfer of assets and an inbound corporate migration have been amended. With regard to inbound transfers of assets and inbound corporate migrations, a step-up in value of the assets as the tax base of the assets applies, provided that the country from which the assets are transferred does not qualify as a tax haven, and that Belgium concluded a treaty or bilateral or multilateral instrument with the exit State that provides for an exchange of information).[75] If these conditions are not fulfilled, the tax base of the transferred assets is set at the pre-transaction book value determined according to Belgian rules (i.e. this was the rule applicable before 2019).[76]

- Hybrid mismatches

  Finally, the ATAD provides for rules to close down hybrid mismatching arrangements, both in a purely European context as well as with third countries.

  In short, these rules serve to avoid the discrepant legal qualifications of legal or financing arrangements resulting in a double deduction or in a deduction without a corresponding taxation in the other jurisdiction. This will be realised in two ways: (i) refusal of a double deduction (the deduction will hereby be linked to the origin of the payment); and (ii) a refusal of the deduction in the absence of an effective taxation.

  As from assessment year 2020 (for accounting years starting as of 1 January 2019), Belgium introduced rules and definitions to tackle hybrid mismatching arrangements, tax residency mismatches and imported mismatches.[77] A hybrid mismatch is an arrangement resulting in either (i) a double deduction of expenses for both a Belgian company (or Belgian PE) and a foreign enterprise (or establishment thereof), or (ii) a deduction for one of these taxpayers and a non-inclusion in the taxable income of the beneficiary (deduction without inclusion). The anti-hybrid rules provide for (i) denial of the deduction of costs relating to

payments made in the context of a hybrid mismatch, (ii) inclusion of the profits received in the context of a hybrid mismatch in the Belgian corporate income tax base, and (iii) limitation of the use of a foreign tax credit in the case of a hybrid transfer. In this regard, the following mismatches are combatted: PE mismatches; reverse hybrid entity mismatches; financial instrument mismatches; and hybrid entity mismatches.[78]

- **Amendments to the Parent-Subsidiary Directive (through Directive 2014/86/EU and Directive 2015/121/EU)**

  This will be discussed below under "Developments affecting attractiveness of Belgium for holding companies".

OESO – BEPS developments

General introduction

Over the past five years, the international tax environment has fundamentally changed.

As explained above, the European Union goes in the direction of a BEPS-compliant Europe. However, other BEPS-compliant measures were introduced in Belgian law as well (or are likely to be introduced in Belgian law in the near future).

Multilateral instrument and anti-abuse

The double tax treaties' limitation of benefits or anti-avoidance rules proposed in the BEPS Action Plans are likely to have an impact in Belgium because, so far, a fair number of Belgian DTCs provide for a tax exemption in the country of residence as soon as the income "may be taxed" in the source State.

Belgium supports the implementation of anti-abuse rules via the outcome of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the "MLI"). The MLI will affect the existing bilateral tax treaties listed by both participating jurisdictions upon ratification by the signatories and after expiration of the waiting periods. Belgium signed the MLI (together with 67 other jurisdictions) on 7 June 2017. As per today, the number of MLI signatories is 87.

On 6 May 2019, the legislative documents implementing the MLI were finally adopted by all six legislative authorities in Belgium. The Belgian law ratified the full application of the MLI and its Explanatory Note, the reservations and notifications made by Belgium, and the amendments made since the signing of the instrument. On 26 June 2019, Belgium became the 29th country to deposit its instrument of ratification for the MLI at the OECD. The convention will enter into force in Belgium on 1 October 2019.[79] The extent to which the MLI will modify Belgium's bilateral tax treaties will depend on the final adoption positions taken by other countries.

No longer annual country-by-country reporting for transfer pricing purposes

Belgium introduced a three-tier documentation approach, as provided under Action 13 of the BEPS Plan, being a country-by-country report, a master file (covering information with regard to the group), and a local file (covering information on the local entity and its intercompany transactions). Belgian tax law provides for an automatic exchange of the country-by-country reports ("CbCr").[80]

By the Law of 2 May 2019 regarding various tax provisions 2019-I,[81] the Belgian transfer pricing reporting obligations have been amended, reducing the compliance burden for Belgian entities obliged to file a country-by-country notification form. For reporting periods ending on 31 December 2019, Belgian entities or PEs of a qualifying MNE group are no

longer required to annually file a CbCR notification with the Belgian tax authorities. Only if the information provided deviates from the previous reporting period (i.e. in case there is a change of ultimate parent entity) will the filing of the CbCr notification form be required.[82] The Belgian tax authorities issued a new draft transfer pricing circular letter on 18 June 2019.

Definition of "permanent establishment"

- Under Belgium's tax treaties

The OECD/BEPS Action 7 guidelines[83] advocate an extended (and more economic-oriented) definition of the concept of a PE in Article 5 of the OECD Model tax treaty.[84] Although Belgium is not a fervent promotor of such extended definition, it has to adapt to this international trend.

With regard to the OECD's *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* (the "MLI"), Belgium accepted the revised definitions of "dependent agent PE"[85] and "independent agent PE"[86] in Belgium's covered tax agreements.[87]

This position is in line with a number of recently-signed tax treaties (e.g., Belgium's new tax treaty with Japan)[88].

- Domestic definition

Belgium enlarged its domestic definition of PE for purposes of its corporate tax on non-resident companies in order to align the definition to the treaty developments referred to above.[89] This extended domestic PE definition is relevant to non-treaty situations and also serves to provide a domestic legal basis for effective taxation if and when the extended PE concept is gradually taken over in Belgium's new or existing tax treaties.

Under the new domestic Belgian PE definition,[90] a person acting in Belgium on behalf of a foreign enterprise constitutes a PE even if this person does not have authorisation to enter into agreements on behalf of the foreign enterprise, unless this person qualifies as an independent intermediary acting in the ordinary course of his business. A person who acts exclusively or almost exclusively for one or more "closely related" enterprises is no longer considered as an independent intermediary. A person is considered to be "closely related" to a foreign enterprise where either one party has control over the other or both are under the control of the same persons or enterprises. This needs to be assessed based on all relevant facts and circumstances, such as the scope and nature of contractual obligations, risks assumed and freedom in the performance of assumed duties. A person is deemed to be "closely related" to an enterprise if one party holds a (direct or indirect) stake of more than 50% in the other, or if another person or enterprise holds such stake in the person and the enterprise concerned.[91]

Belgian tax authorities recognise that the domestic definition of a PE may have to be modified again depending on the outcome of further developments within the EU and the OECD on an enlarged Digital PE definition under the OECD Model tax treaty.[92]

Tax climate in Belgium

Belgium has always had a relatively competitive tax policy objective; e.g. by way of its NID, the advanced tax-ruling system and other attractive tax regimes such as the holding regime.

In the aftermath of BEPS, a series of BEPS-compliant measures has been taken over the last few years. Taking into account that the European Union is also taking steps towards a BEPS-

compliant environment, the challenge for smaller EU countries like Belgium will be to keep their tax system competitive. The Belgian corporate tax reform was introduced in order to deal with this changing environment. In addition, Belgium has several favourable, sector-specific, niche tax regimes (that remain preserved even in the post-BEPS era), such as a tonnage tax regime (for companies active in the maritime transport sector),[93] the diamond tax regime (the so-called "Carat Tax"),[94] and a tax shelter regime for audio-visual productions which was recently even extended to video games and productions in the field of performing arts.[95]

Independently from the BEPS project, the pursuit of the Belgian competitive tax policy objective is restricted by several EU and domestic law constraints. Every domestic favourable tax measure will indeed need to be evaluated on the basis of the European state aid rules and the European freedoms (freedom of establishment and free movement) and European Directives, as well as the Belgian Constitution, in particular the principle of equality and non-discrimination.

Developments affecting attractiveness of Belgium for holding companies

Belgium has a number of incentives to make Belgium attractive as a location for holding companies:

- The DRD: see section *(b) Legislation* under "Domestic – cases and legislation" above.

  However, because of the amendments to the Parent-Subsidiary Directive (through Directive 2014/86/EU and Directive 2015/121/EU), a general anti-abuse provision with regard to the withholding tax exemption for dividends was introduced into Belgian law on 1 December 2016.[96] This general anti-abuse provision will deny the withholding tax exemption when dividends originate from (a whole of) legal acts that are artificial and merely in place to obtain the withholding tax exemption. In addition, a dividend that a Belgian company receives from its foreign subsidiary will not be tax-exempt if the subsidiary already deducted the dividend from its own income. A dividend will also not be tax-exempt when it originates from (a whole of) legal acts that are artificial and that have the main purpose or one of the main purposes to obtain the DRD, or the advantage of the Parent-Subsidiary Directive.[97]
- The NID: see section *(b) Legislation* under "Domestic – cases and legislation" above.
- The capital gains exemption on shares: see section *(b) Legislation* under "Domestic – cases and legislation" above.
- Belgium has a specific fund vehicle that facilitates the investments in private equity and venture capital (the "Private Privak"/"*Pricaf privée*" – "PP").[98] The goal of the legislator when developing this vehicle was to offer a tax-neutral alternative to direct investments, provided that certain investment criteria are met (hereinafter "qualifying Private Privak").[99] The qualifying PP is subject to a special corporate tax regime with a limited tax base[100] (abnormal advantages received and certain non-deductible expenses).[101] However, qualifying PPs are not entitled to credit dividend withholding tax.[102]

  Investors in the qualifying PP can benefit from an attractive withholding tax regime which implies that (i) liquidation bonuses and income derived from a repurchase of own shares by a PP are not considered as movable income and therefore benefit from a full withholding tax exemption, and (ii) dividends distributed by the qualifying PP are exempt insofar as those dividends stem from capital gains realised by the qualifying PP.[103] Belgian corporate investors can benefit from the application of the participation exemption regime on dividends received from a qualifying PP to the

extent that these dividends stem from capital gains or dividends in relation to qualifying investments, irrespective of the participation threshold and holding period.[104] For individuals, the withholding tax regime is the final tax regime. An additional withholding tax exemption is applicable for distributions to foreign companies insofar as the distribution by the qualifying PP stems from dividends received by the qualifying PP from participations in foreign companies.[105]

New tax rules following the corporate law reform

On 1 May 2019, the Belgian Code on Companies and Associations ("Belgian Company Code") entered into force (and is becoming applicable in a gradual manner).[106] The new Code implies a major corporate law reform that simplifies and enhances the flexibility of Belgian company law, thereby improving the attractiveness of Belgium as a place of establishment for investors and entrepreneurs.

The main features of the Belgian company law reform are a reduction of the number of available corporate vehicles,[107] a move from its traditional "effective seat" doctrine (i.e. effective place of management) to the "incorporate" doctrine (i.e. the seat as set down in the company's articles of association) for purposes of determining the corporate law applicable, as well as various measures that will increase the flexibility of certain corporate instruments.[108] Moreover, for the private limited liability company ("BV"), the notion of share capital is abolished under the new company law (for the public limited liability company ("NV"), the term "capital" will be used). The minimum share capital requirement will be replaced by the obligation for the shareholders to ensure that the company has sufficient funds to carry out its activities.

The new Belgian Company Code does not only reform company law *sensu stricto*, but also imposes fiscal consequences. As such, following the abandonment of the real seat theory in favour of the statutory seat theory, a company with its statutory seat in Belgium will be subject to Belgian company law, regardless of whether it conducts its activities in Belgium or abroad. For corporate income tax purposes, however, the place of effective management will remain decisive in determining whether a company qualifies as a Belgian tax resident. This gap between the statutory seat theory for the determination of the *lex societatis*, and the real seat theory for the determination of the tax residence of a company, can create a gap between company law and tax law.

Since the company law reform is not intended to give rise to tax changes, a separate tax bill aims to ensure the tax neutrality of the new provisions.[109] Consequently, new definitions of "companies", "resident companies" and "foreign companies" are introduced in the Belgian Income Tax Code. Moreover, in order to comply with the new corporate rules, an autonomous capital concept will be included in the definitions. In the case of a NV, the notion of capital remains applicable for tax purposes. In other cases, the tax legislator refers to the notion of equity, insofar as the equity is constituted by contributions in cash or in kind (other than contributions of labour).

* * *

Endnotes

1. ITC, Art. 206, §2 (*Wetboek van de inkomstenbelastingen* 1992, ITC).

2. S. Gommers, "'Scharniermoment' verliesbeperking en-overdracht: vragen blijven", *Fiscoloog* 2019, ed. 1600, 8: S. Gommers, "Cassatie toch duidelijk over scharniermoment over scharniermoment fiscale nettowaarde", *Fiscoloog* 2019, ed. 1602, 6.
3. Supreme Court 25 January 2019, F.17.0063.N., see: S. Gommers, "'Scharniermoment' verliesbeperking en-overdracht: vragen blijven", *Fiscoloog* 2019, ed. 1600, 8: S. Gommers, "Cassatie toch duidelijk over scharniermoment over scharniermoment fiscale nettowaarde", *Fiscoloog* 2019, ed. 1602, 6.
4. Supreme Court 24 May 2019, F.16.0053.N. and F.18.0058.N., see: C. Buysse, "Notionale interestaftrek en vereiste van voldoende economische instantie (bis)", *Fiscoloog* 2019, ed. 1618, 11.
5. ITC, Art. 207(7).
6. The EU Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (ATAD I) and EU Council EU Directive 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries (ATAD II).
7. Law of 25 December 2017 on the reform of the corporate income tax regime, Belgian O.J. 29 December 2017 (hereinafter referred to as "Corporate Tax Reform Law") and the Law of 30 July 2018 on Diverse Income Tax Provisions (hereinafter referred to as "Amending Law"). Most of the new measures are introduced to be effective as of tax assessment year 2019; some measures take effect as of tax assessment years 2020 or 2021.
8. I.e., effective as of tax assessment year 2019 for financial years starting on or after 1 January 2018 (ITC, Art. 217/1, §1).
9. I.e., effective as of tax assessment year 2021 for financial years starting on or after 1 January 2020 (ITC, Art. 217/1, §1).
10. For small and medium enterprises a reduced corporate tax rate of 20% is available for the first tranche of €100,000 taxable income if certain conditions (including a minimum annual remuneration for at least one company director) are met (ITC, Art. 215, §1). The 20% rate is applicable as of tax assessment year 2021 for financial years starting on or after 1 January 2020. For tax assessment years 2019 and 2020, the 20% rate is still increased to 20.40% (as a result of the temporary crisis surtax still applying for those years).
11. Such reversals are taxable at the rate of 33.99% when they were recorded before tax year 2019, and to 29.58% when they were recorded during tax year 2019 or later.
12. ITC, Art. 217/1.
13. I.e., effective as of tax assessment year 2019 for financial years starting on or after 1 January 2018.
14. ITC, Art. 204.
15. I.e., effective as of tax assessment year 2019 for financial years starting on or after 1 January 2018 (Corporate Tax Reform Law, Arts 24 and 55).
16. ITC, Art. 192, § 1, with reference to ITC, Arts 202 and 203.
17. ITC, Art. 202, § 2, al. 1, 1°.
18. ITC, Art. 202, § 1, al. 1, 2°.

19. ITC, Art. 203.
20. A transitional regime is applicable for assessment years 2018 and 2019 (separate 25.50% tax where all conditions are satisfied, except for the minimum holding period requirement, unless and to the extent that the capital gains qualify for the reduced SME rate) (ITC, Art. 217, al. 1, 2°).
21. CJEU, decision of 12 July 2012, C-384/11, *Tate & Lyle Investments Ltd*, ECLI:EU:C:2012:463.
22. Which percentage corresponds to the corporate tax conceptually due by a Belgian parent company, i.e., 33.99% corporate tax rate on 5% of the gross dividend.
23. ITC, Art. 269/1.
24. ITC, Art. 205/5. Arts 35, 36, 39, °9 and 48 of the Law of 25 December 2017 on the reform of the corporate income tax regime (modifying Art. 194 *septies* and 198 °15/1 and 205/5 of the Belgian ITC).
25. ITC, Art. 205/5, §2, sec. 3 and 6.
26. D. Garabedian, W. Dedecker and S. Peeters, "Belgium enacts major corporate income tax reform, readies new company code", MNE Tax, https://mnetax.com/belgium-enacts-major-corporate-income-tax-reform-readies-new-company-code-26043.
27. Corporate Tax Reform Law, Art. 40. Initially, Belgium planned to introduce this new limitation only with effect from 2020. After having first applied to the EU Commission for a one-year delay, Belgium finally accelerated the entry into force of the new limitation by making it effective as of tax assessment year 2020 for financial years starting on or after 1 January 2019.
28. ITC, Art. 2, §5°/1 and 198/1.
29. ITC, Art. 205*ter*.
30. I.e., effective as of tax assessment year 2019 for financial years starting on or after 1 January 2018 (Amending Law, Art. 6).
31. Arts 49–51 and 86 of the Law of 25 December 2017 on the reform of the corporate income tax regime (modifying Arts 205*bis* – 205 *novies* and 536 of the Belgian ITC).
32. Art. 207, al. 5 of the Belgian ITC. See D. Vandenberghe, "Minimale grondslag – vorming van een korf, invoering van een tweede aftrekbeperking" in L. Maes, H. De Cnijf and L. De Broeck, *Fiscaal Praktijkboek 2018-2019 – Directe Belastingen*, Mechelen, Wolters Kluwer, 2018, pages 263–306.
33. Art. 205, § 3 ITC.
34. Art. 207, al. 6 ITC.
35. Art. 4 1° and 2°, Art. 16 and Art. 68 of the Law of 25 December 2017 on the reform of the corporate income tax regime (modifying Art. 18, first paragraph 2° and 2°*bis*, Art. 18 second – seventh paragraph, Art. 184, fifth paragraph, Art. 264 first paragraph, 3°, c and Art. 264, second and third paragraph of the ITC).
36. See e.g. http://www.europarl.europa.eu/news/en/press-room/20181120IPR19552/cum-ex-tax-fraud-meps-call-for-inquiry-justice-and-stronger-tax-authorities.
37. Law of 11 January 2019 containing measures to combat tax fraud and tax evasion with respect to movable withholding tax, *Belgian Official Gazette* of 22 January 2019; for an extensive discussion see P. Delacroix and others, *Fiscoloog* 2019, ed. 1598, p. 3.
38. J. Van Dyck, "Nog getrouwtrek rond wie schuldenaar is van de roerende voorheffing", *Fiscoloog* 2019, ed. 1612, p. 4.

39. ITC, Art. 266, al. 4; ITC, Art. 281/1.
40. ITC, Art. 281.
41. ITC, Art. 264, al. 1, 4°.
42. ITC, Art. 262. See also Act of 28 April 2019 on various tax provisions, *Belgian Official Gazette* 6 May 2019; the law entered into force on the day of publication in the *Belgian Official Gazette*.
43. Art. 8-21 of the Law of 11 February 2019, *Belgian Official Gazette* 22 March 2019.
44. Law of 11 February 2019, *Belgian Official Gazette* 22 March 2019.
45. ITC, Art. 414, § 1, al. 2.
46. No. 168/2018.
47. ITC, Art. 418, al. 1. Arts 77–80 and 90 of the Law of 25 December 2017 (modifying Arts 414, 416, 418 and 419 ITC).
48. Law of 2 May 2019 on the implementation of the EU directive (EU) 2017/1852 on tax dispute resolution mechanisms in the European Union, *Belgian Official Gazette* 17 May 2019.
49. Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, COM/2018/0147 final, and Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM/2018/0148 final.
50. CJEU 17 May 2017, C-68/15, ECLI:EU:C:2017:379 and Belgian Constitutional Court 1 March 2018, nr. 24/2018.
51. General Court of the CJEU 14 February 2019, T-131/16, *Belgium vs. Commission*.
52. http://europea/eu/rapid/press-release_IP-16-42_en.htm. More information on this regime can be found in the press release of the European Commission (http://europea/eu/rapid/press-release_IP-16-42_en.htm).
53. Commission Decision (EU) 2016/1699 of 11 January 2016 on the excess profit exemption State aid scheme SA.37667 (2015/C) (ex 2015/NN) implemented by Belgium (notified under document C (2015) 9837), EU O.J. 27 September 2016, L260, Vol. 59.
54. http://curia.europa.eu/juris/document/document.jsf?text=overwinst&docid=215313&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=2998933#ctx1.
55. Joined cases C-116/16 and C-117/16.
56. Joined cases C-115/16, C-118/16, C-119/16 and C-299/16.
57. Art. 53, 1° and 3°–6° of the Law of 25 December 2017 on the reform of the corporate income tax regime (modifying Art. 207 of the Belgian ITC).
58. Art. 4 1° and 2°, Art. 16 and Art. 68 of the Law of 25 December 2017 on the reform of the corporate income tax regime (modifying Art. 18, first paragraph 2° and 2°*bis*, Art. 18 second – seventh paragraph, Art. 184, fifth paragraph, Art. 264 first paragraph, 3°, c and Art. 264, second and third paragraph of the ITC).
59. ITC, Art. 198/1. The Law of 31 January 2019 containing tax, anti-fraud, financial and miscellaneous provisions, published in *Belgian Official Gazette* on 22 March 2019, comprises an earlier entry into force of the interest deduction limitation rules (i.e.

application as from tax year 2020 starting on or after 1 January 2019, instead of tax year 2021).

60. A. Heyvaert and E. Moonen, "Belgium – ATAD Implementation in Belgium: An Analysis of the New Interest Limitation Rule", *European Taxation 2019*, Vol. 59, No. 7 (published online).
61. ITC, Art. 198(1).
62. ITC, Art. 198(1)(11).
63. To the extent that these loans are not materially altered afterwards. See ITC, Art. 198, § 2 (2).
64. ITC, Art. 344, section 1.
65. I.e., applicable as of tax assessment year 2020 for financial years starting on or after 1 January 2019.
66. ITC, Art. 185(2)(2). See also: Arts 20 and 44, 2° of the Law of 25 December 2017 (modifying Arts 185/2 and 202, §1, 4° ITC).
67. ITC, Art. 185/2 §1. Remedies are provided to avoid double taxation in case income taxed under the CFC rule is subsequently effectively distributed as a dividend, or capital gains are realised on shares held in a CFC taxable subsidiary company (ITC, Art. 202, §1, 4° and 192, §1).
68. ITC, Art. 185/2 §1.
69. ITC, Art. 185/2, §2.
70. ITC, Art. 185/2 §3.
71. ITC, Art. 185/1, effective as of tax assessment year 2020 for financial years starting on or after 1 January 2019.
72. Applicable for transactions carried out as of 8 December 2016. To be able to benefit from a deferred payment of the exit tax, Circular 2017/C/58 clarifies that eligible companies and individuals must explicitly file a request within two months after the receipt of the tax assessment and complete and file a form listing the transferred assets every year.
73. 12.5% plus 2% crisis surtax.
74. I.e., effective as of tax assessment year 2021 for financial years starting on or after 1 January 2020 (ITC, Art. 210, § 1, 5° and 6° and Art. 217, first indent, 1°).
75. Arts 17, 2°–5° and 61, 2° of the Law of 25 December 2017 (modifying Art. 184*ter*, §2 and 22ç, §5 ITC). See: W. Willems, "Belgian Exit Taxation after the Corporate Income Tax Reform: What's New on the Horizon", Vol. 2 *Tijdschrift beleggingsfiscaliteit* No. 05, 42–57 (2018).
76. I.e., applicable as of tax assessment year 2020 for financial years starting on or after 1 January 2019.
77. ITC, Art. 198 § 1, 10°/1-4 and Art. 185.
78. ITC, Art. 198, § 1, 10°/2.
79. https://www.oecd.org/ctp/treaties/beps-mli-signatories-and-parties.pdf.
80. Law of 1 July 2016, published in the *Belgian Official Gazette* on 4 July 2016.
81. Published in the *Belgian Official Gazette* on 15 May 2019.
82. ITC, Art. 321/3, § 3.

83. OECD (2017), *Additional Guidance on the attribution of profits to a permanent establishment – Action 7*, OECD Publishing.

84. The changes intend to prevent the artificial avoidance of PE status through i) the use of commissionaire arrangements and similar strategies (MLI, Art. 12), ii) the specific activity exemptions (MLI, Art. 13), and iii) the splitting-up of contracts (MLI, Art. 14).

85. A "dependent agent PE" is broadened to not only include situations where a person is acting on behalf of an enterprise and habitually concludes contracts, but also where this person habitually exercises the principal role leading to the conclusion of contracts that are afterwards routinely concluded by the enterprise without any material modification.

86. The notion of the "independent agent PE" is further restricted and excludes persons acting exclusively or almost exclusively on behalf of one or more enterprises to which the agent is closely related.

87. It has to be noted that Belgium initially opted to reserve the right for the non-application of Art. 12 of the MLI (the tackling of the artificial avoidance of PE status through commissionaire arrangements and similar strategies) to covered tax agreements. The Belgian federal government finally decided to drop that reservation. The broader description of the "personal PE" will therefore have to be included in the tax treaties of Belgium covered by the MLI (provided the treaty partner takes the same position). See: *Parl.St.* 2018-2019, 54-3510/001, 58. See in the same sense: Decree of 5 April 2019 by the Flemish Government (*Belgian Official Gazette* on 2 May 2019).

88. Tax treaty of 12 October 2016 between Belgium and Japan, Arts 5.4 and 5.6 (entered into force on 19 January 2019 and applicable as of 1 January 2020).

89. ITC, Art. 229, §2, applicable as of tax assessment year 2021 for taxable periods starting on or after 1 January 2020 (Corporate Tax Reform Law, Art. 61, 1° and Art. 86).

90. ITC, Art. 229, §2. See also Circular 2017/C/67.

91. Corporate Tax Reform Law, Art. 61,1°. Corporate Tax Reform Law, Art. 62 also abolished an old provision of the ITC (Art. 231, §1, 3°) which stated that intermediaries who limit their intervention to mere "collection of orders" from customers without committing their foreign principal do not constitute a PE.

92. Particular attention is given to the work carried out around Action 1 of the BEPS project "Addressing the tax challenges of the digital economy". See: OECD (2015), *Addressing the tax challenges of the digital economy, Action 1 – 2015 final report*, OECD Publishing. See also: J.A.G. Requena and S.M. González, "Adapting the concept of permanent establishment to the context of digital commerce: from fixity to significant digital economic presence", *Intertax* 2017, (732) 735.

93. Program Law of 2 August 2002. The European Commission approved continuation of the tonnage tax regime until the end of 2022 (notification published in EU Official Journal on January 5 2018, no. C 3).

94. Program Law of 10 August 2015. The European Commission confirmed that Belgium's "Carat Tax" regime is compliant with the EU State Aid rules (notification published in EU Official Journal on 7 October 2016, no. C 369).

95. ITC, Art. 194*ter* – 194*ter*/3. See Act of 29 March 2019 extending the tax shelter regime to the gaming industry, published in *Belgian Official Gazette* of 16 April 2019.

In contrast to the tax shelter for audio-visual productions, the tax shelter regime for video games awaits approval by the European Commission (*Parl.St.* Chamber 2018–2019, No. 54-3078/008, 6).

96. ITC, Art. 266, last al.
97. See also Circular letter no. 2017/c/67 relating to the implementation of the Directives amending the Parent Subsidiary Directive.
98. In this contribution, we will only discuss the Private Privaks that can benefit from the special corporate tax regime with a limited tax base (also called "Tax Private Privaks").
99. ITC, Art. 185*bis*, §3; L. Meeus & T. Gernay, "The Belgian private equity fund vehicle: the 'Private Privak'", *Tijdschrift Beleggingsfiscaliteit* 2019, ed. 8, p. 16 (and in general pages 7–28).
100. A PP is a private alternative investment fund, i.e. an alternative investment fund which raises its capital exclusively from "private investors" and which shares can only be acquired by such private investors. To be a qualifying PP, the PP should invest in shares that qualify for the Belgian participation exemption, or in other PPs (ITC, Art. 192, § 3). In addition, the PP should comply with the specific rules in its articles of association resulting from its status as PP (ITC, Art. 185*bis*, § 3).
101. ITC, Art. 185*bis*.
102. ITC, Art. 185*bis*, §2, sec. 2.
103. ITC, Art. 106, § 9 of the Royal Decree implementing the ITC.
104. ITC, Art. 202, § 2, section 3.
105. L. Meeus & T. Gernay, "The Belgian private equity fund vehicle: the 'Private Privak'", *Tijdschrift Beleggingsfiscaliteit* 2019, ed. 8, 22.
106. Act of 23 March 2019 introducing the Code of Companies and Associations Code, Official Gazette of 4 April 2019. See also Royal Decree of 29 April 2019 implementing the Companies and Associations Code, Official Gazette of 30 April 2019.
107. See e.g. L. De Broe and M. Peeters, "Doorgedreven vereenvoudiging vennootschapsvormen en inwerkingtreding", *Fiscoloog* 2019, ed. 1610, p. 3
108. D. Garabedian, W. Dedecker and S. Peeters, "Belgium enacts major corporate income tax reform, readies new company code", MNE Tax, https://mnetax.com/belgium-enacts-major-corporate-income-tax-reform-readies-new-company-code-26043.
109. Act of 17 March 2019 modifying certain federal tax provisions to the new Belgian Code on Companies and Associations, published in *Belgian Official Gazette* of 10 May 2019.

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Brazil

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Overview of Brazilian corporate taxation

A Brazilian company is subject to two different taxes on income, the Corporate Income Tax ("*Imposto de Renda da Pessoa Jurídica*" or "IRPJ") and the Social Contribution on Net Profits ("*Contribuição Social sobre o Lucro Líquido*" or "CSLL").

The IRPJ and CSLL are calculated over the income earned by a Brazilian company on a worldwide basis. The IRPJ is imposed at a rate of 15% on taxable income, plus a surtax of 10% on any taxable income exceeding BRL 20,000 per month or BRL 240,000 per year. The CSLL is imposed at a general rate of 9%, although other businesses, such as financial institutions, calculate the CSLL at 15%.

A Brazilian company may carry forward tax losses for IRPJ and CSLL purposes and use those losses to offset taxable income earned in subsequent periods. The losses can be carried forward indefinitely, but are limited to 30% of the taxable profit for a given year.

The definition of taxable income for IRPJ and CSLL purposes depends on the taxable regime elected by (or applicable to) the taxpayer.

Under the Adjusted Net Profit Regime ("*lucro real*"), the IRPJ and CSLL are levied upon the company's adjusted net income. The net income for the relevant fiscal year is adjusted by book-to-tax adjustments, called additions and exclusions. Both taxes are determined either on a quarterly basis or on an annual basis, with monthly advance payments.

As a rule, the deductions are allowed from the taxable profit if the expenses are proven necessary, usual and effective for the maintenance of the business activities (the business source). A deductibility limitation for costs on importations of goods, rights or services may apply in accordance with applicable transfer pricing rules, if the transaction is carried out with a foreign related party (or if the transaction is carried out with a person resident in a tax haven or subject to a privileged fiscal regime). There is also a deductibility ceiling for interest based on transfer pricing and thin capitalisation rules.[1]

Under the Deemed or Presumed Profit Regime ("*lucro presumido*"), the taxable basis is determined by the application of a statutory profit margin upon the company's gross revenues (itemised deductions are therefore not allowed under the Deemed Profit Regime). Not all companies are allowed to elect the IRPJ and CSLL under this Regime; for instance, companies that earned gross revenues of over BRL 78 million in the previous year or companies that receive earnings from foreign sources are not eligible.[2]

The Deemed Profit Margin (i.e., the percentage of gross revenues that is considered a taxable profit) for IRPJ is a percentage of between 1.6% to 32% of gross revenues, depending on the industry the taxpayer is engaged in. For CSLL, the Deemed Profit Margin varies from 12% to 32%.

The exceptions to the Deemed Profit Margins in the Deemed Profit Regime are capital gains and financial income. Those must be included in the taxable basis in full, and subject to the aggregate rates of IRPJ and CSLL of 34% (or up to 34%).

Under Brazilian tax legislation, the distribution of dividends is exempt from withholding taxes, regardless of the regime elected by the taxpayer or the jurisdiction of the beneficiary.

Types of corporate tax work

In 2018–2019, we have been assisting our clients in multiple issues involving corporate taxes, both on consulting and litigation engagements. Among others, we can highlight the following:

- Merck KGaA in various tax matters related to the segregation of consumer health business in Brazil and the subsequent sale to Procter & Gamble, including capital gains analysis, transfer pricing, future services, toll manufacturing, and several post-closing arrangements. The total global consideration to be paid to Merck is €4.2 billion.
- United Phosporous Limited – tax assistance on the acquisition of Arysta LifeScience in Brazil, a transaction involving global consideration of over USD 4 billion.
- Confidential (ongoing) – tax assistance on a joint venture between a Brazilian and a Mexican company. Deal to be announced of around BRL 700 million.
- General M&A plannings – assistance on all corporate tax aspects in connection with M&A, including, but not limited to, the following: (i) amortisation of goodwill; (ii) separations; (iii) preparation for going public; and (iv) integration issues, among others.
- Litigation on several cases involving goodwill amortisation (please refer to specific comments below).
- Migration of IP legal or economic rights for the Brazilian territory to circumvent limitations on royalty deductions.
- Asset management restructurings in order to eliminate issues on the potential reform of the investment funds regime.
- Design and implementation of investment funds structures for distressed assets.
- Design and implementation of outbound structures for Brazilian multinationals.

Significant deals and themes

Substance-over-form approach – application by the Tax Authorities

Over the past years, the major developments in audits involve the trend of Tax Authorities as regards recasting transactions under a substance-over-form approach. This trend started in the early 2000s with the Supplementary Law 104/01, which established that "the tax administration may disregard legal acts or transactions aiming at disguising the occurrence of a tax triggering event, or the nature of the elements that constitutes the tax obligation, provided that the regulations to be established by ordinary law are followed" (free translation).

Although an ordinary law to regulate this article has not been enacted yet, the introduction of this legislation gave rise to an important debate in Brazil on tax planning. Brazilian scholars and Brazilian courts have, historically, supported the right of a taxpayer to organise its businesses in legal ways so as to reduce the amount of taxes. Hence, based on the positivist legal tradition, case law has supported that the form adopted, if legal, would have to be respected.

However, this interpretation has been changing over the past years and the Tax Authorities have been taking the "substance" of the legal acts and transactions into consideration, as

opposed to their form. Ultimately, this means that the Tax Authorities may assess a taxpayer based on the ultimate goal ("substance") of the act or transaction, instead of taking the form of the legal act or transaction into consideration.

The Brazilian Tax Authorities have been systematically assessing taxpayers for unpaid taxes, due to their engagement in transactions that are (or seem to be) intended to reduce or even eliminate the allegedly applicable taxation. Moreover, the Tax Authorities have used concepts of Private Law, such as "abuse of law" or the definition of "sham" in order to frame the acts and transactions conducted by the taxpayers as sham or fraudulent transactions.[3]

In case law, the Tax Authorities usually claim that taxpayers engage in sham transactions, and charge taxes, statutory penalties and applicable interests on the basis of "substance over form", "business purpose" and/or "step transaction" doctrines. It is also generally understood in Brazil that such concepts and doctrines have been imported from alien doctrines, especially from the US.[4]

Thus, in any tax planning carried out involving Brazilian shares or assets, in order to mitigate risks of questioning from the Tax Authorities, it is advisable that the tax savings are not the sole and core reason of the restructuring or deal itself, but **a consequence of the restructuring**.

On the other hand, there is no specific Ordinary Law which regulates the Brazilian GAAR. There has been, however, an attempt to implement its regulation, but the rule has eventually not been enacted.[5] In other words, in Brazil no specific parameters of the GAAR are foreseen by law. Hence, the substance over form approach for tax purposes has been a construction of case law in Brazil.

Goodwill on acquisition of shares – recent developments

Under Brazilian tax legislation, when a Brazilian company acquires a relevant investment from a third party, the investor must allocate the acquisition price in three different accounts, as follows:

(i) investment account: net equity amount at the time of the acquisition;

(ii) tangible and intangible assets/liabilities fair value upside or discount ("Upside/ Discount"): difference between (a) the fair value of tangible and intangible assets/liabilities of the acquired company, and (b) their accounting value;[6] and

(iii) goodwill based on future profitability, which corresponds to the difference between the acquisition cost of the investment and the sum of the amounts mentioned in items (i) and (ii).

Based on the current law, the goodwill is the remaining portion from the purchase price paid after deducting the invested company's net equity and fair value measurement of the net assets. During the period that the investment is maintained by the purchaser, goodwill is neutral for tax purposes, which means that it is neither taxable nor deductible for the purposes of the IRPJ/CSLL.

The Brazilian legislation states that, after a merger involving investor and invested companies, the goodwill, under certain conditions, can be amortised and deducted for tax purposes by the surviving entity within a period of at least five years.

Initially conceived as an incentive in the late '90s for the privatisation of public companies, the goodwill planning also became widespread in the private sector and was consistently used to generate value in M&A transactions for years.

The use of the planning also motivated the Brazilian Federal Revenue Agency (the "*Receita Federal do Brasil*" or "RFB") to include goodwill transactions under a high level of scrutiny, with almost BRL 60 billion of tax infraction notices issued on the matter.

Currently, the main discussion on the issue spins around the interpretation of the RFB that certain transactions should be disqualified and the amortisation should not be allowed if the taxpayer is not able to demonstrate that the acquisition vehicle had business purposes and/or economic substance. Under these circumstances, the RFB has been interpreting that the use of the acquisition vehicle is a scheme to dodge taxes in Brazil and has been disallowing goodwill based on a substance-over-form approach.

The most recent cases ruled by the Superior Chamber of the Administrative Tax Courts ("*Conselho Administrativo de Recursos Fiscais*" or "CARF") have been confirming this interpretation and disallowing the amortisation of goodwill if the taxpayer is not able to demonstrate that the acquisition vehicle has business purpose and/or economic substance.

To the extent that there is a consolidated position on administrative case law for cases where the acquisition company is not an operating entity, taxpayers have been increasingly discussing the goodwill amortisation straight at the judicial level, skipping the possibility to discuss it at the Administrative level. This approach tends to avoid the substantial penalties on tax assessment, which may go up to 150% over the principal.

At the judicial level, taxpayers have been discussing that the economic substance and business purposes requirements ruled by the Administrative Tax Court do not have legal basis.

At the lower level, there are several decisions issued in favour of the taxpayers. Although those decisions are favourable, they only benefit the taxpayers proposing the lawsuits and do not indicate a trend favourable to the taxpayers at the Higher Courts as of yet.

On the other hand, planning has been accepted by the CARF in cases where the acquisition entity is an operating entity and the taxpayer is able to demonstrate that the merger produced synergies for the surviving entity.

In the *Ri Happy* and *CVC* cases, for example (Decisions 1401-003.082 and 1301-003.469, respectively), the CARF accepted the planning to the extent that the taxpayer demonstrated that the vehicle company: (i) concentrated funds deriving from different sources for the acquisition; and (ii) was used to raise funds with third parties for a leveraged buyout.

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

New Brazilian Income Tax Regulation

In terms of tax policies, the legislation on corporate taxes underwent no significant changes after a substantial reform implemented in 2014, which modified the worldwide income taxation regime and regulated the tax impacts deriving from the implementation of the IFRS standards.

Since then, only minor changes to the corporate tax legislation were introduced and with limited application. At the end of FY 2018, the Brazilian Government issued Decree 9,580/2018, compiling the legislation on corporate taxes in a new Income Tax Regulation (BITR/18), replacing the prior version issued in 1999.

Although the BITR/18 represented a significant development from a legislative and scientific point of view, largely the new BITR/18 is a mere compilation of several articles provided by sparse legislation and did not provide for relevant changes on the income taxation.

Supplementary Law 160

Articles 9 and 10 of Supplementary Law 160/17 added paragraphs 4 and 5 to article 30 of Law 12,973/2014, providing that all ICMS (the State VAT) tax incentives must be treated as a subsidy for investment.

In practice, these interpretative rules determined that tax incentives should not be qualified as income for the purpose of corporate income taxes. This rule should terminate with substantial litigations around the issue, to the extent that the RFB historically interpreted that those incentives should be qualified as a cost subsidy, which is taxable for corporate income tax purposes.

30% limitation on the use of tax losses

On March 25, 2009, the Brazilian Supreme Court ("STF") stated that the 30% limitation to use the accumulated tax losses against the taxable profit did not violate any constitutional principle. According to the STF, the possibility of offsetting 30% of tax losses from the taxable basis should be construed as a tax benefit granted to taxpayers, and, thus, might be limited by a federal law.

Ten years later, on June 27, 2019, the question returned to the STF for a new judgment under a different perspective. To a large extent, taxpayers argued that certain technical arguments were not appreciated by the STF in the original judgment.

Despite the new arguments, the STF reconfirmed the interpretation that the limitation of the right to offset IRPJ tax losses and the negative calculation basis of CSLL does not violate the Federal Constitution.

International tax developments

Brazil applied for membership of the Organization for Economic Cooperation and Development ("OECD") in 2017 and, since then, the country has been applying several efforts to converge the different non-compliant aspects of international taxation in Brazil to the OECD standards.

The most relevant change currently under discussion with OECD members is the reform on the Brazilian transfer pricing legislation, which is heavily based on formulary apportionment.

In February 2018, the OECD and Brazil launched a 15-month project to analyse the country's cross-border tax rules and assess options to conform its transfer pricing system with the OECD transfer pricing guidelines.

The conclusion report, issued in July 2019, presented a complete analysis on the issue and should serve as the basis to assist decision-makers in deciding the way forward. The Brazilian Government recently created a Council to determine the strategies and monitor the Brazilian application.

In addition, Brazil has also been applying efforts to enhance the existing treaty network with key countries. In the last year, Brazil signed treaties with Switzerland, Singapore, the United Arab Emirates and Uruguay, but they are still pending on ratification of the Brazilian Congress to become effective. Brazil has also been amending important treaties, e.g. with Argentina and Denmark, to eliminate certain benefits and introduce anti-abuse provisions.

BEPS

Although Brazil is not an OECD member yet, the country recently demonstrated commitment to Action 14 of the BEPS project by implementing legislation on Mutual Agreement Procedures.

Tax climate in Brazil

Despite the economic crisis Brazil has been facing since 2014, the IRPJ and CSLL still play a significant role for the Federal Treasury.

According to data provided by the Brazilian Federal Revenue Agency ("*Receita Federal do Brasil*" or "RFB"*)*, the total of corporate taxes collected in the FY 2018 was BRL 220,713 billion, which translates into 15.15% of the total of the taxes collected by the RFB at the Federal level. This amount represents an increase of 16.5% as opposed to the results of FY 2017, an outcome mainly attributed to an upturn of the Brazilian economy.

As to litigation, the IRPJ and CSLL are also taxes under a high level of scrutiny in audit procedures conducted by the RFB, representing BRL 94 billion of contingent collection in 2017, which translates to 52.4% of the tax infraction notices issued by the RFB.

This volume of contingent collection represented 3,605 tax assessments, which reinforces the consolidated RFB's trend of litigation against taxpayers. Still, the Brazilian taxpayers have limited resources to negotiate or discuss tax rulings with the RFB.

As to the segmentation of audits by sector, the focus has been on the companies engaged in manufacturing activities, which represent almost 50% of the tax assessment issued by the RFB in 2018. The digital economy remains a sector to be explored by the RFB with more diligence, especially with the increasingly expanding digital economy giants in Brazil.

Developments affecting attractiveness of Brazil for holding companies

Brazil is a jurisdiction with limited attractiveness for holding companies due to the lack of a participation exemption regime and limited treaty network. In addition, Brazil taxes the income of foreign controlled companies on a worldwide basis at the year end, regardless of actual distribution of dividends.

The year ahead

The Government of President Jair Bolsonaro took office in January 2019 with the expectation of comprehensive liberal reforms.

To date, the Government has been focusing all its efforts on the approval of the reform on public pension regimes – expected to be approved in Q3 – but the discussion on a potential and comprehensive tax reform has been gaining momentum. Although Brazil will likely focus on the reform of its complex indirect tax regime, a more detailed reform on corporate tax has also been discussed.

Despite the lack of a formal bill discussing the reform on corporate taxes for the time being, based on the information provided by the Government it is likely that the potential proposal would focus on two topics: (i) reinstating of the taxation of dividends, which have been exempt from tax since 1996; and (ii) the reduction of corporate tax rates in order to accommodate the nominal rates to global standards.

Brazil has also been discussing a substantial reform on its transfer pricing legislation as part of its effort to join the OECD. Based on the preliminary studies of the OECD, the Brazilian transfer pricing legislation, majorly grounded on statutory apportionment, is one of the main bottlenecks of the Brazilian candidacy.

A reform for the asset management industry is also expected for the coming year, especially with respect to the regimes of investment funds. The investment funds are transparent instruments for tax purposes with several incentives and deferrals, which tend to be eliminated if a reform is passed.

* * *

Endnotes

1. Similarly, if an exportation of goods, rights or services takes place with a foreign related party (or a person resident in a tax haven or subject to a privileged fiscal regime), transfer pricing rules apply to establish a minimum income level for IRPJ and CSLL purposes.
2. Also, companies that benefit from tax incentives, or are incorporated as financial institutions (or as any other institution authorised by the Brazilian Central Bank ("BACEN")), or are incorporated as factoring companies, are not eligible for the Deemed Profit Regime. Further, given that itemised deductions are not allowed in the Deemed Profit Regime, deductibility implications of transfer pricing rules or thin capitalisation rules are not applicable to companies under the Deemed Profit Regime. However, minimum income implications of transfer pricing rules are applicable to that Regime.
3. The Brazilian Civil Code (Law 10.460/2002) in its article 167, § 1 provides that a business will be regarded as a sham transaction when: "(i) it appears to confer or transmit rights to persons diverse from those to which they actually confer or transmit; (ii) it contains not true declaration, confession, condition or clause; (iii) its private instruments are pre or postdated."
4. "Business-purpose doctrine. The principle that a transaction must serve a *bona fide* business purpose (i.e., not for tax avoidance) to qualify for beneficial tax treatment" (*Black's Law Dictionary*, Eighth Edition, Thomson West, p. 212). See also the famous case of the US Supreme Court "*Gregory v. Helvering*" 293 U.S. 465 (1935).
5. In 2002, the Federal Government passed the Provisional Measure nr. 66/2002 ("MP nr. 66/2002"), which aimed at establishing the regulations of the GAAR, but the corresponding articles were suppressed of MP nr. 66/2002 and, therefore, those rules were not converted into law and therefore not enacted at all.
6. This amount must be duly supported by an appraisal report prepared by an independent auditor which must be filed before the "RFB" or Notary's Office (in this case, a summary of the report will be accepted) before the last business day of the 13th month following the acquisition of the investment.

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Canada

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Introduction

The Canadian M&A market experienced a material increase in 2018, with total deal value rising from US$265.8 billion in 2017 to US$331.2 billion in 2018. There was also an increase in average deal size, which rose from US$152 million in 2017 to US$170 million in 2018. In line with the increase in total value and average deal size, 2018 saw the number of deals announced increase from 3,216 in 2017 to 3,785 in 2018, reflecting another strong year for M&A in Canada.

Despite an increase in deal volume, 2018 was a year marked by volatility. The year was also characterised by political and economic uncertainty, including the China-United States trade disputes, Canada's relationship with China and the negotiation of a new North American trade deal. The year also saw oil prices struggling, magnified in Canada by a significant gap between the price of Western Canadian Select bitumen-blend heavy oil and New York-traded West Texas Intermediate oil, a gap that narrowed following the Alberta government's mandatory oil curtailment in late 2018. Should the volatility that Canadian markets experienced in 2018 continue throughout 2019 (which is also a federal election year for Canada), more risk-adverse acquirors may step back and wait for a time of greater certainty to pursue acquisitions.

It is also noteworthy that, in October 2018, Canada became the second nation in the world, after Uruguay, to legalise cannabis for recreational use. Against that backdrop, the cannabis sector experienced a frenzy of M&A transactions. In 2018, Canadian cannabis deal volume rose by over 600 per cent based on deal value (from US$1.27 billion in 2017 to US$9 billion in 2018). Unsurprisingly, in 2018, Canada accounted for 73 per cent of the transactions within the global cannabis sector based on deal value.

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

Taxation of stock options

The 2019 Federal Budget contained an announcement that the government intended to limit certain benefits under the current employee stock option regime. For decades, holders of most employee stock options have enjoyed favourable treatment, specifically (i) no taxation at the time of grant, and (ii) taxation at capital gains rates (i.e., half the normal tax rate) on the in-the-money value at the time of exercise.

The proposed changes include a new C$200,000 limit on the amount of stock options that may vest for an employee in a year and continue to be eligible for the deduction. This limit

will apply to options granted on or after January 1, 2020 by corporations or mutual fund trusts other than Canadian-controlled private corporations ("**CCPCs**") and a yet-to-be defined category of "start-ups, emerging or scale-up companies". The value of the stock option for purposes of the C$200,000 limit is to be calculated based on the fair market value of the shares under the option on the date of grant.

This measure may result in affected employers considering alternatives to stock options, such as stock appreciation rights or other equity-linked compensation plans for some employees. The 2019 Budget curiously refers to aligning Canadian law tax treatment of employee stock options with the U.S. rules. Since many features of Canada's tax system (including notably tax rates) differ fundamentally to those in the U.S., questions regarding the appropriateness of that reference arise.

Private company tax changes

The federal government indicated in 2017 that it was reviewing tax planning strategies involving private corporations that may, in the federal government's view, inappropriately reduce personal taxes of high-income earners in ways not available to other Canadians. The government then followed through in 2018 with the enactment of rules to address tax planning involving income "sprinkling" on family members as a form of income splitting. The tax on split income ("**TOSI**") provides that any split income received by certain individuals will be taxed at the highest individual marginal tax rate.

The TOSI rules potentially impact a significant number of business owners, particularly family-owned businesses. The rules are complex and, as a result of being new, there is very little case law or administrative guidance with respect to the application of the rules, making the rules a continued topic of discussion for the foreseeable future in the tax community.

Changes resulting from international developments

Transfer pricing

Canada, like most jurisdictions, has transfer-pricing rules based on the internationally accepted "arm's length principle". These rules can permit Canadian tax authorities to adjust the quantum or nature of amounts relevant to computing tax liability where the terms or conditions of related-party transactions do not reflect what "arm's length" parties would have agreed to in similar circumstances. In many cases, other provisions of the Act are also applicable to the same facts or transactions.

Recently announced amendments to the Act stipulate that transfer-pricing adjustments (if applicable) shall be made before any other provision of the Act is applied. This amendment is significant as the likely outcome of this change is larger and more frequent transfer-pricing adjustments and, consequently, larger transfer-pricing penalties. There is also the possibility of more frequent assessment of withholding tax under the "secondary adjustment" rules that can apply to deem a dividend to have been paid when transfer-pricing income adjustments are made.

Country-by-country reporting

As of January 2018, 68 countries including Canada had signed on to exchange country-by-country reports in an automated exchange which started in June 2018. Canada has since initiated its first round of exchanges.

Canada remains firmly committed to the multilateral efforts of the Organisation for Economic Co-operation and Development ("**OECD**") to address base erosion and profit shifting ("**BEPS**"). BEPS refers generally to the perceived shifting by multinational enterprises of income from high-tax jurisdictions to low-tax jurisdictions. Canada is in the

process of implementing, or has implemented, a number of measures agreed as to BEPS minimum standards, including the enactment of legislation in December 2016 to implement country-by-country reporting.

The country-by-country report is a form that multinational enterprise groups are required to complete and file annually to provide information of their global operations in each tax jurisdiction where they do business. The reports are intended to place Canadian tax authorities in a more informed position to make transfer-pricing risk assessments with respect to multinational enterprises.

Multilateral Instrument

As mandated by BEPS Action 15, the OECD released the "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting" ("**MLI**"). The MLI is an instrument that many countries could sign to modify certain existing provisions of bilateral tax treaties to implement various treaty-based BEPS measures without the need for burdensome bilateral renegotiation. Once in effect, the MLI could have a significant impact on the application of Canada's tax treaties, including the denial of treaty benefits in certain circumstances and the modification of existing dispute resolution procedures.

Under the MLI, signatories must agree to adopt treaty-related minimum standards in the BEPS recommendations. However, the MLI allows countries some flexibility in determining how the minimum standards will be met and what additional provisions a country will opt into. For Canada, among other things, the MLI, once ratified, will introduce a "principal purpose test" to most of Canada's tax treaties (notably excluding the *Canada-U.S. Tax Treaty*, which already contains a detailed limitation on the benefits rule) to combat so-called "treaty shopping".

Canada signed the MLI in the summer of 2017 and is in the process of ratifying the MLI under its domestic legislative process. As of the date of the most recent March 2019 Federal Budget, the ratification of the MLI was still considered a priority of the current government but is realistically not expected to be ratified before the upcoming fall federal election.

Tax climate in Canada

Audits and litigation

The general anti-avoidance rule ("**GAAR**") in Canada has now been in place for 30 years. The GAAR is a provision that purports to delineate between acceptable tax planning and abusive tax planning, requiring an analysis of broader policy arguments. Reassessments and litigation involving GAAR have become a common feature of the Canadian tax landscape and this reality is not expected to change in the foreseeable future. The relative success of taxpayers and the Canadian tax authorities with respect to court cases involving GAAR has generally been balanced.

Other high-profile cases in Canada generally involve transfer pricing, with one of the most recent cases being decided in favour of the taxpayer in *Cameco v. The Queen* (2018 TCC 195). The case is noteworthy not just because of the sheer volume of material involved, but also because of the Tax Court's efforts in synthesising the material, ranging from the taxpayer's own global operations to general market conditions, and for being one of the rare cases dealing with the intricacies of the Canadian transfer pricing rules. Not surprisingly, the Government has filed an appeal to the Federal Court of Appeal.

Impact of US tax changes

In December 2017, the U.S. enacted significant legislative changes. These changes include a dramatic reduction in the headline U.S. federal corporate income tax rate – from 35 per

cent to 21 per cent, and the introduction of a temporary 100 per cent "bonus depreciation" for certain capital investments. Although these changes were in some respects offset by new U.S. rules pertaining to interest deductibility, loss utilisation and measures to subject some foreign active business income to immediate U.S. tax, it is widely understood that the overall effect of these changes was to greatly reduce, if not eliminate, the long-standing Canadian corporate tax advantage.

In the 2018 Canadian federal budget, the government committed to studying the impact of U.S. tax reform on Canadian competitiveness. The government decided against a reduction in the headline federal corporate income tax rate so that the generally prevailing federal rate will remain at 15 per cent, and the combined federal-provincial rate will generally remain in the range of 26–27 per cent in much of Canada. Instead, the government introduced time-limited changes to the Canadian tax depreciation rules. The government expects these changes to reduce the so-called "marginal effective tax rate" of new business investments in Canada from 17 per cent to 13.8 per cent, the lowest in the G7.

The so-called "Accelerated Investment Incentive" consists of a series of proposed measures. The measures are focused on the rules applicable to capital cost allowance or "CCA", also known as tax depreciation, and the rules applicable to the deduction of certain resource expenditures (specifically Canadian oil and gas property expenses and Canadian development expenses). By way of background, taxpayers engaged in a business in Canada may deduct the cost of capital assets acquired by deducting a specified percentage of the asset's cost in the year of acquisition and subsequent years, in most cases on a declining balance basis. The applicable rate depends on the type of property, and often, though not always, is connected to the property's generally expected useful life.

Eligible assets include virtually all tangible and intangible capital property, such as machinery and equipment, motor vehicles, computers, buildings and intangible assets such as patents, time-limited licences, trademarks and goodwill. The first measure will increase the first-year CCA deduction for almost all new acquisitions of capital assets. Taken together, these measures will generally increase the deduction available in the First Year to three times the otherwise available deduction. For example, for computers, the CCA deduction allowed in the First Year will be 82.5 per cent (three times 27.5 per cent).

The accelerated deduction will not change the total amount of CCA deductible over the period during which the asset is used in the business. The enhanced deductions in the First Year will leave a smaller unamortised balance available to be deducted in later years.

This measure will apply only to capital property acquired after November 20, 2018, and will be gradually phased out starting in 2024. The measure is in response to the corresponding U.S. tax reform measures, and is similarly temporary.

For certain resource expenditures, the Accelerated Investment Incentive measures will largely apply in the same manner (i.e., the rate of deduction for the First Year will be 1.5 times the normal rate otherwise specified for the expenditure pool); however, there is no half-year rule that applies to resource expenditures.

Another measure will provide an enhanced First-Year CCA deduction for manufacturing and processing machinery and equipment. This measure will provide a 100 per cent deduction in the First Year – increased from 25 per cent under current law – for such assets acquired after November 20, 2018. The 100 per cent rate will continue in effect through 2023, after which it will be phased out.

Similar rules will apply to acquisitions of certain "clean energy equipment".

Developments affecting attractiveness of Canada for holding companies

The foreign affiliate dumping ("**FAD**") rules were introduced in 2012 with a stated policy objective of shutting down previously existing tax planning opportunities for certain multinational corporations with Canadian subsidiaries. The government was concerned that such multinationals could cause their Canadian subsidiaries to incur debt to make investments in foreign corporations, the dividends from which would be exempt from Canadian tax. The rules also prevented such entities from using surplus funds to invest in foreign corporations. The government was of the view that such structuring was eroding the Canadian tax base.

The FAD rules currently apply where a corporation resident in Canada ("**CRIC**") that is controlled by a non-resident corporation makes certain investments in foreign affiliates. Where these rules apply, they result in either a reduction of the paid-up capital of the shares of the CRIC or a dividend being deemed to be paid by the CRIC, which dividend would be subject to withholding tax.

Currently, the FAD rules apply only where the CRIC is controlled by a non-resident corporation. The 2019 Budget proposes to extend the application of these rules to circumstances where the CRIC is controlled by: i) a non-resident individual; ii) a non-resident trust; or iii) a group of persons that "do not deal at arm's length" with one another where the group includes any combination of non-resident corporations, non-resident individuals and non-resident trusts. Because the concept of "not dealing at arm's length" in Canadian tax law includes not only related persons but also persons who are considered "factually" non-arm's length, the latter branch of the rule could, in some situations, result in considerable uncertainty as to the scope of the rule.

These proposals may have a significant impact where one or more investment groups or private equity investors acquire significant interests in Canadian target corporations that have foreign subsidiaries. The determination of whether different parties deal with each other at arm's length on a factual basis is highly dependent on the particular circumstances. This determination can be fraught with uncertainty particularly when one is trying to ascertain whether different parties are acting with separate interests or a common mind.

The stated reason for these proposals is to "better achieve the policy objectives of the foreign affiliate dumping rules". It is unclear whether the expansion of the FAD rules beyond the control of foreign corporations aligns with the original stated policy objective noted above.

The year ahead

Budget 2019 contemplates a deficit of C$19.8 billion for the 2019–2020 fiscal year. Notwithstanding some of the highest levels of spending for this current government, the government had signalled that the primary focus of the 2019 Federal Budget would not be business concerns, so no changes to the corporate tax rate have been proposed. Given that 2019 is a federal election year, that should not be surprising.

The year ahead will be materially impacted by the results of the federal election. The election must occur on or before October 21, 2019 and current predictions are that there will likely be a minority government. Some of the business-related issues that are expected to shape the federal election include each party's views on the appropriate level of corporate tax in Canada, as well as the construction of oil and gas pipelines in Canada and taxing carbon emissions.

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Nancy graduated from the University of Toronto law school in 2000 and was called to the Alberta bar in 2001. Her practice focuses primarily on the tax aspects of mergers, acquisitions and reorganisations, including cross-border transactions or financings and intragroup restructurings. She particularly specialises in the area of resource taxation. Nancy has worked on a wide variety of transactions for multinationals, private companies, senior, intermediate and junior resource issuers, income and royalty trusts, and private equity groups.

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China

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Overview of corporate tax work over last year

Types of corporate tax work

In China, the current tax regime is relatively new and has been developing since the 1980s. China's legal system is a socialist system of law based primarily on the Civil Law model. Laws and regulations are codified in statutory instruments which are derived from various sources at different levels of government from national to local with a hierarchy of authority.

The Chinese tax legislation system mainly includes the following:

- tax laws promulgated by the National People's Congress or its standing committee;
- administrative regulations issued by the State Council;
- other administrative documents in the form of tax circulars, notices and decrees issued by the State Administration of Taxation ("**SAT**") or other regulatory authorities, such as the Ministry of Finance ("**MOF**") and the General Administration of Customs ("**GAC**"); and
- local tax regulations and rules issued by the local People's Congress or local tax authority.

From the corporate tax perspective, China imposes direct and indirect taxes on corporate taxpayers:

- Direct tax, which is levied on income and profits, in China refers to the Enterprise Income Tax ("**EIT**").
- The main forms of indirect tax operating in China are Value-Added Tax ("**VAT**"), which applies to all goods and services, and consumption tax, which applies to selected goods.
- Historically, China had a dual system of indirect tax, under which VAT was levied on the sales and importation of tangible goods and the provision of processing, repair and replacement services, whereas business tax is levied on the provision of other services and the transfer of intangibles and real properties. Starting from 1 January 2012, a pilot programme for converting the business tax to VAT has been rolled out in China, and on 1 May 2016, the VAT pilot programme was completed, with business tax being fully replaced by VAT in all industries. Under the current VAT regime, VAT applies to all taxable goods and services.

Enterprise Income Tax

The most important pieces of legislation on EIT are the *PRC Enterprise Income Tax Law*, promulgated by the National People's Congress, and the *Implementation Regulations of the*

PRC Enterprise Income Tax Law, promulgated by the State Council, both of which took effect on 1 January 2008.

- General

Both domestic companies and foreign-invested enterprises in the PRC are subject to EIT on their income derived from production, business operations and other sources at a rate of 25%. The taxable income for EIT purposes is computed as the difference between its total income, less deductible items, in the order of: non-taxable income; exempted income; deductible expenses; and any qualifying tax losses brought forward from prior years. In calculating an enterprise's taxable income, where there are differences or inconsistencies between accounting standards and the tax law, the latter prevails.

The EIT filings in China consist of provisional quarterly filings and final settlement (i.e., annual filing). Normally, the quarterly EIT returns should be filed within 15 days after the quarter end, i.e., from 1–15 of January, April, July and October of each year on a provisional basis.

The EIT annual filing should be performed on or before 31 May of each year. When performing an annual filing, the taxpayer should submit its audited report issued by a qualified accounting firm together with its tax returns and other required documents to the relevant local tax authority.

- Withholding Income Tax ("**WIT**")

The *PRC Enterprise Income Tax Law* provides for 20% WIT on the passive income (including dividends, interests, royalties, rental income, etc.) derived by foreign enterprises from China. However, the *Implementation Regulations of the PRC Enterprise Income Tax Law* provides a reduction of the rate from 20% to 10% (which could be further reduced under an applicable double tax treaty).

The *PRC Enterprise Income Tax Law* imposes the withholding liability for WIT on the payer in China. The payer is the withholding agent and is required to withhold at source the WIT, either when the overseas payment is actually made or becomes due, whichever is earlier. Specifically, the withholding obligation arises:

- for dividends, when the dividend is distributed; and
- for royalties, interest and rental, when the payment is due according to the relevant contract.

To alleviate the administrative burden of taxpayers, the State Administration Taxation ("**SAT**") repealed the contract registration requirements effective from 1 December 2017, and withholding agents in China are no longer required to register the relevant contracts in respect of the China-source dividends, interests, rent, royalties, capital gains, etc. with local tax authorities before making the outbound payments.

- Indirect transfer rules

As part of general anti-avoidance legislation, China issued various tax regulations to combat indirect transfers designated by non-resident enterprises to avoid paying capital gains tax on the direct transfer of equity interest in Chinese resident enterprises. The latest tax regulation is the Public Notice [2015] No. 7, issued by the SAT in February 2015 ("**Public Notice 7**").

According to the Public Notice 7, when a non-resident enterprise engages in an indirect transfer of China taxable properties, including immovable properties in China, assets held under the establishment of a non-resident enterprise, and shares of Chinese resident

enterprises, through an arrangement that does not have a *bona fide* commercial purpose in order to avoid paying EIT, the transaction should be re-characterised as a direct transfer of the Chinese taxable properties. The capital gain will then be subject to China WIT.

- Profit repatriation

Further to the WIT section above, the dividends distributed by foreign invested enterprises in China to the foreign investors will be subject to 10% WIT (unless a lower tax rate is provided under an applicable double tax treaty). In this regard, the overall Chinese income tax burden for income generated from within China may escalate to 32.5% after including the 10% WIT.

Please refer to the following table as an example for easy reference:

Chinese Subsidiary Level	**Tax Rate**	**Income Statement**
Net profit before tax	-	100
EIT liability	@ 25%	(25)
Profit after income tax	-	75
Foreign Investor Level		
PRC WIT	@ 10%	(7.5)
Net Repatriation to the Foreign Investor	-	67.5
Overall Chinese Tax Burden	-	**32.5%**

- Transfer pricing

In China, any transactions between related companies should be conducted on an arm's-length basis. If a taxpayer's inter-company transactions are not considered as at arm's length and result in the reduction of its taxable income in China, the China tax authority is empowered to impose a tax adjustment on the taxpayer's inter-company transactions unless the transactions are purely conducted onshore between Chinese companies. The *PRC Enterprise Income Tax Law* imposes a late payment interest on transfer pricing adjustments.

The *PRC Enterprise Income Tax Law* and its *Implementation Regulations* require taxpayers to provide information relevant to related party transactions. The detailed requirements are set out in Bulletin 42:

- Bulletin 42 introduces the formal templates and filing instructions for the Annual Related Party Transaction Reporting Forms ("**New RPT Forms**"). The total number of the New RPT Forms has now been increased to 22, including the country-by-country ("**CbC**") reporting form, which follows the requirements of BEPS Action 13. The CbC reporting form will be required for Chinese resident enterprises that are (a) the ultimate parents of a multinational enterprise group, with consolidated revenue greater than RMB 5.5 billion in the last fiscal year, or (b) nominated by the multinational group as the filing entity.
- Announcement 42 also introduces a three-tiered documentation framework, including a master file, local file, and special issue file, as set out in the OECD's final report on BEPS Action 13. However, Chinese taxpayers that have only conducted transactions with domestic related party companies, or implemented an Advance Pricing Arrangement ("**APA**"), are exempt from preparing master, local and special issue files.

VAT

China's VAT system is one of the most complex in the world and it requires significant efforts to stay on top of the changing environment. Similar to other VAT regimes throughout the world, China VAT is designed to be "neutral" by relieving the burden of VAT on transactions between businesses through an input VAT credit mechanism and having the VAT cost ultimately borne by end consumers of goods and services. For export-oriented enterprises, no VAT is payable on export sales and VAT incurred domestically may also be refunded if certain conditions are satisfied.

The most important regulations governing VAT are: (i) the *Interim Value-Added Tax Regulations of the People's Republic of China* (2017) issued by the State Council; (ii) the *Implementing Rules for the Interim Regulations of the People's Republic of China on Value-added Tax* (2011) issued by the MOF; and (iii) *Circular on Comprehensively Promoting the Pilot Program of the Collection of Value-added Tax in Lieu of Business Tax* (Caishui [2016] No. 36) jointly issued by the MOF and the SAT.

There are also countless detailed implementation rules and regulations on VAT matters to be complied with by taxpayers. It is challenging for taxpayers to keep abreast of the latest developments of the VAT legislation, though necessary for day-to-day VAT management. Failure in following the requirements can result in significant VAT-related costs hitting the profit and loss ("**P&L**") of taxpayers.

The following sections provide an overview of the current VAT regime in China:

- VAT scope: VAT applies to the sale and importation of all goods in, from or to China and the provision of all services in, from or to China.
- VAT payer types and registration: There are two types of taxpayer in China: general taxpayers and small-scale taxpayers, depending on the sophistication of the accounting system adopted and their annual turnover. Small-scale taxpayers are those with annual sales turnover of not more than RMB 5 million. It is possible for taxpayers that fail to meet the thresholds to register as general taxpayers if they are able to demonstrate to the tax authority that they have sound accounting systems that can produce accurate tax information required for tax filings. Registration as a small-scale taxpayer or general taxpayer determines whether VAT is payable at a 3% levy rate, with no eligibility for input VAT credits, or VAT is payable by adopting the standard tax rates with input tax credits.
- VAT rates: The standard VAT rate for the sale and importation of goods, the provision of repair, replacement and processing services, as well as the leasing of tangible movable assets, is 13% for general VAT taxpayers. The 6% rate applies to most of the services provided by general VAT taxpayers. VAT exemption applies to agricultural products, contraceptive drugs and devices, antique books, and certain exported services. A VAT refund is available for the export sale of goods and certain services. For small-scale taxpayers, a 3% VAT levy rate is applied on all taxable income.
- VAT credit mechanism: In order to claim input VAT credits in China, a business must first be registered as a general taxpayer and it must also obtain valid VAT vouchers, including special VAT invoices for domestic purchases, customs receipts for import VAT paid, agricultural products purchase vouchers, etc., which should be verified online within 360 days of issuance. If there are excess input VAT credits, the credit balance can be carried forward indefinitely to offset future output VAT. Any input VAT not supported by legitimate VAT vouchers, or input VAT incurred for purchases related to non-taxable items, tax-exempted items, collective welfare or abnormal losses, etc., are not creditable and have to be expensed by the business.

- VAT filings: General taxpayers file VAT returns on a monthly basis and small-scale taxpayers file VAT returns on a quarterly basis. The VAT returns contain a main form and several appendices and information-reporting forms.

Significant deals and themes

The year 2018 marks the 40th anniversary of China's reform and opening-up, and in the past four decades of development, China has achieved unprecedented economic and social success. However, the economic growth of China has slowed down since the start of the U.S.-China trade war in March 2018. In order to drive domestic economic growth, China is moving towards supporting private enterprises. In 2018 and early 2019, the MOF and the SAT introduced a series of tax policies and reform measures on tax reduction, business environment improvement, and improving the efficiency of the taxation system.

The U.S. government's decision to blacklist China's tech giant Huawei is also considered a turning point for China to strengthen independent innovation and reduce its dependence on imported technology. Tax incentive policies have been issued to encourage technological innovation.

One of the industry-oriented tax incentive policies is related to the High-and-New Technology Enterprise ("**HNTE**"). If a company is certified as a HNTE, it will be eligible for the reduced EIT rate of 15% (as opposed to the 25% standard rate), and its tax loss can be carried forward for 10 years (as opposed to the general five-year carry-over rule) for deduction. To be certified as a HNTE, a company needs to continuously satisfy a number of conditions, which include, among others, ownership of intellectual property rights, technology and R&D personnel requirements, R&D expenditure ratio, high-tech revenue ratio, etc.

China, on the one hand, encourages technological innovation, and on the other hand, cracks down on the abusing of tax incentive regimes. In 2018, Xiamen tax bureau conducted a tax audit on key taxpayers in the jurisdiction, and identified abnormal issues in the R&D expenditure claim of a taxpayer, which is a certified HNTE, using big data, tax audit software and a tax risk management system, etc. After the investigation, the tax authority uncovered that the taxpayer had undergone a share restructuring and that after the restructuring, the taxpayer changed its R&D model by paying huge technology royalties to a related offshore party instead of conducting R&D itself and using self-developed intellectual properties to manufacture products. The tax authority in the end concluded that the taxpayer failed to meet the requirement of the R&D expenditure ratio and therefore was no longer qualified for the HNTE status. With the disqualification of the HNTE status, the taxpayer also cancelled the preferential tax treatment retroactively and recaptured the underpaid taxes of RMB 230 million, plus late payment interest of RMB 100 million.

The above 2018 case was not a single one. In fact, every year there are a number of companies being taken off from the HNTE list due to different reasons. For HNTEs that undergo corporate restructuring or business model changes, they need to take into account the impact on the HNTE status and ensure that after the reform, they will continuously meet all the requirements for HNTE certification. Otherwise, they should inform the tax authorities and voluntarily apply for deregistering themselves as HNTEs to avoid tax risks.

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

In 2018, China completed its tax administration reform to merge the state tax bureaus with

the corresponding local tax departments into a consolidated local tax authority. The new taxation system is jointly led by the SAT and China's province-level governments.

State and local tax bureaus have existed in parallel at the provincial, municipal and county/district levels in places other than Shanghai and Tibet since the tax-sharing system reform in 1994, and they were in charge of the administration and collection of different taxes. With the cancellation of local taxes in the 2002 EIT reform and the replacement of the business tax with VAT in 2016, the tax collection ability of local tax departments has been weakened due to lacking its main form of levy. In order to improve the efficiency and quality of collection, provide convenience to taxpayers, and unify the tax collection administrative system, China started reforms to merge corresponding state and local tax bureaus into a consolidated local tax authority in March 2018. The completion of the county/district-level merger on 20 July 2018 symbolises the official merger of the state and local tax bureaus in China.

Simplifying administrative procedures for tax-related matters

In April 2018, the SAT issued Public Notice [2018] No. 15 and Public Notice [2018] No. 23 to remove the approval or recordal requirements for claiming asset losses and the tax recordal requirement for enjoying EIT preferential treatment. Both notices took retroactive effect from 1 January 2017.

With the introduction of the two notices, starting from the 2017 annual EIT filing, corporate taxpayers are only required to complete a form of the annual EIT return to claim tax deduction for asset losses and keep the relevant supporting documents for examination by tax authorities in the future. For claiming tax preferential treatment in the annual EIT filing, taxpayers no longer need to perform any record filings. Rather, they should make their own assessment on the eligibility of preferential tax treatment and retain supporting documents in case of future examination.

In accordance with China's Five-year Work Plan of "Streamlining Administration, Delegating Power and Strengthening Regulation, and Upgrading Services" (2018–2022), China issued a number of regulations in 2018 and 2019 to optimise tax deregistration formalities, including:

- waiving the tax clearance certificate requirement for taxpayers who have not handled any tax-related matters since establishment;
- waiving the tax clearance certificate requirement for taxpayers who have handled tax-related matters but have not yet obtained invoices, have no unpaid taxes (including overdue fines) and have not been given any tax penalties. If the said taxpayers apply for going through tax clearance formalities, tax authorities may issue tax settlement documents immediately on the spot if required application documents are complete and in order – and if the application documents are not complete, taxpayers can still obtain the tax clearance certificate after making a commitment;
- for taxpayers who have been declared bankrupt by the People's Court, tax authorities may issue tax settlement documents immediately on the spot based on the court orders on the termination of bankruptcy proceedings provided by the taxpayers; and
- the process and documents required for general tax de-registration procedures are further simplified, and the tax authority may issue tax clearance certificates to qualified taxpayers who have made commitments even if the required documents submitted for application are not complete.

R&D expense deduction for EIT

To promote and encourage technology development by Chinese enterprises, the current PRC EIT regime allows a resident enterprise to deduct 150% of qualifying R&D expenses actually incurred in computing its tax liability, if the expenses do not result in the creation of an intangible asset. If intangible assets are developed, the qualifying R&D expenses that have been capitalised may be amortised based on 150% of the actual R&D costs.

Starting from May 2017, small- and medium-sized science and technology enterprises ("**SMSTEs**") that incur R&D expenses may deduct an additional 75% of the actual costs incurred when computing its EIT liability for the period 1 January 2017 to 31 December 2019, provided no intangible asset has been developed. If an intangible asset has been created as a result of the R&D, the costs may be amortised at a rate of 175% of the pre-tax cost of the assets for the above period. The additional deduction effectively lowers the taxable income of the SMSTEs and thus the EIT payable, if any.

The direction of the Chinese government of encouraging enterprises to engage in more innovative activities and investment was further emphasised in 2018. The MOF and the SAT jointly promulgated the *Circular on Increasing the Super Deduction Ratio of R&D Expenses for EIT Purpose* (Caishui [2018] No. 99) in September 2018, which expanded the 75% additional R&D expenses deduction originally only applicable to SMSTEs to all enterprises during the period of 2018 to 2020.

The scope of R&D super deduction has also been expanded based on circular Caishui [2018] No. 64, which allows taxpayers to claim super deduction of 80% of the R&D expenses incurred in relation to the entrusted overseas R&D activities, as long as the R&D expenses incurred for the overseas entrusted R&D activities do not exceed two-thirds of the eligible R&D expenses incurred domestically.

Deepening of the VAT reform

Since the completion of business tax to VAT reform in 2016, China has been improving the VAT regime and reducing tax burdens.

Effective from 1 April 2019, the standard VAT rate of 16% and 10% should be lowered to 13% and 9%, respectively. This is the second tax cut in the past 12 months (the first one was on 1 May 2018 when the VAT rates were reduced from 17% and 11% to 16% and 10%, respectively). The tax cut will largely benefit Chinese manufactures struggling as a result of the U.S.-China trade war as well as consumers.

Apart from the tax rates reduction, there are also other preferential treatments published by the Chinese tax legislator, including a 10% super input VAT credit eligible to manufacturers and lifestyle-related service providers, to lessen the overall tax burden of the taxpayers, as well as refund of qualified input VAT balance carried forward from previous periods, to relieve the cash flow pressure of taxpayers.

BEPS

Mainland China and government representatives from 67 countries and regions jointly signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the "**MLI**") on 7 June 2017 at the headquarters of the OECD in Paris. The MLI was first introduced by the BEPS Action Plan (Action 15). When signing the MLI, China also submitted the Provisional List of Reservations and Notifications (MLI Positions) and a list of 102 tax treaties it entered into that China would like to be amended through the MLI.

Tax climate in China

With the recent slowdown of the Chinese economy, the tax system in China is full of opportunities and challenges. On the one hand, the central government would like to provide more tax benefits to taxpayers and investors in order to stimulate the economy through tax reforms and simplifying the relevant tax application formalities; on the other hand, the tax authorities need to collect more tax revenue to deal with the increased financial pressure of the governments (especially the local governments).

To further open up to and attract foreign investment, in 2018, the Chinese government released the tax policy that, starting from 1 January 2018, a non-resident enterprise shareholder using dividends distributed from a China enterprise to make direct investment into China is eligible for WIT deferral treatment on the dividends, provided that certain conditions are met.

In addition, China further shortened the 2018 "negative list" for foreign investment aiming to further liberalise market access for foreign investors. China also passed the *Foreign Investment Law* in early 2019, as a guiding document to govern foreign investment in China.

Developments affecting attractiveness of China for holding companies

Generally speaking, China is not an attractive location for incorporation of holding companies. China has a tight foreign exchange control regime and foreign investment is regulated by the governmental authorities.

Historically, a foreign-invested enterprise has business scope and foreign exchange restrictions in making equity investments in China with its registered capital. Thus foreign investors would have to resort to the option of setting up a China Holding Company ("**CHC**") as the vehicle for equity investments in China. However, such restrictions have been relaxed nowadays, which makes the CHC structure less attractive.

That said, a CHC would still be preferable if foreign investors already have multiple investments in China and would like to streamline the management and also cater for envisaged further expansion by either setting up new companies or acquiring existing business in China. This is because a CHC can offer certain economies of scale in operations and management through its investments under a single corporate identity. These include centralised purchasing of raw material, sale of finished products, and marketing efforts for subsidiaries, collective training of project personnel of subsidiaries, coordination of project management, etc. Setting up a CHC would show the foreign investors' commitment of investments and expansion in China and thus would have a better position to get favourable support of local government bodies in day-to-day business operations.

The registered capital of and foreign loans borrowed by a CHC contributed by a foreign investor can be directly used for equity investment in China. Compared with normal foreign invested enterprises, CHCs are able to borrow foreign loans of up to six times its registered capital. But the capital requirements of CHCs are also much higher than normal foreign-invested enterprises.

China sets a high threshold on foreign investors which want to set up a CHC in China. To be qualified to invest in a CHC, a foreign investor must qualify under one of the following two approaches:

- One approach to qualifying is to meet the following three requirements:
  - The total (gross rather than net) asset value of the foreign investor must be at least USD 400 million.

- Existing China investment: the applicant company's paid-up capital contribution in its existing PRC-invested companies must exceed USD 10 million.
- Future additional plans: in addition to its existing investments in China, the applicant company must have and provide summary descriptions of three or more additional intended PRC-invested companies.

- An alternative approach to qualify is for the foreign investor to have more than 10 existing investments in China, in which its total paid-up capital contribution exceeds USD 30 million.

In practice, only big MNCs with a huge amount of Chinese investment (most of them are Top 500 companies) could set up CHCs in China. From a tax perspective, the SAT does not provide special tax incentives or exemptions for CHC in China. However, many local governments provide financial subsidies in the form of tax refunds or cash rewards to CHCs incorporated in their locality in order to attract foreign investment.

Industry sector focus

Tax breaks for software and chip design companies

To support the domestic tech industry due to the escalating trade tension between China and the U.S., China continues to provide financial support to software and integrated circuit companies. On 17 May 2019, the MOF and the SAT jointly issued *Announcement on the Enterprise Income Tax Policy for Integrated Circuit Design and Software Enterprises* (Circular 68) to grant a five-year tax break to qualified integrated circuit design and software companies who became profitable before the end of 2018.

Aircraft finance

Due to the increasing need for Chinese airline companies to import leased aircrafts from offshore, also as a sign of the government's support of the aviation industry, the SAT and the General Administration of Customs jointly issued Pubic Notice [2018] No. 24 to abolish import VAT on the import of leased aircraft with effect from 1 June 2018. With the introduction of the new VAT regime, the double taxation issue will be solved and it will also significantly reduce the cash flow impact on the lessees in China.

Before the new VAT regime, cross-border aircraft leases between foreign lessors and China airline companies were subject to two sets of VAT: (i) 5–13% (depending on the weight of the leased aircraft) import VAT assessed based on the total rent imposed by the China customs office; and (ii) 6% VAT to be withheld by the Chinese airline companies from the outbound rent payment and to be settled with tax authorities.

The year ahead

With the continuous efforts in the implementation of the BEPS package of the SAT, it is expected that the Chinese tax authorities will pay more attention to international tax administration, which can be reflected on the rising transfer pricing adjustment initiated by the SAT and year-by-year revenue increases on taxation of non-resident taxpayers in the past several years.

To echo China's "Belt and Road Initiative" ("**BRI**"), which is essentially a concept of "going abroad" of Chinese entities, the SAT released the *Notice Regarding the Tax Services and Administration to Implement the Development Strategy of the "One Belt One Road"* (ShuiZongFa [2015] No. 60) on the direction of tax management of enterprises making outbound investments. The key message of the BRI tax policy is that the Chinese tax

authority will proactively formulate and implement specific tax policies associated with enterprises' outbound investments to protect the interest of Chinese enterprises, improve the tax services of tax authorities and provide guidelines for tax compliance by enterprises making outbound investments.

In 2017, China amended tax policies on the foreign tax credit mechanism, aiming to avoid double taxation on PRC enterprises investing offshore.

The SAT will continue to support the BRI. The first Conference of the Belt and Road Initiative Tax Administration Cooperation Forum ("**BRITACOF**") was organised by the SAT in Wuzhen, Zhejiang Province during 18–20 of April 2019. Heads and their representatives of tax administrations or finance departments from 85 jurisdictions, 16 international organisations, and a number of academic institutions and businesses have attended the Conference. The discussions focused on how to build a growth-friendly tax environment that would promote economic growth while ensuring tax revenue mobilisation in jurisdictions that support the BRI.

The Belt and Road Initiative Tax Administration Cooperation Mechanism ("**BRITACOM**") was officially launched on the first day of the Conference. The Wuzhen Statement was released where a consensus was reached on building a growth-friendly tax environment by following the rule of law in taxation, expediting tax dispute settlement, raising tax certainty, streamlining tax compliance and digitalising tax administration, and enhancing tax administration capacity. The Wuzhen Action Plan (2019–2021) was adopted subsequently, providing a two-year roadmap as a first step to attain the longer-term goals of the BRITACOM.

The first BRITACOF Conference delivered concrete outcomes, marking a milestone in strengthening tax administration cooperation among BRI jurisdictions towards a growth-friendly tax environment that will contribute to the building of a multilateral tax administration cooperation system, and the fulfilment of inclusive and sustainable economic growth under the framework of the Belt and Road Initiative.

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Cyprus

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Introduction

While Cyprus offers many advantages for corporate entities and individuals that want to use it as a tax base, the regulatory environment with regards to all things to do with corporate tax has tightened significantly, and this does usually require companies to have more of a presence in Cyprus, as opposed to previous years.

Nevertheless, Cyprus has also adopted significant policies with regards to corporate tax matters and has provided considerable support to the promotion of certain industries, such as the film and shipping industries. These policies, in combination with Cyprus's traditional tax advantages, have maintained the corporate tax field and even provided a significant boost to previously unheard-of new industries, creating both more tangible business activities within Cyprus and what is likely the first greenfield investments in Cyprus in the film industry.

The banking sector, as in previous years, will affect Cyprus's attractiveness as a corporate tax base destination, and this is now more to do with the implementation of new international regulatory standards.

Regulatory developments

As an EU Member State, Cyprus's tax policy is influenced by EU policies and regulations. While Cyprus does have a large degree of independence, it must adhere to the basic principles of EU regulation.

It should be noted that in April 2019, the Cyprus Parliament adopted the first implementation of the EU Anti-Tax Avoidance Directive (ATAD), which includes rules with regards to Controlled Foreign Companies (CFCs), interest limitations as well as general anti-abuse provisions. These will obviously have an impact on Cyprus tax resident companies and Cyprus Permanent Establishments of non-Cyprus tax resident companies. These measures have been in effect since 1st January 2019 and, hence, the regulation is retroactive to a certain extent. There are further ATAD provisions that will be implemented gradually over time.

Companies that are neither Permanent Establishments nor members of a group, or have overseas associates (standalone companies) as well as financial undertakings (e.g. banks, investment funds, securitisation vehicles), will be excluded from the scope of the ATAD at least at the initial stage of implementation.

CFC income derived from subsidiaries or Permanent Establishments may be taxed in Cyprus in certain circumstances, provided the parent company is a Cyprus tax resident. The conditions that need to be satisfied are as follows:

- Firstly, the overseas entity's corporate income tax payable overseas should be less than 50% of the corporate income tax payable in Cyprus, should such entity be taxed in Cyprus.

- Secondly, in the case of an entity, the Cyprus-based tax entity would need to be entitled to at least 50% of the profits, or hold at least 50% of the entity's capital, or is entitled to no less than 50% of the voting rights.
- Finally, if an entity's accounting profits are less than €750,000 or less than 10% of its operating costs, then the CFC regulation will not kick in.

It should be noted that when a foreign entity is determined to be a CFC, then the Cypriot taxpayer will be taxed on non-distributed income which is the result of non-genuine arrangements that have been implemented with the main purpose of obtaining tax advantages arising under Cyprus income tax regulations. Furthermore, the said income should not have been previously taxed in another jurisdiction, hence there is no double taxation of the same profits.

Another important aspect of the ATAD is the interest limitation rule, and, just like CFCs, it applies to both Cyprus tax resident corporations as well as non-Cyprus tax resident corporations which have a Permanent Establishment in Cyprus. Under this rule, taxpayers' deductions are limited to just 30% of "tax adjusted earnings before interest, depreciation and amortisation" (EBITDA), unless of course the borrowing costs are larger than €3 million. This limitation rule applies to both intra-group as well as third-party loans. Certain types of loans are, however, excluded from the interest limitation rule; these include loans made before 17th June 2016 (unless there have been subsequent modifications to such loans) and loans with regard to long-term public infrastructure projects (provided that the income, assets, borrowing costs and operator are within the EU). Any interest capacity not used under the interest limitation rule, or borrowing costs exceeding the 30% interest limitation rule, can be carried forward over the next five years; however, this does not apply to unutilised amounts of over €3 million and, hence, the *de minimis* exception is not carried forward.

Finally, a General Anti-Abuse Rule (GAAR) has been implemented, which essentially entails that any arrangements made for the sole purpose of obtaining a tax reduction, and which would otherwise make no commercial sense, should be ignored when calculating corporate tax liability. In cases such as the above, tax would be calculated in accordance with income tax law.

Cyprus shipping sector

Cyprus is in the world's top 10 maritime registries worldwide. The main reason for this is that Cyprus, with regard to shipping operations, exempts all profits and dividends of shipping distributions at all levels of the distribution processes. This is covered by the Merchant Shipping Law that has been in force since 2010 and has significantly enhanced the tonnage tax (TT) scope regime. What this means is that shipping activities are exempt from corporation tax, with a TT on net tonnage being imposed instead. Furthermore, the Department of Merchant Shipping as opposed to the tax authorities regulate qualified persons.

This scheme has been approved by the European Commission until 31st December 2019 and does not constitute state aid.

It should be noted that the TT system applies not only to Cyprus-flagged vessels, but also to EU and EEA-flagged vessels, and EU, EEA and non-EU/EEA fleet vessels that choose to be taxed under the TT system. For non-EU/EEA fleet vessels to be eligible under the regime, however, they will need to be part of a fleet that comprises at least 60% EU/EEA flagged

vessels. The tax exemptions will cover profits from the use, disposal, and selling of shares of ship-owning companies as well as dividends paid out from the above, and interest income from managing and maintaining shipping vessels, excluding investment capital interest.

Cyprus property market

The property market in Cyprus has been going from strength to strength over recent years, and 2019 has been no exception. Property in Cyprus has been significantly boosted by the Cyprus Investment Program (CIP) which, up until 15th May 2019, gave the possibility to wealthy individuals with an acquisition of properties worth at least €2 million to qualify for an EU passport. Criteria for the CIP has, however, been tightened as of 15th May 2019, and it is yet to be seen what impact this is going to have on the Cyprus property market. It should be noted that in the first six months of 2019, property sales were 23% higher than the equivalent six months of 2018, but this is mainly due to a spike of sales in the months of April and May of 2019, which indicates a rush to buy property before the tougher criteria kicked in. This has resulted in a high number of purchases of high-end properties, mainly by foreign buyers.

The property construction sector in Cyprus is boosted not only by residential construction, but also investment in projects such as marinas and casinos. A perfect example is the commencement of construction of the Casino resort in Limassol, "City of Dreams Mediterranean", which is expected to be completed in 2021 and is considered a one-of-a-kind project in the Mediterranean region. In the period between June 2018 and June 2019, Cypriot casinos have managed to attract 880,000 visitors; thus projects such as "City of Dreams Mediterranean" will have a big impact on Cyprus's tourism market, and likely by extension the residential property market.

It should be noted that the CIP, the above-mentioned projects and an overall better economic climate have boosted luxury real estate but negatively affected affordable real estate. Due to this reason, the land development organisation (KOAG) has presented a scheme that will allow vulnerable groups to apply for assistance for the acquisition of housing between July and December 2019. Cypriot citizens, as well as EU nationals who have lived in Cyprus for at least five years, will be able to apply under the scheme. In order to implement this scheme, certain central locations have been selected within towns for construction by developers, who will be incentivised through favourable zoning regulations as well as other tools in order to construct affordable housing.

Changes to Investment Program

In February 2019, the Cyprus Government has announced new changes to the CIP in order, as it describes, to reduce the risk of abuse.

These include notable changes, in that the potential investor should already be a holder of a Schengen Visa before being able to apply for investment, and Government Bonds are no longer included in the list of qualifying investments.

Overall the CIP, as it now stands, includes citizenship by investment, through new aspects that cannot be waived, such as a €75,000 donation to the Cyprus Land Development Association.

Other changes to the Program include:

- The inclusion of the shipping sector in the list of eligible investments for the CIP, which should adhere to certain criteria determined by the Ministry of Finance and the Deputy Ministry for Shipping.

- Investment in housing units (including a private permanent residence) has now been increased to €2.5 million from the previous €2 million.
- Potential candidates can now invest in Cyprus Registered Alternative Investment Funds (AIFs), as well as up to €200,000 in the Cyprus Stock Exchange's secondary market.
- If the applicant's three total investments, including a private residence valued at €2.5 million, and residential units already used for the purposes of the CIP which will be reused under the same Program, following the stipulation that if the applicant has made investments in a residential unit(s) on the basis of the "Investment in Immovable Property, Land Development and Infrastructure Projects" criterion, there is no requirement for the purchase of another private residence in Cyprus.
- The required investments will now need to be maintained for at least five years as opposed to three years under the previous regime.
- If another EU Member State has rejected the applicant's previous application for citizenship in that Member State, then the applicant will not be eligible to apply for Cypriot citizenship through the CIP framework.

Investment funds

Cyprus legislation allows both AIFs and Undertakings in Collective Investments in Transferable Securities (UCITSs). There are significant tax benefits in offering these types of vehicles in Cyprus.

The law governing AIFs in Cyprus, known as the Alternative Investment Fund Law, was enacted in 2014 and governs all investment products, investment firms, as well as asset managers under the supervision and regulation of the Cyprus Securities and Exchange Commission (CYSEC). The Alternative Investment Funds Law of 2014 is in line with all EU directives with regards to investor protection, transparency and asset management. Cyprus's regulatory framework offers transparency through audited reports on an annual as well as six-month basis towards CySEC, as well as towards investors, which includes information such as net asset value, financial statements, portfolio statements and borrowing costs.

Since the regulatory framework of Cyprus is aligned with the EU directives, it should be noted that AIFs under Cyprus jurisdiction can be marketed to investors within the EU under the AIFMD passport, or sold on a private placement basis.

The main tax benefits of AIFs in Cyprus are that unlike other jurisdictions, the majority of dividend and capital gains of Cyprus tax residents are tax-free, and furthermore, since there is a notional interest deduction (NID) on new equity, the tax on interest income can be significantly curtailed effectively by 80% in some cases, bringing the corporate tax rate to 2.5%. Furthermore, resident funds enjoy all double taxation treaty benefits and there are no capital gain taxes on disposal of shares or other units, no withholding taxes on payments to foreign residents as well as no subscription taxes on fund assets.

It should be noted that funds established under Cyprus domestic legislation can take three different forms: these are known as Common Fund; Fixed Capital Company; and Limited Partnership. Provided that the number of investors is not limited, Cyprus AIFs can be listed on the Cyprus Stock Exchange as well as other European Stock Exchanges, and can be set up as umbrella funds with various compartments underneath. There are also no restrictions on the type of investments that the AIF can make, as opposed to other jurisdictions.

Cyprus Film Scheme

The Cyprus Government has begun introducing incentives in order to attract film production to the island. The incentives include cash rebates, tax credits, tax discounts on investment in equipment and infrastructure, as well as VAT returns on expenditure. These incentives are outlined in some detail below.

Cash rebate – can include rebates of as much as 35% on expenditure in Cyprus; the final amount, however, will depend on the final mark the production achieves on the cultural test.

Tax credit – is something that can be chosen instead of the cash rebate, and includes a discount of up to 50% on corporate tax owed during the tax year by the film production company. Furthermore, tax credits not given due to the percentage restrictions will be carried forward and given within the following five years, subject to the percentage restriction. In order to qualify for a tax credit, the production will have to achieve a certain mark on the cultural test.

Tax discount on investment in equipment and infrastructure – if a small to medium-sized enterprise invests in infrastructure and/or technological equipment for the purpose of cinematographic infrastructure, then it will be able to deduct its investment amount from its tax income. This can be up to 20% of relevant expenditure with regards to small enterprises and up to 10% of relevant expenditure with regards to medium-sized enterprises, with the stipulation that the investment in equipment should remain within Cyprus for at least five years.

VAT refunds – these include refunds on VAT for qualifying expenditures with regards to film production in Cyprus; in order for a person or legal entity from a third country to qualify, expenditures will need to be related to the film production.

Holding companies

One of the main changes in recent years pertaining to the once easily-accessible tax environment of Cyprus has been the fact that the Central Bank of Cyprus, with its circular dated 2nd November 2018, expressly erases the possibility for companies with no substance, i.e. no physical presence or economic activity in Cyprus, to open and maintain a bank account with local banking institutions. However, the circular expressly excludes from its ambit holding companies which are defined as those companies that are established for the purpose of holding shares of another business entity or entities engaged in legitimate business with identifiable ultimate beneficial owners. As a result, holding companies can continue to benefit from the advantageous tax regime of Cyprus.

It is noted that although a large number of companies registered in Cyprus were forced to close down as a consequence of the aforesaid circular of the Central Bank of Cyprus, investors and entrepreneurs with real businesses continue registering their corporate structures in Cyprus, and these are the businesses that the Government is looking to attract; at the same time, international corporate structures continue to use Cyprus for their holding companies, since the benefits to be derived both on a corporate and individual level are still very attractive. Essentially, the corporate tax rate remains at 12.5% and, depending on the activities of the company, there may be further deductions. Some examples are:

- Intellectual Property (IP) Box.
- Filming incentives.
- Shipping.
- Notional Interest Deduction (NID).

On an individual basis, on the other hand, the benefits to be derived are:

- 20% deduction, total emoluments or €8,550, whichever is lower, exempt from taxation for five years following the commencement of employment in Cyprus, provided the individual concerned was not tax resident the previous year;
- 50% tax deduction on income above €100,000 for 10 years; and
- non-domicile status – no withholding tax on dividends and other passive income.

Overall, despite the Central Bank circular, Cyprus is still an attractive jurisdiction to do business in, both on an individual as well as an entity basis.

Notional Interest Deduction

As of 30th January 2019, the Cyprus Government announced 10-year bond yields for selected countries, and these, with the addition of a 3% premium, will be used to calculate the NID for 2019. These are included below:

Country	10-year Bond Yield	2019 NID Reference Rate
Cyprus	2.302%	5.302%
Austria	0.484%	3.484%
British Virgin Islands	N/A	N/A
Bulgaria	0.966%	3.966%
Canada	1.965%	4.965%
China	3.261%	6.261%
Croatia	2.415%	5.415%
Czech Republic	1.884%	4.884%
France	0.705%	3.705%
Germany	0.284%	3.284%
Greece	4.346%	7.346%
Hong Kong	1.946%	4.946%
Hungary	2.971%	5.971%
India	7.261%	10.261%
Ireland	1.166%	4.166%
Italy	2.739%	5.739%
Latvia	1.029%	4.029%
Luxembourg	0.522%	3.522%
Mauritius	5.380%	8.380%
Netherlands	0.383%	3.383%
Norway	1.754%	4.754%
Poland	2.812%	5.812%
Romania	4.811%	7.811%
Russia (expressed in USD)	8.720% 5.020%	11.720% 8.020%
Serbia	4.722%	7.722%
Slovakia	0.789%	3.789%

Country	10-year Bond Yield	2019 NID Reference Rate
Slovenia	1.166%	4.166%
South Africa	9.206%	12.206%
Spain	1.413%	4.413%
Sweden	0.457%	3.457%
Switzerland	0.197%	2.803%
Ukraine (expressed in USD)	10.780%	13.780%
United Arab Emirates	N/A	N/A
United Kingdom	1.275%	4.275%
United States	2.685%	5.685%

The relevant legal framework is that of the Cyprus Income Tax Law as amended in 2015, with the addition of article 9B "deduction on new equity", to which Cyprus registered companies as well Cyprus Permanent Establishments on non-tax resident companies are entitled.

The NID is a notional interest tax deduction expense that results from new equity used for the creation of income by a Cyprus entity or Cyprus Permanent Establishment that is taxed. As it is a notional expense, it does not affect the accounting profit or loss. NID can achieve an 80% deduction of tax profits which, hence, means entities are essentially taxed at 2.5% as opposed to the standard 12.5% company tax.

It should be noted that new equity is that which is introduced after 1st January 2015, and can either be paid-up share capital or share premium. New equity includes all types of shares as well as unpaid share capital that can trigger interest subject to income tax. It should also be noted that shareholders' credit balances, realised reserves, non-refundable reserves (after 1st January), as well as debt instruments such as loans payable are considered as new equity as per Cyprus tax regulations once converted into issued share capital.

Cyprus Intellectual Property Box regime

The IP Box regime adopted by the Cyprus tax authorities can effectively reduce the income tax rate from 12.5% to as low as 2.5%; that is up to 80%, provided that the tax profits qualify under the regime as tax deductible. The assets that can be used to qualify under this regime are copyrighted software programs, patents and possibly other intangible assets, excluding trademarks and copyrights.

Qualifying profits are calculated through the positive correlation of the level of research and development (R&D) that the claimant achieves in order to develop the relevant assets with the company. With regards to losses resulting from R&D, it should be noted that only 20% may be carried forward or group relieved.

Conclusion

Overall, the year 2019 has brought significant changes to the tax environment for businesses in Cyprus. Some changes, like the Central Bank regulations on company entities, have made some aspects of business tougher. However, other new aspects and incentives such as that of the Film Scheme have created new opportunities, and brought new businesses to Cyprus willing to take advantage of Cyprus' favourable tax regime. While the taxation policies are likely to undergo further changes down the line, it should be noted that new opportunities and incentives will also be implemented, hence ensuring that Cyprus's tax regime remains competitive and thus attractive for potential investors.

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Soulla Dionysiou is the founding partner of Dionysiou & Partners LLC in Cyprus. Soulla possesses a wealth of experience of over 15 years within the corporate and commercial legal sectors, having previously worked for one of Cyprus's leading law firms. Soulla's immense experience working in correlation with leading international law firms includes in many practice areas, from banking, M&A, contract, corporate, shipping law, banking law and stock market to investment law. Soulla has led numerous complex high-net-worth transactions, including the acquisition of one of the biggest business centres in Moscow by way of a joint venture structure and the reassignment and release of securities of an international airline company. She has also acted as corporate legal counsel, for over five years, of one of the oilfield services giants involved in oil drilling in Cyprus.

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Czech Republic

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Overview of corporate tax work over the last year

As in other countries, tax work in the Czech Republic breaks down to (i) compliance work, and (ii) transaction/structuring work.

Tax compliance

In terms of tax compliance, the following notable developments should be mentioned:

- Increased volume of reporting

  Recently, the volume of information that must be reported by Czech taxpayers has been increasing continuously. For example, an itemised report on material transactions with related parties must be enclosed with corporate tax returns. Also, all VAT payers must submit (monthly) itemised lists of supplies (both received and provided) with a value exceeding CZK 10,000 (approx. €400), including identification of the counterparty of the supply. The tax authorities then automatically verify that a purchaser's VAT claim has a corresponding VAT payment reported by the seller. Another example is a reporting system for restaurants and retail shops, which requires that every single sale, irrespective of the amount, is electronically reported to the tax authorities at the moment of printing the receipt, whereby the printed receipt must show a unique transaction reporting number which may be subsequently verified by the customer. The government even runs a lottery whereby any receipt from a restaurant or a retail shop (with the unique transaction reporting number) can be submitted.

- Electronic communication

  The Czech tax system is steadily moving towards electronic-only communication between the authorities and the taxpayers. Currently, many filings can only be made electronically (e.g. VAT returns), and hardcopy filings are not accepted. Official communication in the other direction, from the tax authorities to the taxpayers, has also become almost purely electronic. For that purpose, all corporate taxpayers (and some individual taxpayers) mandatorily use so-called data boxes, in which all electronic communication is stored and anything delivered to/from such data boxes has the same legal effect as official paper filings/documents. It seems clear that this trend will continue and even more filings will be prepared by electronic means only in the near future.

Transaction/structuring work

In terms of transaction/structuring work, the work volume in this sector has been increasing significantly, in line with the Czech economy booming over the past few years.

M&A deals

We have been working on, and have also seen on the market, an increasing volume of standard M&A deals in the areas of private equity and real estate. As in the rest of Europe, the M&A and real estate markets are affected by increased demands by investors who struggle to find meaningful investment targets, with a limited supply. Naturally, this results in the market becoming a *sellers'* market, with prices going up. With tax authorities becoming more sophisticated and aggressive (see below), the importance of proper tax due diligence as part of the M&A process is increasing, as is negotiation of proper tax representations and warranties in contractual documentation.

Real estate transactions

While working on real estate transactions in relation to existing real estate projects requires similar tax work as M&A deals, working for real estate developers, especially in the area of residential housing, opens possibilities for interesting tax structuring.

Transfer pricing

Although the concept and principles of transfer pricing have been part of Czech tax law for decades, only a few years ago has it become a topic of serious attention for the tax authorities. Unlike in other countries, Czech law does not legally require taxpayers to have transfer pricing documentation on file, but the tax authorities recommend having such documentation ready. We have seen an increasing number of cases whereby the tax authorities challenge transfer prices within a group and assess corporate tax on that basis.

Tax disputes

In our experience, the tax authorities are becoming increasingly sophisticated and aggressive, which has resulted in an increasing number of tax disputes that we have both been working on and seen on the market. The areas of typical attention include mostly (i) transfer pricing, (ii) tax-driven schemes which might be challenged on the basis of anti-abuse provisions, and (iii) VAT claims.

Unfortunately, the process of resolving a tax dispute remains quite long. First, an appeal against a tax assessment needs to be filed, which is resolved by a higher-level tax authority. It can easily take more than a year to get a decision on appeal. Second, the matter can be taken to a regional court which, again, may take between one and two years to make a decision. And third, both the taxpayer and the tax authority can bring the matter to the higher administrative court (another one to two years), which will issue an ultimate, unappealable decision. So, from the beginning of a tax audit (which can take by itself several months and sometimes more than a year before a tax assessment is issued) to reaching a final decision on the matter typically takes several years.

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

As of April 1, 2019, the Czech Republic has adopted an amendment implementing the EU Anti Tax Avoidance Directive. This includes, most importantly, new interest deductibility limitations (30% of EBITDA or CZK 80 million per year, whichever is higher), CFC rules and exit taxation rules.

In the area of tax case law, we have seen a few major court decisions based purely on anti-avoidance principles. These decisions make it quite clear that any transaction should be primarily motivated by business (non-tax) reasons. If, on the other hand, a transaction is

solely or predominantly based on tax motives, the tax benefits resulting from such transaction may be denied.

European – ECJ cases and EU law developments

Being an EU country, the Czech Republic naturally implements tax directives approved by the EU. In the area of EU case law, especially in the area of VAT, ECJ decisions are becoming increasingly important in tax disputes, and both taxpayers and the tax authorities have started to refer to EU case law regularly in their disputes. There has been no major development in this area recently significantly affecting the Czech business environment.

Tax climate in the Czech Republic

As noted above, the Czech tax authorities are becoming increasingly sophisticated and aggressive. Some clients feel that the approach taken by the authorities is largely unfair. In some cases, an attack by the tax authorities resulted in bankruptcy of the respective companies, even though a few years later the attack proved to be unlawful at court.

Generally speaking, the tax system seems to be working well and the tax climate is acceptable, but the cases mentioned above are a serious concern for both the government and taxpayers because, in these cases, the system of handling tax disputes proved to be very inefficient.

Developments affecting attractiveness of the Czech Republic for holding companies

The Czech Republic has never been, and probably never will be, a traditional holding company jurisdiction. In the past, before the Czech Republic joined the EU, we did not have any crucial tax exemption for an effective holding company operation (dividends, capital gains). At that time, even Czech-based investors with Czech-based target companies would sometimes establish a holding company abroad.

At present, however, the Czech Republic offers exemptions for dividends and capital gains to EU and to some extent even non-EU subsidiaries. The key conditions for exemption are 10% of shares being held for at least 12 months and a qualifying legal form. On that basis, there is, in most cases, no motivation for Czech-based investors to seek a foreign jurisdiction in order to establish a holding company. In addition, historically we have seen quite a few foreign holding companies, established by Czech investors abroad, being migrated into the Czech Republic.

On the other hand, the Czech system offers nothing more than most other EU countries and we do not expect to attract holding companies into the Czech Republic from foreign-based investors purely based on the local tax regime.

The year ahead

The legislative proposals for 2020 have not been published yet.

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Overview of corporate tax work over last year

Types of corporate tax work

Over the past few years, we have observed the following case types and trends in corporate tax work:

- Public takeovers and delistings.
- Private equity acquisitions.
- Large real estate transactions.
- Initial public offerings ("IPOs").
- Transfer pricing ("TP") disputes at the appeals court level.
- Reorganisations of business operations.
- Analysis of and adjustments to legislative changes such as EU ATAD and OECD BEPS.
- Withholding tax cases regarding, e.g., comparability of foreign funds and the introduction of the concept of beneficial ownership in Finnish tax praxis.

Significant deals and themes

Transfer pricing-related tax disputes

The Supreme Administrative Court issued a precedent in a landmark case on 18 December 2018 (KHO 2018:173), highlighting the taxpayer's right to choose its business model and the most appropriate transfer pricing method. According to the precedent, the taxpayer's corporate taxation could not be reassessed based on an assumed business model and by justifying the tax reassessment with other transfer pricing methods than those applied by the taxpayer. The Supreme Administrative Court confirmed the "as structured" principle that applies in Finnish transfer pricing.

In addition to the above-mentioned landmark case, several transfer pricing disputes in which the Finnish Tax Administration ("FTA") has challenged the arm's-length nature of a transaction or a business model have been pending in appeal processes. In most cases, the court has rejected the FTA's interpretation of the Finnish TP adjustment provision and set forth limits for the application of the aforementioned provision.

Real estate transactions

Several large real estate transactions have taken place over the past couple of years, comprising of acquisitions of, e.g., large office premises, shopping malls and buildings in the metropolitan area and other growth centres. The tax advice work in such transactions has included, *inter alia*, tax due diligence, the evaluation of tax consequences and planning

the structure of the acquisition. The largest real estate transactions in the previous years include, *inter alia*, the acquisition of the Itäkeskus shopping centre by Morgan Stanley from Wereldhave N.V. in October 2018 and the sale of an office property by Ilmarinen Mutual Pension Insurance Company to Deka Immobilien GmbH in February 2018, which was the all-time largest single office asset transaction in Finland.

Public takeovers and IPOs

In the past couple of years, there have been multiple public takeovers in the Finnish market, such as the public tender offers for Amer Sports Plc, Sponda Plc, Ramirent Plc, Pöyry Plc and Affecto Plc, to name a few.

There have been several IPOs in the Finnish stock market over the past years, such as Terveystalo Plc, DNA Plc, Harvia Plc, Altia Plc and EAB Group Plc.

Private equity acquisitions

The private equity market in Finland has been very active in the past couple of years, and several M&A transactions have taken place. In particular, the healthcare industry has faced several acquisitions and business restructurings, including, *inter alia*, acquisitions of Mehiläinen Ltd, Attendo Ltd and Med Group Ltd.

Key developments affecting corporate tax law and practice

Significant amendments have been made to tax laws and new case law has been released over the last year. Most of the amendments relate to EU or BEPS-related initiatives, but purely domestically driven measures have also been implemented. A new Finnish Parliament and, respectively, a new government were elected in spring 2019. As a result, further changes in the field of taxation are anticipated in the near future as well.

Domestic – cases and legislation

Corporate income tax reform

Finnish corporations have previously been taxed separately and under a different set of rules for their business operations and other, non-business operations. In practice, this division has increased the inefficiency and complexity of the Finnish tax system even though only some corporations have been affected by this regime. As an example, real estate-related operations have been generally classified as other operations and been subject to separate tax treatment.

The Finnish corporate income tax reform that will abolish the separate income source for other operations will enter into force on 1 January 2020, and the amendments will be applied for the first time to fiscal year 2020. Thereafter, all operations of Finnish companies will, in general, be calculated in accordance with the same rules, i.e. the Finnish Business Income Tax Act ("BITA"). The amendments will benefit taxpayers by allowing cost deductions and offsetting of losses against income from business and other operations. In addition, group contributions will also be available to holding companies and ordinary real estate companies ("RECs") irrespective of whether they carry out business activities or not. Other entities than corporations, such as limited partnerships, will still have separate sources of income.

Legislative changes to taxation of Finnish sourced dividends paid to nominee-registered securities

According to the currently applied rules, the Finnish sourced dividend payments for nominee-registered shares are entitled to a treaty-based withholding tax ("WHT") rate – usually 15% – on the basis of the so-called simplified procedure. Under this procedure, the

treaty-based WHT rate can be applied at source if certain conditions are met. As a result of the simplified procedure, Finnish sourced dividend payments for nominee-registered securities have been subject to the WHT rate of 15% at source in many situations.

The simplified procedure was initially introduced in 2006 to improve the functioning of capital markets in Finland, but during recent years, this procedure has been criticised for the lack of opportunity for the Finnish Tax Administration to effectively ensure that the correct amount of WHT is withheld in Finland. Currently, there is also a great deal of uncertainty with regard to the definition of beneficial ownership and how it should be interpreted in the Finnish context, especially in relation to securities lending transactions.

A proposal for the amendment of legislation concerning nominee-registered securities was accepted in April 2019. The primary aim of this amendment is to improve tax supervision and the disclosure of final recipients' identity in terms of Finnish-sourced dividend payments made for nominee-registered securities in order to confirm that the right amount of WHT will be withheld at source. The new legislation will be applied to dividends paid on 1 January 2021 or afterwards.

The key amendment is that the currently applied simplified procedure will be abolished. Under the new rules, the treaty-based WHT rate will not apply if detailed information on the recipient of the dividend is not submitted to the Finnish Tax Administration either in connection with the dividend payment or later in the annual information return. If information on the final recipient is not provided, Finnish-sourced dividend payments for nominee-registered shares are subject to the WHT rate of 35% at source. The amendment primarily affects foreign shareholders who own nominee-registered securities in Finnish listed companies.

Another major change is that, under the new legislation, Finnish-sourced dividend payments for nominee-registered securities held by Finnish residents will become subject to a WHT rate of 50%. This rule, applicable as from 1 January 2020, is meant to prevent situations where Finnish residents would try to avoid taxation in Finland by using nominee-registered securities.

The new legislation will also lead to changes in the obligations and liabilities of foreign custodian banks and other intermediaries. Under the new legislation, the current foreign custodian (intermediary) register will be closed and replaced with the new Register of Authorised Intermediaries that will go live on 1 January 2021. From the beginning of 2021, custodians registered in Finland will have the principal responsibility to confirm the residence state of the final recipient and to confirm that the provisions of the tax treaty can be applied to the final recipient.

The new legislation introduced in Finland is based on the OECD TRACE model, but it would currently seem that Finland will be the first country to implement changes on the basis of this model.

Advance discussions with the tax authorities

In 2012, the Finnish Tax Administration initiated a transfer pricing-related project resulting in multiple aggressive tax audits and tax disputes. In recent years, many of these cases have been decided in the taxpayers' favour, and the FTA has simultaneously switched its focus from *ex post* measures, i.e. tax audits, to *ex ante* measures. Consequently, the FTA has been promoting advance discussions and preliminary guidance. This means that the FTA is willing to engage in informal discussions with taxpayers concerning possible actions and structures that will have an impact on their taxation that the taxpayers may be planning to take. As a result of such discussions, the FTA may provide the taxpayers with a memorandum in which

the tax treatment of the planned actions is confirmed. Advance discussions may, in some cases, be also held in cross-border situations with the FTA and the tax authorities of another country (so-called cross-border dialogue). Advance discussions are an alternative to applying for a preliminary ruling from the FTA.

Resolution of international tax disputes (MAP and arbitration)

Finland has enacted a domestic mutual agreement procedure ("MAP") law that entered into force on 30 June 2019.

As an EU Member State, the EU Arbitration Convention (90/436/EEC) applies to Finland. Finland has also implemented Council Directive 2017/1852 on tax dispute resolution mechanisms in the European Union. Furthermore, Finland has included the mutual agreement procedure article in its double tax treaties. Moreover, following the adoption of the multilateral instrument ("MLI"), mandatory binding arbitration is applicable with respect to tax treaties covered by the MLI.

The new legislation applies in all respects to cases covered by the Directive and applies partially to tax treaty MAP and EU Arbitration Convention procedures.

European – CJEU cases and EU law developments

Implementation of the ATAD

The most recent developments in Finland relate closely to the implementation of the Anti-Tax Avoidance Directive ("ATAD"). Finland had enacted interest deduction limitation rules and CFC already prior to the ATAD, but the old rules have been amended to comply with the Directive. No actions have been taken to implement the general anti-avoidance rule included in the ATAD, since the existing Finnish general anti-avoidance rule was considered sufficient in this respect. The amendments and the new ATAD-related initiatives are described below.

- Interest deduction rules

Finnish interest deduction limitations concerning the tax deductibility of related party interest expenses have been generally applicable as of fiscal year 2014. Due to the national implementation of the ATAD that entered into force 1 January 2019, the limitations have been expanded in scope to also cover unrelated party net interest expenses. Furthermore, the scope has been expanded in other respects as well since, e.g., real estate companies are no longer intact and the definition of interest also covers other financial expenses.

As previously, interest deduction limitation rules do not apply if the overall net interest expenses of a company do not exceed EUR 500,000. Additionally, a general safe haven of EUR 3 million applies to net interest expenses on unrelated party loans (i.e. to interest expenses that exceed interest income), meaning that unrelated party net interest expenses up to EUR 3 million are always deductible. Interest expenses may become non-deductible if net interest expenses exceed 25% of the company's tax EBITD.

Although the implementation is in line with the minimum standards set forth in the ATAD, the amended rules in force are more stringent in comparison to the ATAD, which will restrict intra-group debt financing.

- CFC rules

Finland amended its CFC regulation due to the implementation of the ATAD. The amendments entered into force on 1 January 2019. After the amendment, the CFC regulation no longer applies only to Finnish residents but also to non-resident taxpayers if control of a CFC is attributed to a permanent establishment ("PE") of a non-resident taxpayer in Finland.

A foreign company is generally deemed as a CFC if the taxpayer's control or capital or profit

entitlement (including direct or indirect holding of related parties) is at least 25%, and the effective income tax rate in the taxpayer's country of residence is less than ⅗ of the Finnish corporate income tax (i.e. 12%). The CFC regulation may not apply if an EEA corporation carries on a substantive economic activity in the country of residence. As regards a company resident in a non-EEA country, the company may be exempt under the same conditions, but additional requirements related to tax information exchange and activities performed must be met.

In practice, a foreign company that primarily operates as an investment company, IP holding company, financing company or management company in a low-tax jurisdiction may be deemed to constitute a CFC for Finnish tax purposes. Even holding companies in the EU with few or no activities may prove to be problematic.

- Hybrid mismatch rules

In June 2019, a draft proposal for the Finnish implementation of the hybrid mismatch rules (as set forth in the ATAD II) was introduced. The implementation is planned to take place in phases from 31 December 2019 onwards, and rules would be applied as of 1 January 2020.

At present, there is no domestic legislation in place for hybrid mismatch rules in Finland apart from hybrid rules related to the EU Parent-Subsidiary Directive. The new legislation is aimed to prevent any double deductions and loss of tax revenue arising from non-uniform tax systems. The draft proposal sets forth rules according to which a cost that is based on a hybrid arrangement is not considered as a tax-deductible expense in the event that the corresponding income item is not included in the tax base or if the expense could be deducted multiple times. Accordingly, an income item is taxable to the extent that the payer has deducted the same in its taxation and the deduction has not been rejected. The new legislation would apply to corporations and partnerships.

- Exit taxes

Currently, Finland has exit tax rules in place for corporations that apply to cross-border transfers of assets in certain situations. The application of these rules has been evaluated by the CJEU in its judgment C-292/16 concerning A Oy, which is the most significant recent CJEU judgment concerning Finland. The CJEU found that the Finnish exit tax legislation that applies to transfers of assets is against the freedom of establishment and that this infringement cannot be justified by overriding reasons of the public interest recognised by EU law. The CJEU found Finnish exit taxation, which does not allow for the deferred collection of tax, to be against the freedom of establishment.

In connection with the implementation of the exit tax rules set forth in the ATAD, Finland will also amend existing exit tax rules that are not covered by the ATAD to fall in line with EU law by enabling the deferral of tax collection. The exit tax rules established in the ATAD must be implemented by 1 January 2020, and a draft proposal for domestic implementation was introduced in June 2019.

The draft proposal sets forth the definition of the so-called exit value, which would be taxable income in exit situations. The situations in which the exit tax would become applicable are as follows: 1) the taxpayer transfers assets from a Finnish PE to a head office or to a PE located in another state, resulting in Finland losing its taxing rights; 2) assets located in a Finnish head office are transferred to a PE located in another state, resulting in Finland losing its taxing rights; 3) the business operations of a Finnish PE are transferred out of Finland, resulting in Finland losing its taxing rights; or 4) a Finnish tax resident company transfers its domicile to another state pursuant to a double tax treaty or Finnish domestic legislation,

except for assets that factually remain in a Finnish PE. Only some of these situations are covered by the current Finnish exit tax rules, meaning that new rules will extend the scope of the exit tax rules. However, it is estimated in the draft bill that the exit tax rules will only rarely be applied in Finland.

Mandatory disclosure rules

EU has introduced new mandatory disclosure rules for intermediaries (the Intermediaries Directive, commonly referred as the DAC 6) that are adopted as an amendment to the EU Directive on Administrative Cooperation. These rules will impose an obligation on intermediaries providing tax-planning services (e.g. lawyers, tax consultants) to inform tax authorities of certain cross-border arrangements that could potentially be used for aggressive tax planning. Although the provisions will apply from 1 July 2020 onwards, certain cross-border arrangements are also reportable retrospectively from 26 June 2018 onwards (i.e. when the Intermediaries Directive came into force).

Finland will implement the EU rules on administrative co-operation, mandatory disclosure and exchange of information. A draft proposal for the domestic implementation was in June 2019.

Finland has implemented the Council Directive 2015/2376 on automatic exchange of tax ruling information. The mandatory and automatic exchange of information applies to advance pricing agreements ("APAs") and other advance rulings by the tax authorities concerning cross-border situations. These measures have been applicable in Finland and other EU Member States since 1 January 2017.

Digital taxation

The European Commission published two proposals for EU-level directives on the taxation of the digital economy in March 2018, and a lighter version of the digital service tax is currently being further explored. Finland has opposed the Commission's initiatives related to digital taxation, and no unilateral legislative actions have been taken in Finland in this respect either.

CJEU case law concerning the concept of beneficial ownership

Three Danish withholding tax cases (C-115/16, C-118/16 and C-299/16) resolved by the CJEU in February 2019 concerning the application of the concept of beneficial ownership and abusive tax practices may have an impact on Finnish tax praxis. So far, the concept of beneficial ownership has not been recognised in Finnish legislation or in domestic tax praxis, but recently there have been indications that the concept will be established in domestic legislation. Such a development would have a great impact especially in relation to the taxation of portfolio dividends.

Infringement procedure against Finnish group contribution schemes

In March 2019, the Commission sent a letter of formal notice to Finland asking for it to amend its legislation on the tax deductibility of group contributions between affiliated domestic companies. Currently, group contributions can be utilised between Finnish companies to offset their profits and losses. However, current Finnish legislation does not grant tax deductibility to contributions made to affiliated companies in other EU/EEA States to the extent that these cover definitive losses incurred by the affiliated company. The Commission stated that this different treatment of companies resident in Finland and those resident in other EU/EEA States is against the freedom of establishment and that Finland should take action in this respect.

BEPS

Finland has been active in putting the BEPS actions into practice. Most of the BEPS actions have been or will be implemented through coordinated measures at the EU level. In addition to the EU-level actions mentioned in the previous section, Finland has enacted new transfer pricing documentation rules and country-by-country reporting rules that apply to accounting periods ending in 2017 and later.

Additionally, Finland has signed the OECD multilateral competent authority agreement to automatically exchange information under the standard and implemented the OECD CRS obligations, as well as the EU FATCA by virtue of the DAC (Directive 2014/107/EU). The automatic exchange of information entered into force in 2017, and it applies to information concerning 2016 and later.

Finland signed the multilateral instrument ("MLI") implementing the tax treaty-related BEPS measures in June 2017. The Finnish parliament approved the adoption of the MLI in February 2019, and the MLI entered into force on 1 June 2019.

Finland opted only for the minimum standards of the MLI and made reservations to other articles. This means that existing provisions concerning, e.g., PEs will remain unchanged in the covered tax treaties. Finland has chosen to apply mandatory binding arbitration as a part of the covered tax treaties, but made reservations concerning, *inter alia*, the scope of eligible cases and tax years. Finland has adopted the Principal Purpose Test as a means to fulfil the minimum standard related to the prevention of treaty abuse.

Finland has decided that the Nordic Income Tax Treaty, the Bulgarian Income Tax Treaty, the German Income Tax Treaty and the Income Tax Treaty with Hong Kong are not covered by the MLI.

Tax climate in Finland

Taxation has been in the public spotlight in past years. Finland aims to be an attractive destination for companies and investors from the perspective of taxation. For example, the corporate income tax rate has been lowered to a flat 20%. No special corporate tax regimes exist in Finland, and it is not anticipated that such regimes will be introduced in the coming years. There are, however, several anti-avoidance rules and measures in place, and tax avoidance has been a much-discussed topic. Transfer pricing has especially been often cast in a negative light.

The Finnish parliamentary elections took place in April 2019, and a new government was formed in June 2019. Some of the parties in the government have been aiming to introduce stricter tax rules (such as new WHT rules on Finnish-sourced dividends) and to raise tax rates. At present, the government programme does not include significant changes to the current situation, but some uncertainty exists. The most important proposals in relation to corporate taxation will be referred for further investigation with no instant changes introduced for the time being. The emphasis is put on BEPS measures such as anti-tax avoidance and the prevention of aggressive tax planning. The key changes already introduced mainly concern value-added tax and excise duties.

Developments affecting attractiveness of Finland for holding companies

In general, special purpose vehicles organised as Finnish limited liability companies are used in acquisitions. The use of Finnish holding companies may facilitate the use of group contributions, which enables the offsetting of Finnish group companies' profits and losses

and using it as a means of allocating taxable income for enabling more optimised interest deductions. In practice, third-party borrowers may require for multiple Finnish holding companies to be set up, and these structures may facilitate the minimisation of the amount of non-deductible interest expenses.

Foreign holding companies in the structure may be utilised to limit possible Finnish income tax and transfer tax implications in acquisitions of Finnish real estate companies and mutual real estate companies. Due to the limited applicability of the Finnish participation exemption rules, foreign holding companies may also be used in order to ensure a tax-exempt exit in future.

Under the Finnish participation exemption regime, capital gains derived from the transfer of shares are tax-exempted if certain conditions are met. For example, the transferred company must be resident in Finland, in the EEA/EU or in a tax treaty state, and the transferor must have owned at least 10% of the company's share capital for one year. Moreover, the transferred company's shares must belong to the transferor's fixed assets, meaning that the shares should benefit the business operations of the owner. Recently, fulfilment of this condition has been subject to dispute in holding company structures and, in many cases, the FTA has challenged the applicability of the exemption due to insufficient business relations between the transferor and the transferred company.

Finland has a broad income tax treaty network comprising approximately 80 tax treaties, which ensures the preferential treatment of payments to foreign holding companies, provided that the application of the provision is not denied; e.g., due to the principal purpose test. Finnish tax treaties follow, for the most part, the OECD model tax convention.

It should be also noted that, pursuant to Finnish legislation, no tax is levied on interest paid to non-residents, i.e. interest income is exempted from Finnish withholding tax. Additionally, in many circumstances, reduced withholding tax rates apply to outbound dividends under EU law or tax treaties. Dividends are tax-exempt in most domestic relations between limited companies, and the exemption may also apply to inbound dividends based on EU law or tax treaties.

There are no specific substance requirements for holding or finance companies tax resident in Finland. So far, the FTA has not issued specific substance requirements for foreign holding companies in a similar manner, as many other jurisdictions have. However, the applicability of the Finnish General Anti-Abuse Rule and the adoption of the Principal Purpose Test through the MLI must be evaluated on a case-by-case basis. There are tax avoidance-related tax disputes pending in Finnish courts that may have a significant impact on the evaluation of holding company structures in the future. Moreover, the CJEU's recent beneficial owner cases provide tools for the FTA to intervene in holding company structures more aggressively. Tightened CFC rules must also be observed when evaluating Finland's attractiveness as a jurisdiction for holding companies.

Industry sector focus

New definition of tax-exempt investment funds

New legislation, including a more detailed definition of tax-exempt investment funds, came into force on 1 March 2019 and will apply for the first time in the tax year 2020.

Both mutual and special mutual funds are currently tax exempt in Finland. However, Finnish tax laws do not include specific provisions on the characteristics of tax-exempt funds. The lack of specific provisions has made it difficult, in some cases, to compare foreign funds whose legal structures differ from those of Finnish funds.

The tax treatment of foreign funds is based on the European Union's principles of the free movement of capital and on the comparability of foreign funds with the characteristics of Finnish tax-exempt mutual and special mutual funds. A number of cases are currently pending in Finnish courts that pertain to various foreign funds and their comparability to Finnish funds under EU law. The new legislation states that only foreign funds that are contractually set up can be comparable to Finnish mutual funds. The compatibility of this requirement with EU law is subject to interpretation.

Under the new law, for common funds to be tax exempt, they must: (i) be contractual; (ii) have at least 30 unitholders; and (iii) be open to the public and be open-ended (i.e. common funds are obliged to issue and redeem units). Special mutual funds that have at least 30 unitholders are tax exempt under the same requirements as mutual funds.

Special mutual funds that have under 30 unitholders or which cannot be deemed as open-ended may qualify as tax-exempt if: (i) they annually distribute at least three-quarters of the accounting period's profits (excluding unrealised appreciation in value); (ii) the fund's minimum capital is at least EUR 2 million; and (iii) all unitholders are professional investors or comparable wealthy private individuals. The foregoing also applies to foreign contractual funds that correspond to special mutual funds. Special mutual funds that primarily invest in real estate or real estate companies may qualify as tax exempt if they annually distribute at least three-quarters of the accounting period's profits (excluding unrealised appreciation in value).

In order to qualify for the exemption, funds registered outside the European Economic Area must be registered in a country with which Finland has concluded a treaty on the exchange of information. Moreover, all foreign funds must demonstrate to the FTA that they meet the requirements for tax-exempt funds as set out above.

Legislative change in tax legislation regarding foreign funds of funds

The tax regime governing foreign limited partners ("LPs") in Finnish private equity and venture capital funds was amended in 2019 in order to attract further investments from foreign funds.

Tax legislation previously required for foreign LPs to be treated as tax treaty subjects in their home countries in order to avoid the creation of a PE in Finland when investing in a Finnish limited partnership. In practice, this has limited the number of foreign investors and funds of funds that would have been willing to invest into Finnish funds.

The new rules consist of the following two separate regimes under which foreign LPs are able to invest in Finnish private equity and venture capital funds without a PE in Finland:

1) Foreign LPs that are non-transparent for tax purposes will continue to be eligible under the existing regime, and the tax treaty residence requirement remains. An additional requirement will be introduced, according to which the Finnish target fund must be an alternative investment fund within the meaning of the AIFMD.
2) In addition, foreign LPs that are transparent for tax purposes would be eligible under the following criteria:
   - the foreign investor or fund that intends to become an LP in the Finnish fund must be established or registered in a country that has concluded an information exchange agreement for tax purposes with Finland (no income tax treaty is required here, meaning that funds registered in offshore locations that have concluded an information exchange agreement with Finland are also eligible);
   - the foreign fund must be comparable to a Finnish limited partnership for tax purposes (this requirement should cover the majority of international limited-partnership fund structures);

- the ultimate beneficial owner, e.g. the investor of the foreign fund of funds, must be resident in a state that has concluded a tax treaty with Finland (this requirement is applied separately for each ultimate investor in the structure); and
- the Finnish target fund must be an alternative investment fund within the meaning of the AIFMD.

This amendment is anticipated to extend the scope of the relief to apply to a large number of foreign funds, including fiscally transparent funds of funds, and facilitate fundraising by Finnish private equity and venture capital firms.

Real estate companies

The recent tax law changes affect real estate companies especially and the real estate business in general. The new interest deduction rules that apply from 2019 onwards also concern housing companies, mutual real estate companies and other real estate companies that did not previously fall within the scope of the restrictions. Furthermore, the Finnish corporate income tax reform that will become effective in 2020 will amend tax law that applies to ordinary real estate companies. This means, e.g., that their taxable income or loss can be adjusted through group contributions. However, housing companies and mutual real estate companies will remain unaffected, meaning that they will not be taxed under the BITA in future.

The year ahead

The key developments that will take place this and the following year comprise the implementation of ATAD measures in Finnish legislation. These include rules on mandatory disclosure, exit tax and hybrid mismatch situations. The draft proposals for the new legislation implementing these measures were issued in June 2019, and the government bills will most likely be issued during the autumn of 2019.

Another issue to be considered in the following years is changes that may be introduced in Finland by the new government. At the moment, several propositions introduced in the government programme have been sent for further assessment (such as the concept of beneficial ownership, withholding tax on Finnish-sourced portfolio dividends, exit tax for natural persons, the OECD's guidance for profit attribution to PEs and the expansion of interest deduction rules), and these changes may be implemented during the following years.

Over the past few years, the FTA has invoked the Finnish GAAR provision in relation to several corporate income tax cases concerning, e.g., the tax deductibility of interest expenses relating to loans that have arisen as a result of intra-group acquisitions. The aforementioned cases are currently pending in the courts, and they are anticipated to provide valuable guidance on the application of the Finnish GAAR provision. The Finnish GAAR provision is rather wide in its wording, and even though a fair amount of related case law is available, limitations on the application of the GAAR cannot be regarded as fully established.

The advance discussions introduced by the FTA will most likely gain more traction in future years. So far, the advance discussions have proven to be favourable, and such advance measures can be seen as benefitting both taxpayers and the FTA by preventing tax disputes.

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France

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Overview of corporate tax work over last year

In 2018, the French mergers and acquisitions (**M&A**) market has been quite active. In 2018, the objectives of the French groups with important investment capacities have been to consolidate and expand their international presence. It holds true notably for AXA, which announced its $12.4 billion acquisition of Group XL in March 2018.

However, the M&A market suffered a decrease in value in comparison with 2017. The value of announced M&A transactions involving French companies indeed decreased to $175 billion (source: Refinitiv).

However, the importance of this decline in value of M&A transactions has to be mitigated. Indeed, the 2017 record-breaking year in value for M&A deals in France (€205 billion) was essentially due to the surge of two "jumbo deals" (i.e. the acquisition of Luxottica (Italy) by Essilor in January 2017 and the acquisition of Westfield (Australia) by Unibail-Rodamco in December 2017).

In the field of taxation, it is worth emphasising that 2018 marked the closing of the acquisition of Westfield by Unibail-Rodamco. This transaction is one of the first international transactions to have been implemented under the new French tax regime of cross-border mergers and restructurings, which was enacted at the end of 2017. The tax structuring of the deal relied on the stapling of two listed entities (the first one since Eurotunnel in the 1980s) and the combination of real estate investment trust (**REIT**) regimes in France, the Netherlands, the USA and the UK. It also required several sophisticated rulings from the French tax authorities. As such, it showed that the French M&A market is open to complex and innovative tax structuring solutions.

Tax climate in France

The tax climate in 2018 in France reveals a trend towards compliance with the European Union (**EU**) and the Organisation for Economic Cooperation and Development (**OECD**) recommendations as regards the prevention of tax fraud and evasion and aggressive tax planning.

The 2019 Finance Bill (adopted at the end of 2018) illustrates this tendency. It includes measures designed to ensure that French tax rules for companies are in line with EU and OECD initiatives, while maintaining the attractiveness of France as a place to invest. For example, the 2019 Finance Bill amended the French "patent box" regime to comply with the OECD's "modified nexus approach", which consists of apportioning the tax benefits that may be obtained by a taxpayer in relation to the exploitation of a patent or similar intangible assets to the amount of research and development (**R&D**) expenses incurred in the State of

residence of such taxpayer. The 2019 Finance Bill also transposed the EU Anti-Avoidance Directive (**ATAD**) into national law and consequently introduced new interest deduction limitation rules in French legislation (see the "Industry sector focus" section below).

Even though the reforms have been rather important concerning corporate taxation, the 2019 Finance Bill also includes highly significant measures for taxation on individuals (e.g. change to the taxation regime of unrealised gains on securities where a taxpayer transfers his tax residence outside France – "exit tax regime").

Developments affecting attractiveness of France for holding companies

Implications of the Multilateral Instrument on French double tax treaties

Following the submission of the instrument ratification of the Multilateral Instrument (**MLI**) by France to the OECD (on 27 September 2018), the MLI entered into effect in France as from 1 January 2019.

The French double tax treaties that are covered by MLI provisions are those that are qualified as such by both contracting States in the submissions they made to the OECD (i.e. France and the other contracting State). At this stage, 15 double tax treaties signed by France have been amended by the MLI (i.e. the MLI mainly concerns double tax treaties signed with Australia, United Kingdom, Sweden, Austria, Japan, New Zealand, etc.). It is expected that further French double tax treaties will be covered in the next few months.

The MLI will have a significant impact on cross-border transactions and on arrangements involving entities benefitting from favourable tax treaty provisions. It notably provides for a general anti-abuse rule, which is based on a principal purpose test. It follows from this rule that if one of the principal purposes of any transaction or arrangement is to obtain treaty benefits, such benefits may be denied unless it can be shown that granting such benefit would be in accordance with the objective and the purpose of the provisions of the treaty. According to the MLI, the application of treaty provisions will thus be conditional upon taxpayers being in a position to (i) provide appropriate justifications to the reasons why certain group companies have been incorporated in low-tax jurisdictions, or (ii) provide evidence that the tax structures they implement do not mainly intend to minimise French taxes.

Introduction of a general anti-abuse rule

As part of the transposition of the ATAD, the 2019 Finance Law implemented a new general anti-abuse rule (**GAAR**) into national legislation. The implementation of such a measure as of 1 January 2019 (applicable to EU companies liable to corporate income tax) will strengthen France's position against tax fraud and avoidance.

The GAAR provides that, with respect to corporate income tax, "non-genuine" arrangements put in place for the main purpose (or one of the main purposes) of obtaining a corporate income tax advantage that defeats the objective or purpose of an applicable tax law may be disregarded by the French tax authorities. Under the GAAR, an arrangement will be considered as being "non-genuine" when it is not put in place for "valid commercial reasons reflecting the underlying economic reality".

The wording of the GAAR is quite vague and, therefore, it creates uncertainty as to whether taxpayers will retain the right to optimise their tax structures in the near future or not. In addition, as of the date of this chapter, the French tax authorities have not yet released any official guidelines on the GAAR. As a result, it is still difficult to determine which types of tax structures will effectively be hit by this new rule. In principle, structures that are implemented for financial, patrimonial or organisational reasons should most likely be

regarded as being "genuine" for the purpose of the GAAR. The French tax authorities had notably confirmed this point in the past, in comments they had released on former anti-abuse provisions of the French participation-exemption regime on dividends (French tax authorities guidelines: BOI-IS-BASE-10-10-10-10 n°220 dated 5 October 2016). But this simple confirmation does not address all legal certainty concerns that are raised by the GAAR. The French market thus hopes that the French tax authorities will release comprehensive guidelines in the coming months. Otherwise, the GAAR could have a deterrent impact on the French M&A market.

In addition, as opposed to the French abuse of law (article L64 of the French Tax Procedure Code which remains applicable), the GAAR does not provide for the automatic application of tax penalties in case of a reassessment. As a result of this, the law does not give taxpayers the right to benefit from the broad procedural guarantees they enjoy under the abuse of law (and it is important to note that under the GAAR, tax inspectors do retain the right to apply the same penalties they could apply under the abuse of law).

In summary, the GAAR is very restrictive and several French authors have thus pointed out that the legal uncertainty it creates could have negative effects on investments in France.

Industry sector focus

M&A – private equity

Changes to interest deduction rules (ATAD)

The 2019 Finance Law introduced new rules limiting the deductibility of financial expenses as provided in ATAD. In doing so, it significantly amended the existing French rules in this area as of 1 January 2019 by (i) implementing a new haircut limitation rule (replacing the so-called "*rabot*" rule which generally limited the tax deduction of financial expenses to 75% of their amount), and (ii) amending the French traditional thin-capitalisation rule. These new rules will add several new limitations to interest deduction in France and may thus negatively affect the attractiveness of France as a place to invest.

The new interest limitation rules will apply to all net financial expenses incurred by entities that are liable to French corporate income tax. Their scope is very broad as any financial expenses and related costs due in respect of all forms of debt will be targeted (i.e. interest on bank debt, interest on shareholder loans, swap costs, forex gains or losses, loan guarantee fees, etc.).

For entities whose related-party debts do not exceed 1.5 times the amount of their shareholders' equity, the deductibility of net financial expenses will be limited to the higher of 30% of their so-called "fiscal EBITDA" (i.e. taxable income before interest, tax, depreciation and amortisation restated with certain tax exempt items) or €3 million.

For entities whose related-party debts exceed 1.5 times the amount of their shareholder' equity, stricter rules will apply. In proportion to the amount of their related-party debts which exceeds 1.5 times their shareholders' equity, any financial expenses they incur (on related-party debts as well as on third-party debts) will only be deductible up to the higher of 10% of their "fiscal EBIDTA" or €1 million.

Entities that are part of French tax consolidated groups will also be affected by the two above-mentioned interest limitation rules. In this context, the above ratios will have to be computed at group level. A tax consolidated group's net financial expenses (i.e. the aggregate of all group members' stand-alone financial results) will be deductible up to 30% of such tax group's fiscal EBIDTA, or €3 million if higher. However, in case that tax consolidated

group is thinly capitalised, a portion of its net financial expenses will be subject to the restrictive 10% and €1 million thresholds.

However, in certain cases, if the above-mentioned entities are part of group that files eligible consolidated financial statements, a safe-harbour clause will allow an additional deduction equal to 75% of the net financial expenses not deducted pursuant to the above limitation rules. Taxpayers will also be able to rely on a specific safe harbour clause where their debt-to-equity ratio is lower than that of the consolidated group to which they belong.

As a result of the above changes, the so-called "*rabot*" rule (i.e. a 25% limitation on all financial expenses) and the so-called "*carrez*" rule (i.e. a rule under which interest deduction on the acquisition of shares in a company was conditional upon such company being effectively controlled in France or in the EU) have been repealed, effective as of 1 January 2019.

Extension of the participation exemption regime on dividends provided for tax consolidated groups

According to the 2019 Finance Law, as from 1 January 2019, a 99% participation-exemption regime will be applied to dividends paid to French holding companies by EU/EEA companies that are not members of a French tax consolidated group, provided that they fulfil the conditions that are normally required to enter a French tax consolidated group. Before 2019, this favourable rule was only applicable to dividend distributions made between companies that effectively belonged to the same tax consolidated group.

Abolition of the neutralisation of capital gains realised between members of a tax consolidated group

The 2019 Finance Law abolished the "neutralisation" of capital gains derived from intragroup sale of assets for purposes of determining the taxable income of a French tax consolidated group. As from 1 January 2019, such transactions will be subject to corporate income tax under standard conditions (being specified that under the French participation-exemption regime, capital gains-derived sale of shares generally are 88% exempt from corporate income tax).

Real estate

Change to SIIC distribution requirements

The 2019 Finance Law has amended the distributions requirements to which French SIICs (i.e. listed real estate companies or REITs) are subject to. As of 1 January 2019, French SIICs will be required to distribute 70% of the amount of the capital gains they derive from sales of real estate assets or shares in property companies (while the distribution requirement on capital gains previously was 60%).

French ratification of the new double tax treaty between France and Luxembourg

On 25 February 2019, France adopted a law authorising the ratification of the new double tax treaty signed by France and Luxembourg. The Luxembourg Parliament should pass a law approving the new double tax treaty in the coming months. If adopted before 31 December 2019, the new double tax treaty between France and Luxembourg will enter into effect as of 1 January 2020.

The new double tax treaty signed by the Luxembourg and French Governments on 20 March 2018 adversely affects the structuring of French real estate transactions and, more precisely, investments channelled via French real estate funds (**OPCIs**) held by a Luxembourg company.

Under the current double tax treaty between France and Luxembourg (signed on 1 April 1958), dividends distributed by a French OPCI to a Luxembourg company are subject to a 5% withholding tax if the Luxembourg company is a corporation holding at least 25% of the share capital of the French OPCI. In contrast, under the new double tax treaty, a 15% withholding tax will be granted, but only to the extent that the Luxembourg company holds less than 10% of the share capital of the French OPCI. Luxembourg companies holding 10% or more of the shares of French OPCIs will be subject to dividend withholding tax at domestic tax rates (currently 30%).

Intellectual property

The 2019 Finance Law has put the French patent box regime in line with the OECD's "nexus approach" (BEPS action 5) as from 1 January 2019. Such method consists of apportioning the tax benefits that may be obtained by a taxpayer in relation to the exploitation of a patent or similar intangible assets to the amount of R&D expenses incurred in the State of residence of such taxpayer.

Under the previous regime (applicable until 31 December 2018), income and capital gains arising from patents were taxed at a 15% reduced corporate tax rate, regardless of whether the corresponding R&D expenses were incurred in France or not.

The new patent box regime provides that net income and capital gains realised on patents (patentable inventions for small and medium-sized companies under certain circumstances) and software protected by copyright will be taxed at a preferential 10% corporate tax rate and will be determined by application of a "modified nexus approach". Accordingly, taxpayers will be required to submit documentation that tracks R&D expenditures and to justify the determination of the taxable result that is eligible to the 10% reduced rate upon the request of the French tax authorities.

The decrease of the corporate tax rate on R&D from 15% to 10%, and the inclusion of net income or capital gains realised on original software protected by copyright within the scope of the new patent box regime, should increase France's attractiveness in the digital market. However, this new regime will also create an additional administrative burden on taxpayers, which will be required to implement very sophisticated follow-ups of their R&D expenditures.

The year ahead

Implementation of the Anti-Avoidance Directive (ATAD II)

Adopted on 29 May 2017 by the European Union Council, ATAD II amends ATAD by expanding its scope to hybrid mismatches involving third countries and by encompassing new forms of hybrid mismatches not covered by ATAD. Unlike ATAD (which covers only hybrid entities), ATAD II applies to hybrid mismatches resulting from arrangements involving permanent establishments, hybrid transfers, imported mismatches and reverse hybrid entities.

It notably provides for the following measures to neutralise hybrid mismatches:

(i) in the event that a hybrid mismatch results in a double deduction, the deduction is denied in the payee Member State, or as a secondary rule, in the payer Member State (double deduction measure); and

(ii) in the event that a hybrid mismatch results in a deduction without inclusion, the deduction is denied in the payer Member State, or, as a secondary rule, the amount of the payment is included as a taxable income in the payee Member State (deduction without inclusion measure).

At this stage, France has not yet implemented ATAD II. Even though it has already adopted measures regarding hybrid mismatches, France has until 31 December 2019 to transpose ATAD II into national legislation (except for the measure regarding reverse hybrid mismatches, which must be implemented by 31 December 2021 and applied by 1 January 2022). To date, the schedule and modalities for implementation into French legislation are not entirely known.

Introduction of the "GAFA tax"

On 9 April 2019, the French Parliament voted for a bill creating a tax on the digital giants (Google, Apple, Facebook and Amazon), also known as the "GAFA tax". This bill provides for a 3% tax on digital advertising and on the sale of personal data and other revenue from any technology company with revenue over €25 billion in France or €750 billion worldwide. This bill is still to be adopted by the French Senate and published by the French Official Journal before entering into force.

In parallel, France reached on 4 December 2018 an agreement with Germany to establish a European GAFA tax. However, this proposal was not adopted because it did not receive approval from all the 27 Member States (i.e. Ireland, Sweden, Denmark and Finland did not approve the introduction of the GAFA tax into the European legislation).

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Germany

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Overview of corporate tax work over last year

Types of corporate tax work

As in previous years, the German M&A market has been booming in 2018/2019 due to continuously low interest rates and a relatively stable economy in comparison to other EU countries. Therefore, corporate tax work has been focused on M&A transactions together with subsequent restructurings again.

Moreover, the German tax authorities continued to increase the application of instruments of criminal enforcement law to tackle structures and put pressure on management. This was strengthened by discussions on tax policies of multinationals as well as a commencing debate on corporate criminal law. Accompanying this, the topic of (international) tax compliance is still relevant.

Significant deals and themes

- **Vodafone/Liberty Global**: The planned acquisition of Liberty Global's European business (including in particular the cable network operator Unitymedia) by the British telecommunications group Vodafone last year has still not been completed. The transaction volume is expected to amount to EUR 16.5 billion. At present, there are apparently still unresolved antitrust issues and the corresponding antitrust clearance remains pending.
- **Infineon/Cypress Semiconductor**: The German microchip manufacturer Infineon, a former spin-off of Siemens, is currently trying to acquire its US competitor Cypress Semiconductor for EUR 9 billion. If the acquisition were successful, the company would become the eighth-largest chip manufacturer in the world. Infineon itself had a turnover of EUR 7.6 billion in the past fiscal year 2017/2018 with a profit of EUR 1.1 billion.
- **ZF Friedrichshafen/Wabco**: The German technology group ZF Friedrichshafen plans to take over the American-Belgian automotive supplier Wabco. The purchase price is expected to be around USD 6.2 billion. The deal is to be completed by the beginning of 2020. Wabco is a leader especially in the field of heavy-duty vehicle braking systems, which ZF Friedrichshafen considers to be relevant for (partially) autonomous driving.
- **Deutsche Wohnen/Akelius**: The real estate developer and real estate group Deutsche Wohnen has purchased almost 3,000 real estate properties, including 2,850 apartments and around 100 commercial units in urban centres in Hesse and North Rhine-Westphalia, from the Swedish housing group Akelius by way of an asset deal. The transaction volume for this amounted to EUR 685 million. The real estate portfolio consists mainly of historic buildings as well as post-war buildings. Financing is to be provided with available financial resources and funds from the sale of other properties.

- **SAP/Qualtrics**: In autumn 2018, it was announced that the software group SAP intends to acquire Qualtrics International for around EUR 7.1 billion. The company evaluates the online behaviour of Internet users and is considered a pioneer in experience management, which evaluates customer, brand and product feedback. The acquisition still has to be approved by the authorities.
- **CVC Capital/DKV Mobility**: At the end of 2018, the Luxembourg financial investor CVC Capital Partners acquired a stake of around 20 per cent in the German DKV Mobility Services Group. DKV Mobility is one of the world's leading providers of fuel and service cards. According to media reports, the pre-money valuation for DKV Mobility was around EUR 2 billion. The previous DKV family shareholders will retain an 80 per cent stake after the sale.

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

The so-called Brexit Tax Accompanying Act (*Brexit-Steuerbegleitgesetz*)[1] came into force at the end of March 2019. The tax provisions of the Act, which apply both to a Brexit without a withdrawal agreement and to the conclusion of a withdrawal agreement with a transitional phase after its expiration, are intended to prevent taxes arising from Brexit alone, where no further actions are taken by a taxpayer with regard to past circumstances.

For corporations, for example, the Act alleviates the risk that Brexit alone would trigger a fictitious taxable dissolution under Sec. 12 Para. (3) of the German Corporate Tax Act (*Körperschaftsteuergesetz*) or the revocation of the deferment of payment in the case of exit taxation under Sec. 6 Para. (5) S. 4 of the German Foreign Tax Act (*Außensteuergesetz*). In the absence of the new law, the hidden reserves would be taxed in both cases. According to the law, exit tax is only levied if the company subsequently exits after Brexit to another third country.

The new Act also provides that Brexit alone will not affect the exemption from inheritance and gift tax for business assets. In particular, there could have been implications under German law if employees of a group of companies were employed in Great Britain and had to be included in the payroll relief provisions for inheritance tax purposes, pursuant to which inheritance tax is waived if the amount of salaries paid from a group of inherited companies is maintained for a certain period of time following the inheritance. Now, the potential risk to the inheritance tax exemption has been addressed by the new legislation.

European – CJEU cases and EU law developments

In the case "**Hornbach**" (Ref. C-382/16), which has been decided and released in the meantime, the ECJ had to decide on the basic provision of German-controlled foreign company (CFC) rules in Sec. 1 Para. (1) of the German Foreign Tax Act (*Außensteuergesetz*). The case dealt with the question of whether the adjustment provision – under which transactions with related parties need to be concluded at arm's-length terms and, where this is not the case, the tax treatment needs to occur as if they had been undertaken at arm's-length – is in line with European law. The ECJ has now ruled[2] that the regulation may restrict the freedom of establishment, which requires justification. One justification could be the general interest of a balanced division of taxation powers. As a result, it should be possible for the taxpayer to put forward any existing economic reasons which might justify a deviation from transfer prices customary for third parties. Such economic reasons may arise from the position of the taxable person as a shareholder and thus from the relationship between the

parties. In this respect, the judgment restricts the general arm's-length principle. This decision initially creates uncertainties for the transfer pricing practice, which would have to be eliminated by the tax authorities and the legislator in the future.

Furthermore, there are new developments in Sec. 8c Para. (1) of the German Corporate Tax Act (*Körperschaftsteuergesetz*), which in its current version provides for the complete elimination of loss carryforwards if more than 50% of the shares in a corporation are transferred, and which has meanwhile been modified in its application by various regulations. In order not to interfere with cases of transferring restructuring, the legislator had already created **Sec. 8c Para. (1a) of the German Corporate Tax Act** (*Körperschaftsteuergesetz*) in 2009. Due to concerns under EU law, the application of the restructuring clause of Sec. 8c Para. (1a) of the German Corporate Tax Act (*Körperschaftsteuergesetz*) was suspended. However, on June 28, 2018 (Ref. C-203/16 P),[3] the European Court of Justice ruled that the restructuring clause did not constitute state aid contrary to EU law. The so-called Annual Tax Act 2018 therefore stipulates that the restructuring clause applies retroactively from 2008 and to the transfer of shares after 31 December 2007. As a result, the loss carryforwards will not be eliminated if the shares in the corporation are transferred for the purpose of restructuring and the corporation is basically suitable for restructuring and capable of being restructured.

The new Directive 2018/822/EU,[4] which amends the EU Directive on Administrative Cooperation in Tax matters (the so-called **DAC 6 Directive**), lays down requirements according to which an EU reporting obligation for model cross-border tax arrangements must be transposed into national law by 31 December 2019.

At the end of January 2019, the Federal Ministry of Finance adopted a corresponding draft bill on the implementation of the DAC 6 Directive. However, it does not only provide for reporting obligations for cross-border tax structures, but also for reporting obligations for purely domestic tax structures. Due to this overarching regulatory trend, the draft has already been sharply criticised.

In principle, every model that meets at least one of the specified Hallmarks must be reported within 30 days of 1 July 2020.

The primary reporting obligation applies to the external intermediary. An intermediary is anyone who designs, markets, organises, makes available for use or controls the implementation of a model. The users of the marketed model, i.e. the taxpayers, only have a reporting obligation if an intermediary invokes its duty of confidentiality, if there is no reporting intermediary or if a user has designed a model himself as an in-house agent. Marketable models, i.e. those which are designed only once and which can then be used for a large number of taxable persons with only minor adjustments, are to be subject to the duty of reporting.

BEPS

The draft for the establishment of a **Digital Services Tax**, i.e. a taxation of digital services independent of the physical presence of the provider, submitted by the EU Commission in March 2018,[5] has essentially not developed any further. Although individual countries (e.g. the UK, France, Italy and Spain) have already implemented measures or intend to do so, the issue is still a subject of controversy throughout the EU. The German Federal Ministry of Finance has recently reaffirmed its intention to wait for an internationally agreed solution instead of creating a legislative situation on its own that would make it possible to tax digital services beyond existing rules. At their meeting in Japan at the beginning of June, the G20 reached an agreement on the development of a concept for a global minimum taxation and

access for the *Fisci* to the digital economy. The International Monetary Fund (IMF) has also made it clear in a policy paper entitled "Corporate Taxation in the Global Economy", which it presented a few weeks ago, that the lack of taxation of the profits of foreign digital corporations in the target countries follows established tax principles.

Tax climate in Germany

The most publicised tax cases still revolve around cum-/ex-trades, i.e. cases where multiple refunds of German withholding tax on dividends paid only once were obtained. A parliamentary enquiry commission in the Bundestag has concluded its investigation and has issued its final report, sparking increased media attention on this complex issue, which may complicate the tax issues of banks that have any kind of operations in Germany at all. As the first indictments for such cases were served in early 2018, this tax structure has gained increased media attention and public discussions on the subject matter are ongoing, especially as there are further indictments that still are to be lodged.

In addition to this topic, the issue of interest on taxes, more precisely, interest rate charged under German tax laws, has become increasingly relevant in the past year. Already in April 2018, the Federal Fiscal Court raised doubts as to whether the current 6% interest rate for late payments was constitutional.[6] In view of the fact that interest rates have been falling for almost 10 years and considering the low level of interest rates that has meanwhile manifested itself, the 6% rate seems at first sight questionable to the Federal Fiscal Court. Meanwhile, the tax authorities have also started to issue assessments of interest subject to change.

Besides, it can be stated that the German real estate market is still booming, partly because of the low interest rates. Compared with other asset classes, German real estate still offers secure and profitable opportunities. As prices for ground in first-tier cities like Munich, Frankfurt or Hamburg steadily rise, second- or third-tier places are also targeted by investors, who aim not only at office spaces, but also residential property and special real estate. This strong demand for German real estate has already triggered and realised the desires of fiscal authorities and politicians to implement real estate transfer tax (RETT) rates of up to 6.5% (depending on the federal state) of the purchase price, or the fair market value in case of absence of a purchase price.

Developments affecting attractiveness of Germany for holding companies

Apart from a general 95% tax exemption on capital gains and dividends for substantial shareholdings (more than 10%), Germany does not provide for further specific tax incentives or attractions for holding companies.

Industry sector focus

In connection with the booming real estate market, it should be noted that, at the beginning of May, the Federal Ministry of Finance presented a draft bill to amend German Real Estate Transfer Tax laws. This draft bill aims at tightening rules on the RETT treatment of so-called share deals, which have been under discussion between the federal states for more than a year. In the area of share deals involving entities that hold real estate, tax is currently only levied if either 95% of the shares or economic control of the landowning company are at least indirectly united in one hand, or if the shareholder structure of a partnership changes by at least 95% within five years. With regard to these acquisitions within the meaning of

Sec. 1 Para. (2a), (3) and (3a) of the German Real Estate Transfer Tax Act, the draft provides for a reduction of the participation quota from 95% to 90%. It is also planned to extend the holding period from five to 10 years. Equally, the holding period required to benefit from a reduction of RETT in case of transactions between a partnership and its partner will be extended to 10 years. Furthermore, a new Para. (2b) is to be introduced in Sec. 1 of the German Real Estate Transfer Tax Act (*Grunderwerbsteuergesetz*), pursuant to which a change of ownership in real estate-owning corporations would be subject to RETT, provided that at least 90% of direct or indirect ownership change within 10 years. The provision is very far-reaching, as it can lead to recurring RETT, particularly in the case of listed companies, depending on the trading volume. As discussions of the draft continue, the final legislation is still unclear.

Equally in the field of RETT, the ECJ has, in December 2018, ruled that the exemption from RETT for certain qualifying intra-group restructurings does not violate EU state aid law. The case had been referred to the ECJ from the Federal Tax Court, which is now expected to rule on the application of the exemption provision, pursuant to which mergers between wholly-owned subsidiaries can be achieved RETT free.

The banking sector is still facing intense scrutiny over several tax-based structured finance products that have been rolled out in the last decade. With increasing litigation on damages from cum-/ex-cases holding custodian banks liable for tax refunds the revenue refused to pay, substantial losses can be expected from this litigation. The number of banks' claims for damages against each other has increased notably again this year.

The year ahead

After the German centre-left and centre-right parties lost considerable support in the past state parliamentary elections and especially in the European elections, the German government, which currently consists of these parties, is showing the strain. Given the increase of disputes within the ruling coalition, premature general elections cannot be excluded. The outcome of such elections is unclear, but tendencies show that coalitions for a new government may be more difficult to forge and, as the case may be, involve socialist parties. In this context, it would be likely that tax policies in Germany might be shifted as a result.

* * *

Endnotes

1. Federal Law Gazette (*Bundesgesetzblatt*) 2019 I, 357 from 28 March 2019.
2. ECJ, judgment of 31 May 2018, Ref. C-382/16.
3. ECJ, judgment of 28 June 2018, Ref. C-203/16 P.
4. Council Directive 2018/822/EU of 25 May 2018.
5. EC, proposal from 21 March 2018, COM (2018) 147 final.
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Ghana

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Overview of corporate tax work over last year

Types of corporate tax work

In the previous edition of this guide, the issue of recapitalisation of banks was mentioned as likely to be a significant development in the coming years. The central bank raised the minimum capital requirements for banks in Ghana, with the end of 2018 being the deadline for all banks to comply. Industry players requested a staggered approach over a three-year period, but this was refused by the central bank. The penalty for failure to meet the minimum capital requirement was a withdrawal of the offending institution's banking licence. Therefore, at the end of the recapitalisation exercise, 23 banks met the new paid up minimum capital requirement. Out of the 23 banks, 16 banks met the new minimum capital requirement through capitalisation of income surplus and a capital injection. As anticipated in last year's edition, there was a merger of six banks to meet the minimum capital requirement, whilst private equity funds injected fresh equity capital in five banks through a special holding purpose vehicle.

The major tax implications for this capitalisation requirement is the imposition of tax on the shareholders according to their respective shareholdings, which may increase as a result of the capitalisation of profits. The Ghana Income Tax Act of 2015 requires the Revenue Authority to direct a company to pay the appropriate tax whenever there is capitalisation of profits. Financial institutions required to recapitalise by the regulator may request from the Revenue Authority a tax waiver on the recapitalisation, on the premise that the recapitalisation is a regulatory requirement. This may cause some controversy as to the (in)appropriateness of imposing a tax on deemed income arising out compliance with the rules governing a particular industry.

The last year also witnessed five banks being declared insolvent and put into receivership by the regulator, the Bank of Ghana. The regulator revoked the banking licences of these five banks and appointed a Receiver over their assets and liabilities. Deposits and selected assets and liabilities of these banks were acquired and assumed by a new bank created by the Government called the Consolidated Bank Ghana Limited.

In another shakeup to the financial sector, the regulator declared 347 microfinance companies insolvent, revoked their licences and appointed a receiver to wind up the affected companies.

Significant deals and themes

M&A

As noted above, last year witnessed the merger of some banks in order to meet the paid up minimum capital requirements. The regulator approved three applications for mergers:

Atlantic Merchant Bank Limited and Energy Commercial Bank; Omni Bank and Bank Sahel Sahara; and First National Bank and GHL Bank. The three resulting banks out of these mergers were then able to meet the new minimum capital requirement.

Typically, the sale of assets during a merger should give rise to tax liabilities on the gains from the realisation of capital assets. However, the Ghana Income Tax Act provides that the gains on realisation of an asset arising out of a merger, amalgamation or reorganisation of a company is exempt from tax where there is continuity of at least 50% of the underlying ownership in the asset.

Returns of value to shareholders

The clean-up in the banking sector and the emergence of financially strong and stable financial institutions may improve access to credit as a result of the reduction in lending rates. Consequently, this could give rise to increased profitability from the lending businesses of these banks.

Tax disputes

Management and technical service fees continue to be a tax dispute concern whether registration of a technology transfer agreement is a precondition of deductibility of the expense under income tax laws. A high court decision on the issue is currently on appeal. New transfer pricing regulations are being prepared, and with the incorporation of some of the G20 BEPS actions, proposals may have a significant impact on corporate taxation.

Secondly, the tax consequences of the capitalisation of the financial institutions due to regulatory requirements may give rise to tax disputes. This would centre on whether the provisions of the income tax law, that requires the imposition of tax on capitalisation of profits, can be applied in a situation where the regulator compelled such capitalisation.

In the coming year, these disputes are bound to impact corporate income taxation.

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

There are proposed amendments to the Revenue Administration Act to provide for an Independent Tax Appeals Board. The law seeks to insert a layer between decisions of the Ghana Revenue Authority and the formal judicial process, allowing for some level of arbitral proceedings when adjudicating tax disputes.

The benchmark value of import duties was slashed by up to 50%. In April, the government introduced a reduction in benchmark value of import duties. The benchmark value of import duties was reduced by 50%, and that for vehicles was reduced by 30%. This measure may impact on volumes and, consequently, on corporate profit and taxation.

The Standard for Automatic Exchange of Financial Account Information Act was passed during the year under review, with implementation due in September 2019.

Tax climate in Ghana

As noted in the previous edition of this book, the tax climate in Ghana is generally more favourable to businesses, notwithstanding the extension of some taxes, particularly since other taxes have been removed or reduced (especially the tax on spare parts). The likelihood of a reduction in the corporate income tax rate, as alluded to in the previous edition, did not materialise, and may be further delayed.

Developments affecting attractiveness of Ghana for holding companies

Avoidance of Double Taxation Agreements (DTAs)

The four DTAs which were mentioned in the last update between Ghana and the Czech Republic, Mauritius, Morocco and Singapore were ratified by Parliament in the year under review, and that of Ghana-Mauritius came into effect at the beginning of 2019. The other treaties will become effective in January 2020.

Industry sector focus

With the signing of new oil and gas contracts, natural resource taxation is likely to become an important corporate tax issue with potential for tax disputes on assessment.

The year ahead

A general overview of the tax incentive regime which began in previous years will continue, and a major overhaul is expected. Tax incentives are a major feature of the country's taxation and any revision would have an impact on corporate taxation.

Furthermore, the country's exit from the IMF bailout programme and increasing national debt stock is likely to put pressure on the government to increase tax revenue to avoid the country becoming debt distressed.

Also, the implementation of the common reporting standards which require automatic exchange will come into stream in September 2019.

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Melisa has undertaken due diligence and advisory regarding the acquisition of a palm oil business by a Fortune 500 company. She provided crucial legal advice on the structuring of the transaction to ensure compliance with the rules of the Ghana Stock Exchange on Mergers & Acquisitions as well as Ghanaian laws governing regulatory compliance, corporate matters, and tax issues.

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India

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Background and tax regime in the past

The year 2019 was marked by a lengthy election campaign for the general election that took place in April–May 2019. The electorate has given a resounding mandate to the incumbent and, thus, the nation is expected to move on a similar growth trajectory as it did with the past government. As per a press release of the World Bank, global economic growth is forecast to ease into a weaker-than-expected 2.6% in 2019 before inching up to 2.7% in 2020, whereas growth in India is projected to accelerate to 7.5% in FY 2019–20.[1] Further, according to the International Monetary Fund ("**IMF**"), the Indian economy is expected to grow by 7.3% in 2019,[2] a projection which follows those made by the Reserve Bank of India and the Asian Development Bank.[3]

The financial sector witnessed a paradigm shift on account of the initiation of corporate insolvency resolution process against several major companies under the newly enacted Insolvency and Bankruptcy Code, 2016 ("**IBC**"), and it has been observed that the IBC contributed in the recovery of INR 800 billion through the corporate insolvency resolution process.[4]

In July 2019, the Union Budget was presented by the Finance Minister of India with the aim of making India a $5 trillion economy. The focus of the Budget is on developing infrastructure and connectivity, the space capabilities of India, uplifting the rural economy by strengthening the agricultural sector and fisheries, improving the quality of education (so as to appeal to foreign students as well) and ensuring water security.

Further, the Budget 2019 has proposed to make it easier to avail of affordable housing loans, to extend pension benefits to retailers and small businessmen, to make the taxation procedures simpler, to empower women economically, and to promote R&D in India. The Budget 2019 is demonstrative of the vision that the newly elected government has in mind for the Indian economy.

The Government of India has aligned the domestic tax provisions with the Base Erosion and Profit Shifting Action Plan ("**BEPS Action Plan**"), created by the Organization for Economic Cooperation and Development ("**OECD**") and has also deposited the instrument of ratification of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("**MLI**"). Pursuant to this, the concept of "business connection" under the domestic tax law already stood expanded and a new concept of "significant economic presence" had been introduced. Further, guidelines had been laid down for the concept of Place of Effective Management ("**POEM**") to determine whether a foreign company has a POEM in India, thereby qualifying it as tax resident in India, and the provisions relating to Country-by-Country Reporting ("**CbCR**") have been rationalised.

Key developments affecting tax laws and practice

Domestic tax

Rationalisation of corporate tax rates

The then Union Finance Minister, in his annual Budget speech in 2015, had expressed a commitment to reduce the corporate income tax rate for domestic companies from 30% to 25% over a period of four years.[5] These words were translated into action by bringing in changes to the Finance Acts/Bill of 2017 through 2019. The Union Budget 2019 has proposed a corporate income tax rate of 25% for domestic companies with a turnover of not more than INR 4 billion in the financial year 2017–18.

Electronic tax scrutiny (e-assessment)

With a view to impart greater efficiency, transparency and accountability, an e-assessment scheme was implemented by the Government of India from 1 April 2018. This scheme is expected to considerably transform the onerous assessment procedure and the manner in which the Revenue authorities interact with taxpayers and other stakeholders.

The main purpose of this scheme is to eliminate the interface between the tax officer and the taxpayer in the course of proceedings to the greatest extent technologically feasible, optimise resources through economies of scale and functional specialisation and introduce a team-based assessment with dynamic jurisdiction.

This e-assessment initiative has the potential to substantially reduce the compliance/tax scrutiny cost (both for taxpayers and the Revenue authorities) and to help curb corruption.

Thus, the current Union Finance Minister in her Budget Speech of 2019 has committed to nearly all income tax assessments being done electronically and anonymously.[6]

Fast-track disposal of drawn-out litigation

A major issue that is faced when doing business in India is money being blocked in various litigation matters in long, drawn-out processes, which sometimes take more than a decade to complete.

A brief snapshot of pending tax cases[7] as on April 1, 2018 is as follows:

Revenue amount involved	No. of cases pending
More than INR 500 million	841
INR 10 million – INR 500 million	36,369
INR 1 million – INR 10 million	88,749
Less than INR 1 million	131,157

According to the Economic Survey 2018, the appeals filed by the Revenue authorities constitute 85% of the total appeals filed in direct tax matters, whereas their success rate at all levels of appeals is less than 30%. Over a period of time, this rate has been declining, while the number of cases has been increasing.

In order to streamline and reduce the number of litigations, internal directives have been issued to the Revenue authorities, wherein individual limits have been placed on tax officers to dispose of cases/appeals where the demand amount in question is less than INR 1 million. The Central Board of Direct Taxation ("**CBDT**") is in the process of taking various measures to set up a cell and specialised benches in each jurisdiction to fast track drawn-out cases/appeals and track and report orders on a daily basis.

International tax

Among the G20 countries, India has been an active participant in regards to BEPS and is committed to implementing the BEPS initiatives. On June 7, 2017, India signed the MLI. Against this backdrop, the Government of India is consciously and gradually aligning the domestic tax law with the BEPS recommendations. In June 2019, the Union Cabinet of India approved the ratification of the MLI.[8] Thus, the penultimate step for bringing MLI into force has been undertaken. India has deposited the instrument of ratification before the OECD as per which the date of entry into force of the MLI is October 1, 2019.[9]

Aligning the scope of "business connection" with the modified permanent establishment ("PE") rule as per the MLI

Under the Income Tax Act, 1961 ("**ITA**"), all income accruing or arising, whether directly or indirectly, through or from a "business connection" in India is liable to tax in India. The term "business connection" for this purpose shall include any business activity carried out through a person who, acting on behalf of the non-resident, has and habitually exercises the authority to conclude contracts on behalf of the non-resident. In such cases, the ITA further provides that only so much income as is attributable to the operations carried out in India is liable to tax in India.

In order to incorporate the recommendations under BEPS Action 7: "Prevention of the artificial avoidance of PE status", the Finance Act, 2018, with effect from April 1, 2018, widened the scope of "business connection" to include situations where the person who, acting on behalf of the non-resident, "habitually concludes contracts" or "habitually plays the principal role leading to conclusion of contracts". The expanded definition is likely to cover more cases of foreign companies having a business connection in India under the ITA and consequently a higher tax risk, specifically in cases where such foreign entity is not entitled to any tax treaty benefits.

Equalisation levy, digital PE and significant economic presence

With the expansion of information and communication technology, the supply and procurement of digital goods and services have undergone expansion globally. Business these days is conducted without regard to national boundaries, thus dissolving the link between an income-producing activity and a specific location. The new e-business models have created various tax challenges and the typical issue pertains to characterising the nature of payment and establishing a "nexus" or a "link" between a taxable transaction, activity and a taxing jurisdiction.

- Equalisation levy

The report on BEPS Action 1 has provided several measures to tackle the direct tax challenges in the digital economy, which include modifying the existing PE rule to include entities under the tax ambit which constitute a PE by having significant digital presence in another county's economy. The report on BEPS Action 1 also includes the possibility of the creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries out business through that website, under certain prescribed circumstances.

To address the above tax challenges and to align domestic tax law with the BEPS project, in 2016, the Government of India introduced the equalisation levy. Under this rule, tax is payable at the rate of 6% of the gross consideration received by a non-resident for specified services (such as online advertisement, provision for digital advertising space or any other facility or services for the purpose of online advertisement, which includes any other service as may be notified by the Central Government in this behalf) provided to a resident in India

or to a non-resident having a PE in India. However, this levy is not applicable if the aggregate amount of consideration for specified services received or receivable by a non-resident does not exceed INR 0.1 million in any previous year.

- Digital PE/significant economic presence

Recently, *vide* the Finance Act, 2018, the Government of India has taken another bold step towards implementation of BEPS Action 1 by incorporating a new clause that provides that a foreign entity will have a business connection in India if it has a "significant economic presence" in India. Significant economic presence, for this purpose, is defined as:

- any transaction in respect of any goods, services or property carried out by a non-resident in India, including provision of the downloading of data or software in India, if the aggregate of payment arising from such transactions exceeds the prescribed amount; or
- systematic and continuous soliciting of business activities or engaging in interactions with a prescribed number of consumers in India through digital means.

It has also been clarified that transactions or activities performed by a foreign entity shall constitute significant economic presence in India, whether or not: (i) the agreement for such transactions or activities is entered in India; (ii) the non-resident entity has a residence or place of business in India; or (iii) the non-resident renders services in India.

India is one of the early movers to include digital PEs in its tax framework. It is important to note that, currently, the digital PE rule of "significant economic presence" does not feature in most tax treaties signed by India. Once this concept is added to the tax treaties, either through MLI or through specific amendments to the tax treaties, there is likely to be a significant scrutiny of business operations of foreign enterprises.

Rationalisation of provisions relating to Country-by-Country Reporting

As part of the implementation of BEPS Action 13 regarding Three Tier TP Documentation, India introduced CbCR requirements effective from financial year 2016–17 (i.e. beginning April 1, 2016).

This required certain Indian-headquartered multi-national enterprises ("**MNEs**"), and in some cases Indian affiliates of foreign headquartered MNEs, to file prescribed forms in India reporting country-wide details of revenue, profits, taxes, number of employees, etc. The Finance Act, 2018 has amended these provisions to align with the OECD's recommendations, and the same are as follows:

- the time limit for furnishing the CbCR shall be 12 months from the end of the reporting accounting year, as compared to the earlier time limit of the return filing date; and
- CbCR shall also be required to be filed in India by Indian affiliates of foreign headquartered MNEs, if there is no obligation to file CbCR in the home jurisdiction and the parent has not designated any Alternate Reporting Entity outside India.

Key tax proposals of the Union Budget 2019

The current ITA undergoes amendment by the Finance Act passed in the course of the annual Budget session of the Parliament. The Budget proposals, applicable from the current financial year April 2019–March 2020, were proposed on July 5, 2019. Some of the key proposals to amend the ITA are summarised below:

- General corporate tax rate is 30%. Certain prescribed corporates are liable to tax at the rate of 25%. The benefit of this reduced corporate tax rate of 25% has now been extended to domestic companies with a turnover of up to INR 400 crores during

Financial Year 2017–18 (presently the benefit was available for companies with a turnover of up to INR 250 crores for Financial Year 2016–17).

- Presently, unlisted companies are liable to pay additional income-tax at the rate of 23.29% (including surcharge and cess) in case of buy-back of its shares. Such buy-back tax is now extended to shares bought back by listed companies.
- Presently, in order to qualify for a tax-neutral demerger, the existing provisions required the resulting company to record the assets and liabilities at values appearing in the books of account of the demerged company. It has now been proposed to relax this condition and allow the resulting company to record the value of assets and liabilities at a value different from book value in compliance with Indian Accounting Standards ("**Ind-AS**").
- In order to incentivise start-ups, the current conditions for the carry-forward and off-set of losses have been relaxed for *eligible start-ups*. Further, the sunset date of the capital gains exemption, from sale of residential property and investment of such proceeds into equity shares of an eligible start-up, has been extended by two years (i.e. until March 31, 2021) along with the relaxation of certain other conditions.
- In order to promote development of world-class financial infrastructure, it has been proposed to give additional benefits to units located in an International Financial Services Centre. The additional benefits include: (a) exemptions from capital gains on transfer of specified assets by Category III AIF (with non-resident investors) located in an IFSC; (b) tax exemption on interest earned by non-residents from monies borrowed by a unit located in an IFSC; (c) no dividend distribution tax on distribution of accumulated profits by a unit of an IFSC; and (d) tax holiday (profit-linked incentive) extended to 100% for 10 consecutive tax years out of a block of 15 years.

Other changes

Overriding effect of the IBC over the ITA

The IBC was enacted as a consolidated, complete code on any matter relating to re-organisation and insolvency resolution of corporate persons, and the aim of the legislation was to ensure speedy resolution regarding whether a company could be put back on its feet or would need to be liquidated. It was to achieve this aim that the IBC has been given overriding effect over all other laws in India. Thus, due to a non-obstante clause, the provisions of the IBC would prevail over anything inconsistent contained in any other law in force in India, and this includes the ITA.

The Hon'ble High Court of Delhi, in *PCIT, New Delhi v. Monnet Ispat & Energy Ltd.*,[10] held that the IBC would prevail over the ITA and that the moratorium granted under the IBC would, thus, disallow the initiation or continuation of any case against the taxpayer under the ITA. It was against this finding that the Revenue preferred a Special Leave Petition ("**SLP**"), which was not entertained by the Hon'ble Supreme Court of India.[11] This position taken by the judiciary has been further elaborated in the case of *Leo Edibles & Fats Ltd. v. Tax Recovery Officer, ITD, Hyderabad*,[12] wherein the two pieces of legislation were analysed and the conclusion was reached that due to the non-obstante clause in the IBC and the provisions of ITA applicable to the companies under liquidation, the IBC has an overriding effect on the ITA. Accordingly, the Revenue authorities can no longer claim priority (except as provided for in the IBC for companies under liquidation) over other creditors of a company under liquidation, since it does not hold the position of a secured creditor.

POEM Rules clarified

The concept of POEM was introduced into the ITA, effective from financial year 2016–17, for the purposes of determining whether a foreign company is tax resident in India. Under

the ITA, a POEM is defined to mean the place where key management and commercial decisions necessary for the conducting of the business of an entity as a whole are, in substance, made.

Since the inception of this concept in the ITA, the CBDT has come up with several rules and guidelines for determination of a POEM for an entity. In October 2017, the CBDT issued a new circular that clarified the application of the POEM rules to multinational companies with a regional headquarters in India that is merely conducting routine activities for the entire group, in line with the global policies of the parent entity.

As per the circular, the activities of a regional headquarters will not establish a POEM in India, provided: (i) the regional headquarters carries out activities for subsidiaries/group companies in line with the general and objective global policies set forth by the group parent entity (in areas such as payroll and human resource functions, accounting, information technology infrastructure and network platforms, supply chain functions and routine banking operational procedures); and (ii) these activities are not specific to any subsidiaries/group companies.

Patent Box Regime

Multinational companies around the globe have been registering their Intellectual Property (IP) in tax havens/low-tax jurisdictions, purportedly even in cases where IP is developed in a different jurisdiction. This results in the shifting of profits to a low-tax jurisdiction(s).

With the intention to curb the shifting of profits from one jurisdiction to another and to encourage local research and development activities to make India a global hub, the Government of India introduced the Patent Box Regime. This is a concessional tax regime. Under this regime, a 10% tax is levied on royalty income from patents developed and registered in India, with no allowance for expenditures. It is the option of the taxpayer to avail of the benefits under this regime. Once the option is exercised in any year, the taxpayer is required to continue to avail of such benefits for the next five consecutive years. In case the above option is not exercised in any of such five consecutive years, the taxpayer cannot avail of the benefits for five years following the year in which the option was not exercised.

Attribution of profits to a PE

In April 2019, the CBDT placed a report by the Committee on Profit Attribution to a PE in the public domain to invite comments and suggestions to bring changes to Rule 10 of the Income Tax Rules, 1962. Rule 10 of the Income Tax Rules, 1962 gives arbitrary powers to the Assessing Officer to compute profits of non-residents having a PE in India. As non-resident taxation is a significant issue, a need was felt to bring clarity and predictability in the tax regime. For this, a committee was formed to examine the existing scheme of profit attribution to PE and to recommend changes in the relevant rules.[13]

Tax climate

India has a three-tiered economy, comprising the service, agricultural and manufacturing sectors. The Government of India has been taking various initiatives to promote business and make India a lucrative place to invest. For the first time, India jumped a record 23 positions from 100 to 77 in the Ease of Doing Business Report for 2019,[14] which is an influential 190-country index of competitiveness that many businesses likely consider for investment decisions. India was among the top 10 improvers with the highest jump in rankings among 190 countries, which shows that the country is closer to global best practices regarding its regulatory framework for businesses, as indicated by World Bank's latest report.

Clarifications and guidelines are issued by the CBDT on a continuous basis for the ease and convenience of taxpayers. Initiatives have been taken by the Government to digitalise assessment procedures to reduce compliance costs and bring about greater efficiency, effectiveness and transparency. Efforts are being made to reduce drawn-out and protracted litigation, which results in undue harassment of taxpayers. The CBDT has taken measures to provide relief, address the grievances of taxpayers on a continuous basis and expedite the processing of refunds, where possible. Directions are given to the Revenue authorities to curb litigation where the issue in question is already settled by the Revenue authorities or the appeal is no longer relevant in view of subsequent amendments.

India introduced the Transfer Pricing ("**TP**") provisions in April 2001. Over the years, TP litigation has increased considerably, and aggressive tax positions have been adopted by the Revenue authorities. The Indian Courts have been able to provide guidance on various TP issues; however, TP litigation continues to dominate and rule the Indian tax litigation landscape. To curb litigation and resolve future tax controversies, the Government of India rolled out the Advance Pricing Agreement ("**APA**") programme. Under this programme, the taxpayer has the option of entering into an agreement with the Revenue authorities regarding the arm's-length price of the international transactions it has entered into with related parties. The APA programme has been a considerable success and has been much appreciated, as it is able to resolve the issue under contention for the taxpayer and provide tax certainty. As per the recent CBDT press release,[15] CBDT has entered into 18 more APAs and a total of 271 APAs to date. Thus, the APA regime has acted as a boon for taxpayers, as they are able to arrive at a mutually acceptable solution on multiple issues with the Indian Revenue authorities.

Until a few years ago, the procedure for obtaining tax registrations for a newly set up company was cumbersome. To promote business growth and the ease of doing business, the Government of India has initiated steps to expedite the process of setting up a company in India and merged the process to apply for income tax registrations (such as Permanent Account Number ("**PAN**") and Tax Deduction Account Number). This has made the registration process for new companies simpler, more convenient and faster. In addition, the electronic PAN card has also been introduced, which is sent by email, in addition to the issuance of a physical PAN Card, to all applicants, including individuals, to which a PAN is allotted.

In what can be considered to be a defining moment in the Indian tax landscape, the Government introduced General Anti Avoidance Rules ("**GAAR**") with effect from 1 April 2017. The GAAR applies to an arrangement where the main purpose is to obtain a tax benefit, and which, among others, lacks commercial substance. Considering the broad scope of the GAAR and the sometimes thin line between taxpayers availing of legally available benefits under tax law, and what can be considered as artificial transactions undertaken with the main purpose of avoiding tax, the GAAR has the potential to increase tax litigation in India.

New Direct Tax Code proposed

In order for the existing tax regime to be in line with the economic needs of the country and to keep pace with evolving global practices, the Government of India has set up a six-member "Task Force" to draft a new Direct Tax Code that will replace the current ITA. It is expected that the new tax code will be ready by July 2019 and is likely to give relief to individual taxpayers and small businesses, reduce tax evasion and improve compliance. The following are the terms of reference of the Task Force (including original terms and additional terms introduced later on):[16]

1. To draft an appropriate direct tax legislation keeping in view:
   (i) The direct tax system prevalent in various countries.

(ii) The international best practices.
(iii) The economic needs of the country.
(iv) Any other matter connected thereto.

2. Faceless and anonymised scrutiny assessments.
3. Reduction of litigation and expeditious disposal of appeals from the Commissioner of Income Tax (Appeals) ("**CIT(A)**") stage right up to the Supreme Court.
4. Sharing of information between the Goods and Services Tax Council ("**GST**"), Customs, CBDT Teams, etc.
5. Simplification of the procedure to reduce the compliance burden.
6. System-based cross-verification of financial transactions.

The new direct tax code is expected to bring more taxpayers into the tax net, make the system more equitable for different classes of taxpayers and eventually phase out the remaining tax exemptions that lead to drawn-out litigation (under the current regime).

Key judicial decisions

Ge Energy Parts Inc. V. Cit[17]

Facts: GE Energy Parts Inc. is a tax resident of the USA engaged in the business of manufacturing and offshore sale of highly sophisticated equipment. They have a Liaison Office ("**LO**") (GE India) in India providing limited marketing support functions to the taxpayer. The Income Tax Department carried out a survey on the premises of the LO and found that certain expatriate employees of the taxpayer were carrying out marketing services and were involved in negotiation of prices therefrom. Against this background, the ruling of the Delhi High Court was as follows:

Whether the taxpayer has a Fixed Place PE in India? [Held: YES]

Some of the core activities of the taxpayer are taking place in the premises of the LO in India. Further, the expatriate employees of the taxpayer working from these premises were not merely liaising, but were either gathering information or negotiating contracts. Thus, the LO forms a Fixed Place PE.

*Whether the taxpayer has a Dependent Agent PE ("**DAPE**") in India? [YES]*

It was held that since the negotiation takes place in India on the core substance of the contracts (though not the entire contract), there was no need for the entire contract to be concluded in India. In light of this, applicability of DAPE also cannot be ruled out.

The taxpayer has challenged the judgment of the Hon'ble High Court of Delhi before the Hon'ble Supreme Court of India.

Significant deals in India

Cognizant buy-back of shares: non-payment of dividend distribution tax

In 2016, under a Scheme of Arrangement and Compromise, Cognizant Technology Solutions India Pvt. Ltd. (Cognizant India) planned to purchase its own shares from foreign shareholders, i.e. a buy-back, under the provisions for amalgamations and arrangements of the Companies Act, 1956, for which it was granted approval in the same year.

Consequently, Cognizant India bought back 9.4 million equity shares (approximately) for INR 190 billion and paid the consideration to the concerned shareholders in May 2016. Further, Cognizant India paid a total of INR 8.98 billion (approximately) as withholding tax on capital gains arising in the hands of shareholders who were resident abroad.

With regard to this transaction, the Revenue authorities issued a notice, treating the consideration paid by Cognizant India for the buy-back as a "distribution of dividends",

thereby holding Cognizant India liable for paying Dividend Distribution Tax ("**DDT**") under the ITA. DDT was payable at the rate of 15% (plus applicable surcharge and cess) during the year 2016 when the buy-back was undertaken. The Revenue authorities made a claim of approximately INR 25 billion (tax plus interest), treating the transaction as a distribution of dividends and hence subject to DDT.

A writ petition was preferred by Cognizant India for quashing the notice on the ground that the buy-back would be covered under a specific provision in ITA (section 46) which qualifies income from a buy-back transaction as capital gains income in the hands of the shareholder. Thus, the buy-back consideration should not be treated as distribution of dividends, subject to DDT.

The Hon'ble High Court of Madras, relying on the provisions of ITA and various juridical precedents, dismissed the petition based on a *prima facie* view that the shares purchased consequent to the buy-back scheme should not be treated as capital gains and should be treated as dividends. Cognizant India, however, was provided with the liberty to approach the appellate authorities as a regular appeal remedy.

* * *

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Indonesia

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Introduction

The Indonesian legal system is primarily based on the civil law model of which the laws and regulations are codified into a set of hierarchical statutory instruments. The taxation laws are a subset of the national laws. Article 23A of the Constitution of the Republic of Indonesia of 1945 states that "*taxes and other compulsory levies required for the needs of the state are to be regulated by Law*".

There are currently around 10 key taxation laws in Indonesia. Under each of the laws, there are further implementing regulations issued by the Government, Ministry of Finance ("**MoF**"), and/or Director General of Tax ("**DGT**"). For local taxes, the implementing regulations can be found in the Regional Government Regulation, and the Governor/Regency Head Regulation.

There are also DGT (circular) letters, which are not considered as part of the formal laws, but in practice, they are generally followed by the tax officials.

Key developments affecting corporate tax law and practice

A new implementing guideline of a Permanent Establishment determination

Indonesian Income Tax Law[1] provides the definition of a Permanent Establishment ("**PE**") in Article 2 paragraph (5) of Income Tax Law. A PE shall be a business form that is used by an individual who does not reside in Indonesia, an individual who lives in Indonesia for not more than 183 days in a period of 12 months, and/or an entity that is not established and has no domicile in Indonesia to carry on business or conduct activity in Indonesia, that can be in the form of a:

a. domicile of management;
b. branch of a company;
c. representative office;
d. office building;
e. factory;
f. workshop;
g. warehouse;
h. space for promotion and sale;
i. mining and quarrying of natural resources;
j. working area of natural oil and gas mining;

k. fisheries, animal husbandry, agriculture, plantation, or forestry;

l. construction project, installation, or assembly project;

m. furnishing of services in any form by an employee or any other persons, as long as it is conducted for more than 60 days in a period of 12 months;

n. person or entity that acts as an agent with dependent position;

o. agent or employee of an insurance company that is not established and has no domicile in Indonesia that receives insurance premium or covers risk in Indonesia; and

p. computer, electronic agent, or automatic equipment that is owned, leased or used by an operator of an electronic transaction to conduct business activity on the internet.

The Ministry of Finance has just recently issued Ministry of Finance Regulation Number 35/PMK.03/2019, which provides more detailed guidance for taxpayers regarding Permanent Establishment determination. This regulation first defines a Permanent Establishment as a place of business in Indonesia, which is permanent in nature and is used by the foreign individual or entities to conduct business or perform activities.

A PE must register for a Tax Identification Number at the latest of one month after the business or activity takes place in Indonesia. The DGT has the right to provide a Tax Identification Number *ex officio* to the PE in case the PE does not apply for the Tax Identification Number. The PE must also register for a Taxable Entrepreneur Number for Value-Added Tax ("**VAT**") purposes in case the annual gross turnover is above Rp 4.8 billion.

In addition, this Regulation also provides four other types of PE: 1) construction, installation, or assembly project; 2) services PE; 3) dependent and independent agents; and 4) insurance PE.

In line with UN and OECD commentaries, this regulation now states that preparatory or auxiliary activities are excluded from the definition of a PE. The preparatory activities are defined as initial activities needed so that the essential and significant activities are ready to be done. Thus, auxiliary activities are additional activities to accelerate the essential and significant activities.

The essential and significant activities include activities that:

a. are the main business or activity of the foreign individual or entity;

b. are inseparable from the main business or activity of the foreign individual or entity;

c. directly generate income for the foreign individual or entity; or

d. use a significant amount of the asset or human resources.

Construction, installation, or assembly projects

Construction activities include construction consultation services, construction works, and integrated construction works. Installation or assembly projects include those projects that are related to construction works or related to machinery and equipment. In relation to the implementation of a tax treaty, the projects are considered as PEs as long as they are conducted beyond the time test in the tax treaty. These projects also cover construction, installation, or assembly projects in Indonesia that are conducted outside Indonesia and/or subcontracted to a foreign or domestic subcontractor.

Services PE

Any kind of services rendered by employees or other people for more than 60 days in 12 months are considered as a PE with the following conditions: the employees or other persons are employed by foreign entities or persons; the services are rendered in Indonesia; and the

services are rendered to other parties in Indonesia or outside Indonesia. In relation to tax treaty implementation, the time test shall follow the time test stipulated in the tax treaty.

Dependent and independent agents

The dependent agents are considered as a PE as long as the person or entity is acting for and on behalf of other parties. The person or entity receives instruction on the interest of the foreign person or entity in conducting its business or activities or does not bear business or activity risk. The foreign entity or person does not have a PE if in conducting its business or activity, it uses an agent, broker or intermediary that is independent in nature when conducting its own activities.

Insurance PE

An agent or employee of an insurance company that is not established and domiciled in Indonesia is a PE as long as it receives an insurance premium in Indonesia, or has borne risk in Indonesia where the insured parties reside, are domiciled, or stays in Indonesia. In relation to tax treaty implementation, this provision is not applied for reinsurance.

Updated tax treaty implementation procedure

In 2018, the DGT issued Director General of Tax Regulation Number PER-25/PJ/2018 ("**PER-25**") regarding the updated tax treaty implementation procedure. There are four main conditions under which the foreign tax resident can use the tax treaty facility, as follows:

a. the income recipient is not an Indonesian tax resident;
b. the income recipient is an individual or an entity that is a domestic tax resident in the tax treaty partner country or jurisdiction;
c. there is no misuse of a tax treaty; and
d. the income recipient is a beneficial owner, in case it is required in the tax treaty.

The Indonesian tax withholder or collector can withhold or collect the income as stated in the tax treaty, as long as the foreign tax resident has provided a Domicile Letter, a DGT form that is legalised by the competent authority in the tax treaty partner country or jurisdiction in relation to tax treaty implementation. Previously, there were two types of DGT forms.[2]

In this new regulation, the DGT now only uses one type of DGT form. In the case that the foreign taxpayer is not able to provide a DGT form that has been legalised by the competent authority in the tax treaty partner country or jurisdiction, the foreign taxpayer must still complete the other section of the DGT form and also provide a certification of residence. The longest period stated in the DGT form is 12 months.

PER-25 provides a stricter definition of the criteria of misuse of the tax treaty and a beneficial owner. The DGT has provided specific conditions to determine that there is no misuse of a tax treaty, as follows:

a. the foreign tax resident has:
    1. the economic substance of the entity establishment or transaction implementation;
    2. the same legal form with the economic substance of the entity establishment or transaction implementation;
    3. business activity that is managed by its own management and which has sufficient authority to conduct the transaction;
    4. sufficient and adequate fixed assets and a non-fixed asset to conduct business activity in the tax treaty partner country or jurisdiction, other than the income-generating asset in Indonesia;

5. sufficient and adequate employees with specific expertise and skills suitable for the business activity; and
6. active business or activities, other than income in the form of dividends, interest, and/or royalty from Indonesia; and

b. there is no direct or indirect transaction arrangement for the purpose of obtaining tax treaty implementation, such as:
   1. tax expense reduction; and/or
   2. double non-taxation.

The active business or activity is the actual active business or activity that is shown by the expenses incurred, efforts made, or sacrifices that were made, which is directly related to the business or activity carried out to earn, collect, and maintain income, including significant activities carried out by the foreign tax resident to maintain the continuity of the entity.

This DGT regulation also provides the definitions of an agent, a nominee, and a conduit. An agent is defined as a person or entity that acts as an intermediary and conduct activities for and/or on behalf of other parties. A nominee is an individual or person that legally has the asset and/or income (legal owner) for the interest or based on the mandate from the actual party that has the asset and/or enjoys the benefit of the income. A conduit is a company that receives the benefit of a tax treaty in relation to the income originating from Indonesia; meanwhile, the economic substance of the income is owned by a person or entity in the other country that will not receive the benefit of the tax treaty if the income is directly received.

Further, the DGT regulation also provides the definition of a Beneficial Owner, as follows:

a. for an individual foreign tax resident, not acting as an agent or nominee; or
b. for a corporate foreign tax resident, they must fulfil the following provisions:
   1. not acting as an agent, a nominee, or a conduit;
   2. have control to use or enjoy funds, assets, or the rights that originate income from Indonesia;
   3. not use more than 50% of the income to fulfil an obligation to another party;
   4. have borne risk on the asset, capital, or other obligations; and
   5. do not have an obligation (written and not written) to pass partial or whole income received from Indonesia to another party.

A foreign tax resident can request a refund in case of an excess of withholding tax in several situations related to tax treaty implementation, as follows:

a. incorrect tax treaty implementation;
b. late fulfillment of the administrative requirement to implement the tax treaty after the withholding and/or collecting; or
c. Mutual Agreement Procedure ("**MAP**").

Updated tax holiday facilities

The Ministry of Finance has updated Ministry of Finance Regulation No. 35/PMK.010/2018 on Corporate Income Tax Reduction Facility with Ministry of Finance Regulation No. 150/PMK.010/2018. In this Regulation, the taxpayers that have new capital investment in the pioneer industries are eligible for corporate income tax reduction. The minimum capital investment is Rp 100 billion.

The available corporate income tax reduction is as follows:

- The first category: 100% for corporate income tax reduction is given for new minimum

capital investment of Rp 500 billion (the corporate income tax reduction facility is given between five years and 20 years depending on the capital investment plan); and

- The second category: 50% for corporate income tax reduction is given for a new capital investment of Rp 100 billion up to below Rp 500 billion (the corporate income tax reduction facility is given for five years).

After the above initial corporate income tax reduction facility period has ended, the first category taxpayer is given 50% corporate income tax reduction facility for another two years for new capital investment. Meanwhile, the second category taxpayer is given 25% corporate income tax reduction facility for another two years for new capital investment.

The starting period for a corporate income tax facility is when commercial production has started. The DGT will conduct a field audit to determine the commencement of commercial production. The DGT will issue a stipulation consisting of the starting date of commercial production, the new capital investment realisation and the conformity of the new capital investment realisation with the main business plan. The taxpayer that has received the Ministry of Finance decision regarding the corporate income tax reduction facility must submit a regular report every year regarding the capital investment realisation report and production realisation report.

The above corporate income tax facility must fulfil the following criteria:

a. be in the pioneer industries (18 industries are classified as pioneer industries);[3]
b. be an Indonesian legal entity;
c. be a new capital investment that has not been given a decision for the granting or rejection of a corporate income tax reduction;
d. have a new capital investment minimum of Rp 100 billion; and
e. fulfil the criteria of debt-to-equity ratio, as stipulated in the Ministry of Finance regulation to calculate corporate income tax.

In the case that a taxpayer submits a request for a corporate income tax reduction facility in the industry as a pioneer industry, but it is not yet classified as a pioneer industry as per the Ministry of Finance regulation although fulfils several other criteria, the request will be discussed across ministries. The discussion is coordinated by the Capital Investment Coordinating Board.

Adoption of BEPS Action 14 related to the Mutual Agreement Procedure

Indonesia aims to apply a minimum standard of BEPS Action 14 regarding More Effective Dispute Resolution Mechanisms. In relation to this, the Ministry of Finance issued Ministry of Finance Regulation Number 49/PMK.03/2019 related to the MAP.

The domestic taxpayer can apply for a MAP to the DGT, as the competent authority in Indonesia in the case of tax treatment by the tax treaty partner competent authority that is not in line with tax treaty provisions, as follows:

a. tax treatment by the tax treaty partner competent authority that causes double taxation from transfer pricing correction, PE existence and/or profit, and other taxable income objects;
b. tax imposition, including income tax withholding or income tax collection in a tax treaty partner jurisdiction that is not in line with the tax treaty;
c. status determination as domestic tax subjects by the tax treaty partner competent authority;

d. tax treatment discrimination by the tax treaty partner country; and/or

e. tax treaty provisions interpretation.

The MAP request can be requested by the domestic taxpayer, an Indonesian citizen through the DGT, or a tax treaty partner competent authority according to tax treaty provisions. The MAP request by the DGT can be requested in the following events: to avoid double taxation as a result of a transfer pricing adjustment that has been carried out by the DGT by proposing the corresponding adjustment for the domestic taxpayer of the tax treaty partner country/jurisdiction, to follow up the advance pricing agreement ("**APA**") that is requested by the domestic taxpayer including the implementation of the APA prior to the period covered in the APA, and/or to interpret the tax treaty provisions.

The MAP request can be submitted in parallel with the taxpayer dispute process of objection, appeal, and reduction or cancellation of an incorrect tax assessment letter. The content of the MAP request must be included in the disputed materials. The MAP request is submitted within the period as stipulated in the tax treaty. The DGT provides a response on the MAP request at the latest one month after the request is received. The DGT then issues the request of MAP implementation to the tax treaty partner competent authority and written notification of the MAP request submission to the domestic taxpayer. In the event that the DGT has not received a written response related to the MAP implementation request by the tax treaty partner competent authority within eight months after the submission of the MAP request, the DGT will issue a written notification to the domestic taxpayer that the MAP request cannot be processed, and to the competent authority of the tax treaty partner that the MAP request is revoked.

The DGT conducts discussion and negotiation with the tax treaty partner competent authority within 24 months after the MAP request is received in writing by the tax treaty partner competent authority, or when the MAP request is submitted in writing to the tax treaty partner competent authority. The discussion can be done through a direct meeting, phone call, video conferencing, and/or other channels that are agreed between the DGT and the tax treaty partner competent authority. The result of the discussion is written in a Mutual Agreement.

In case an MAP produces a Mutual Agreement before a tax assessment letter from the audit process is issued, the domestic taxpayer will conduct a revision of the tax return considering the content of the Mutual Agreement. In case the MAP process has produced a Mutual Agreement and the tax assessment letter is issued, but taxpayers do not file an objection, the DGT will *ex officio* revise the tax assessment letter according to the Mutual Agreement. If the taxpayers have filed an objection but the objection decision has not been issued, the DGT will issue an objection decision according to the MAP. Further, if the DGT has issued the objection decision or the taxpayers do not file an appeal, the DGT will *ex officio* revise the objection decision.

Export of Taxable Services that are subject to VAT with a rate of 0%

VAT is imposed on the export of certain Taxable Services with a tariff of 0%. An export of Taxable Service is defined as a service activity rendered inside the customs area that causes goods, facilities, conveniences, or rights to be available for use used outside the customs area.

The Ministry of Finance, through the Ministry of Finance Regulation Number 32/PMK.010/2019, has expanded the type of services that are subject to VAT with the tariff of 0%, as follows:[4]

a. the activity that is attached to movable goods that are taken out or used outside the customs area, which are contract manufacturing services, maintenance, and repair services, and freight forwarding services related to goods for export services;
b. the activity that is attached to immovable goods outside the customs area, which is the construction consulting service that covers construction assessment, planning, and design related to building or building plans outside the customs area; or
c. any activity, other than the above activities, of which the result is given to be used outside the customs area:
    1. through direct or indirect delivery, among others through post or electronically;
    2. through provision of rights to be used (or accessible) outside the customs area; or
    3. based on the request of the recipient of the taxable services export.

The services in the above letter (c) are as follows:

a. information technology;
b. research and development;
c. transportation equipment rental service in the form of an airline or ship for international flights or shipping;
d. business and management consulting, legal consulting, interior and architect design, human resources, engineering, marketing, accounting, bookkeeping, financial auditing and tax services;
e. trading service in the form of searching for seller of goods inside a customs area for an export purpose; and
f. interconnection service, satellite and/or communication/data connectivity service.

The above export Taxable Services are subject to VAT with a tariff of 0%, as long as:

a. they are based on a written agreement or contract with the Taxable Entrepreneur with the recipient of the Taxable Services export, which clearly states the type of service, the activity details that are produced inside the customs area to be utilised outside the customs area, and the total value; and
b. there is payment with payment proof from the recipient of the Taxable Services export to the Taxable Entrepreneur related to the Taxable Services export.

The Taxable Entrepreneur must prepare a Tax Invoice in the form of Taxable Services Export Notification that is attached to the commercial invoice. All the input tax related to the Taxable Services Export can be credited in the VAT return.

Income tax credit from overseas income

Indonesia adopts a worldwide income system, whereas the Indonesian taxpayer is taxed on foreign income that is earned or received overseas. The income tax that is already paid overseas is able to be utilised as a tax credit in Indonesia according to the Ministry of Finance Regulation Number 192/PMK.03/2019. For taxable income calculation, the net foreign income is combined with domestic income.[5] The domestic taxpayer cannot take into account the business loss from a foreign branch or foreign representative and other foreign losses.

Determination of the foreign income sources are as follows:

a. income from shares or other securities: the country where the entity that issues the shares or securities is established or domiciled;
b. income from interest, royalty, and rent related to the use of movable goods: the country

where the paying entity of interest, royalty, or rent is domiciled or exists;

c. income from rental from immovable property: the country where the immovable property is located;

d. income from services, work, and activities: the country where the paying entity is domiciled or exists;

e. income from the PE: the country where the PE runs its business or conducts activities;

f. income from the transfer of all of parts of mining rights or participation in financing or capital in mining companies: the country where the mining is located;

g. profit from the transfer of immovable property: the country where the immovable property is located; and

h. income from transfer of property as part of a PE: the country where the PE is located.

The foreign income tax can be credited in the fiscal year where the foreign income is earned or received and then combined with the income sourced from Indonesia. The foreign tax credit that is recognised in Indonesia is determined based on the smallest amount, between:

a. the income tax that should be payable, paid, or withheld overseas, by observing the provisions in the tax treaty, in case there is an effective tax treaty with Indonesia;

b. foreign income tax; and

c. a certain amount, which is calculated according to the proportion between the overseas income and taxable income in Indonesia multiplied by the Indonesian income tax payable on the total taxable income (overseas and domestic income); the highest amount is the Indonesian income tax payable.

Tax climate in Indonesia

After the Tax Amnesty programme, the DGT was able to significantly increase the tax base and thus has more information about the tax revenue potential from taxpayers. With the increased access to financial information (both overseas and domestic), it is expected that the DGT will strengthen its law enforcement initiatives. The DGT will be able to discover previously undetected tax evasion, continue its extra efforts to meet the tax revenue collection target, and eventually increase the tax ratio. With better data/information accuracy and by implementing more sophisticated compliance risk management, the DGT can employ a more targeted approach for tax supervision and tax audits of high-risk taxpayers.

On the other hand, the government of Indonesia has also tried to provide several incentives for taxpayers, such as the newly issued regulation on tax holidays, and to streamline the necessary administration burden for taxpayers, simplified registration for a Tax Identification Number and Taxable Entrepreneur Number (for VAT purposes), and a faster restitution process for low-risk taxpayers and taxpayers that meet certain criteria. It is expected that Indonesia can improve the ease of doing business and thus attract more potential investors.

The year ahead

Previously, under the bank secrecy regime, there were difficult (and lengthy) processes for the DGT to access taxpayers' bank accounts since approval from the Minister of Finance and Financial Service Authority Commissioner was needed. With information from the Tax Amnesty and improved access to financial information through automatic exchange of information ("**AEOI**"), it is expected that the DGT will continue its law enforcement efforts to detect both offshore and onshore tax evasion. For the Indonesian taxpayers that previously

did not use the Tax Amnesty facility, the DGT aims to identify the tax potential for these taxpayers. For those that have used the Tax Amnesty facility, the DGT will evaluate their declaration and repatriation of their offshore financial accounts obligations, which will also improve consistency in their tax reporting.

The DGT will also continue its tax reform agenda in the year ahead in all aspects (organisation, human resources, business processes, information systems and databases, rules and regulations, and synergy with other parties).

* * *

Endnotes

1. Law Number 7 of 1983 on Income Tax Law, as lastly amended by Law Number 36 of 2008.
2. Previously, there were two DGT Forms: Form DGT-1; and Form DGT-2. Form DGT-2 was used for banks and financial institutions. Form DGT-1 was used for foreign tax residents, other than banks and financial institutions.
3. According to Investment Coordinating Board Regulation Number 1 of 2019, pioneer industries are defined as industries that have high relevancy, provide value-added, high externality, introduce new technology, and have strategic value to the national economy. There are currently 18 industries classified as pioneer industries, such as: the steel industry; basic chemical industry; vehicle industry; power plant machinery component industry; digital economy related to data management; hosting; and other related activities.
4. In the previous regulation, there were only three types of export Taxable Services that were subject to VAT with a tariff of 0%: subcontractor services; repair and maintenance services; and construction services.
5. Indonesia adopts the worldwide income system.

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Overview of corporate tax work over last year

Ireland's 12.5% corporation tax rate continues to be the foundation of Ireland's tax regime, demonstrated by Irish Revenue reporting that net corporation tax receipts for 2018 totalled €10.4 billion, representing an increase of 26.7% compared to 2017. The main focus of Irish tax lawyers' work over the last 12 months has included advising on mergers & acquisitions ("**M&A**"), investment into property structures and the on-shoring of intellectual property ("**IP**"). The continuing effects of pre-Brexit have also resulted in a steady volume of banking, treasury and insurance activities as companies seek to establish a base in Ireland. M&A activity strengthened throughout 2018, reflecting the continued confidence in the Irish economy despite the global economic and political volatility experienced throughout the year.

Mergers & acquisitions

2018 represented another impressive year for M&A activity in Ireland. Deal volume is reported to be at its highest level in recent years, indicating that Ireland's international reputation is going from strength to strength with €92 billion worth of M&A activity taking place last year. Irish company acquisitions have historically been driven by US multinationals; however, technology and medtech/life science industries are now gaining traction from foreign multinationals in Canada, France and China.

Banking, treasury and insurance

The international banking sector has developed into a crucial element of the Irish economy with approximately half of the world's top 50 banks now located in Ireland. Ireland has also attracted a large number of multinational corporations who have set up corporate treasury operations in Ireland and remains a key player in the global insurance market. The surge in the number of leading insurance companies establishing an Irish base for their EU operations in this sector is largely due to Brexit, coupled with Ireland's attractive corporate tax rate and generous double taxation relief regime.

Corporate restructuring

Following a strong 2017, corporate restructuring activity particularly in the indigenous sector remained at a high level for 2018. The majority of the focus of transactions which these companies engaged in related to pre-sale restructurings and group tidy-ups. Changes to domestic and international law continue to be the drivers behind much of the corporate restructuring taking place as many multi-national level groups seek to take advantage of cross-border tax regimes. It remains to be seen what effect any amendment to the current transfer pricing rules (discussed in the "Transfer pricing" section below) will have on

corporate restructuring transactions in Ireland going forward. Brexit also continues to accelerate activity in the corporate restructuring sphere as companies seek to establish an Irish base for their pan-European activity. The high rate of M&A activity taking place in Ireland has also increased the focus on corporate restructuring as corporations seek to cement their post-acquisition integration.

Intellectual property

The Knowledge Development Box was introduced for accounting periods commencing on or after 1 January 2016 and has had little traction since its introduction; however, Revenue anticipates that more companies will make use of the 24-month time frame in which a company has to submit its claim in respect of the relief. Therefore, more claims in respect of the year ended 31 December 2017 are expected to be made by corporate taxpayers in 2019 in comparison to the current 10 claims which were made in the 2018 tax year. The Department of Finance is expected to carry out a review of the current research and development ("**R&D**") tax credit during the course of 2019. At present it is not anticipated that the R&D tax credit will be radically affected. The recent US tax changes were predicted to have potentially impacted Ireland as an attractive location for carrying out R&D activities. To date, however, there is no evidence to suggest that the US tax rate of 13.125% on Foreign Derived Intangible Income has negatively affected Ireland's rate of foreign direct investment ("**FDI**") from US entities. A European Attractiveness Survey carried out by Ernst & Young as part of their annual review concluded that Ireland won 205 new FDI commitments in 2018, which was an increase of 52% from 2017.

Tax disputes

Tax disputes is an area in which activity picked up substantially in 2018 due to the increasing levels of cases being heard by the Tax Appeals Commission ("**TAC**"). Since it replaced the Office of the Appeals Commissioners in 2016, the TAC has received 4,341 tax appeals arising over various tax heads. Over a quarter of these cases appeared before the TAC in 2018, representing significant work for tax experts. A substantial increase for 2019 of nearly double the existing budget for the TAC is expected to lead to an approximate doubling of staff for the TAC. With the remaining backlog of over 2,500 tax appeals still currently in the TAC's system, this represents an area which should continue to grow; in particular, there is a number of high-profile cases expected to be heard, including *Cintra* and *Perrigo*. Given the nature of the cases that have been heard this year, this reflects Revenue's change of approach challenging more high-profile cases. This is highlighted further by the submission of five appeals in the final week of December 2018 which related to an aggregate quantum in dispute of approximately €2.1 billion.

Key developments affecting corporate tax law and practice

In September 2018, the Irish Department of Finance published ''Ireland's Corporation Tax Roadmap" (the "**Roadmap**'') outlining how Ireland will address some of the international tax developments. This document laid out the pathway for Irish compliance with:

- The EU Anti-Tax Avoidance Directives ("**ATAD**").
- The OECD Base Erosion and Profit Shifting project ("**BEPS**").
- The EU Directive on Administrative Cooperation.

The Roadmap details when certain elements of the above frameworks will exist on a statutory footing in Ireland. It also details when Irish policy on other elements of the above frameworks is to be formulated.

Transfer pricing

The Department of Finance is also currently reviewing whether Ireland's current transfer pricing ("**TP**") rules are BEPS compliant. The OECD states that the updated transfer pricing rules are designed to deal with weaknesses in the current system. They argue that these have arisen due to a perceived emphasis on contractual allocations of functions, assets and risks in the current system. The OECD intends to broaden the scope of TP rules to deal with certain transactions which are more difficult to assess under the current framework.

It is expected that the new TP rules which may be adopted include the following amendments:

i. Irish TP rules should be amended to incorporate the 2017 OECD transfer pricing guidelines.
ii. The application of the TP Rules should be expanded to apply to transactions agreed before 1 July 2010 (the TP Rules do not currently apply to transactions the terms of which were agreed prior to 1 July 2010).
iii. The removal of the current exemption for small and medium businesses ("**SMEs**") should be considered (SMEs are currently exempt from the TP Rules).
iv. The expansion of the application of the TP rules to non-trading transactions and capital transactions should be considered (currently the TP Rules only apply to trading transactions).

Common Consolidated Corporate Tax Base

The Common Consolidated Corporate Tax Base ("**CCCTB**") is an EU proposal which would involve a degree of standardisation of tax regimes across the EU, which could affect Ireland's 12.5% corporate tax rate. It has not been previously adopted as EU tax decisions require unanimous support. The European Commission raised the proposal again in 2019, expressing the view that the time has come to move away from unanimity on tax issues. Ireland has continued to express the view that it is not in favour of the CCCTB.

Tax climate in Ireland

Digital economy

One issue which tax policy makers are facing is whether proceeds derived from the sale of digital goods and services can be taxed using traditional methods of taxation or whether an entirely new approach is required. The OECD's BEPS project identified the need to evaluate and assess digital business models continuing its work on digital issues via the Task Force on the Digital Economy, which was established in 2013 as a subsidiary of the OECD's Committee on Fiscal Affairs.

The OECD's BEPS Action 1 Report released in October 2015 identified a number of challenges associated with digitalisation, specifically relating to tax nexus, data and income characterisation. This report discussed some potential solutions on the basis that existing treaty provisions were followed. It is likely that any proposals will be approved at an OECD level before being adopted across the European Union.

Multilateral Convention to Implement Tax Treaty

On 29 January 2019, Ireland deposited with the OECD its Instrument of Ratification for the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the "**MLI**"), which came into force on 1 May 2019. The MLI is an instrument which amends the terms of pre-existing international tax treaties to make them BEPS compliant. The MLI only affects a treaty where both parties to the treaty have ratified the MLI.

Developments affecting attractiveness of Ireland for holding companies

Irish holding companies still remain an attractive prospect on the global market. This outlook continues due to the Irish low-tax regime. The participation exemption which provides for a capital gains tax exemption on the sale of certain shareholdings is utilised by many holding companies, and exemptions for certain foreign dividend policies have allowed in certain circumstances for a net effect of no charge to Irish tax on foreign dividends. However, there were two major policy developments in the past year which may affect the continuing attractiveness of Ireland as a location for holding companies. The two new measures introduced are a new exit tax and a regime in relation to Controlled Foreign Companies ("**CFCs**").

Exit tax

Prior to the Finance Act 2018, Ireland had a limited exit tax regime that was designed as an anti-avoidance measure to restrict companies from moving their tax residency out of Ireland to avoid Irish capital gains tax. However, the EU Anti-Tax Avoidance Directive 2016/1164 (the "**ATAD**") required Member States to introduce further, more comprehensive measures in relation to exit tax by 1 January 2020. The new exit tax rules are therefore not entirely unexpected, but their introduction is earlier than anticipated.

With effect for transactions on or after 10 October 2018, the new rules impose a tax of 12.5% on unrealised capital gains where companies migrate their tax residency or transfer assets offshore, putting them outside the scope of Irish tax law. In such a scenario, the company is deemed to have disposed of the assets and immediately reacquired them at market value. The gain arising from this disposal will be subject to the exit tax of 12.5%. However, any deemed gain which is made as part of a transaction to dispose of an asset, the purpose of which is to ensure the gain is taxed at the 12.5% rate as opposed to the general capital gains rate (i.e. in cases of tax avoidance), will be charged at the current capital gains tax rate of 33%.

It is now clear that the general exit rate to be applied is 12.5% rather than the 33% rate that currently generally applies to taxable gains and, as such, reaffirms Ireland's commitment to the 12.5% corporation tax brand and to being viewed as a competitive country with an attractive tax regime for international business. It has additionally been speculated that the new rules may discourage US multinational companies from undertaking group restructurings involving the transfer of intellectual property from Ireland back to the US in order to avail of the new lower US tax rate on foreign-derived intangible income which, if true, would also be positive for the Irish economy.

Controlled Foreign Companies

With effect for accounting periods beginning on or after 1 January 2019, a new regime in relation to CFCs has been introduced for the first time which represents a significant change to the Irish tax landscape. The new CFC rules are designed to prevent companies from moving profits to low or no tax jurisdictions, thus eroding the Irish tax base. Under these rules a company will be considered to be a CFC where it is a non-Irish resident company which is controlled by an Irish company, branch or agency. While Ireland was required to establish a CFC regime by the ATAD, significant comfort may be taken from the policy approach adopted by Ireland in implementing the regime. The ATAD allowed Member States to determine whether the income of a CFC should be attributed to its parent using one of two options – the first option considers the nature of the income in the CFC and whether it is passive (as opposed to trading), whereas the second is primarily focused on

whether the CFC is engaged in artificial/non-genuine activities. Ireland selected the second option, which has the benefit of avoiding the potential pitfall of option one, which could have seen broad swathes of income being treated as CFC income regardless of whether or not that income has any Irish nexus.

Industry sector focus

Corporate real estate

A range of recent measures, both international and domestic, have been introduced which impact the Irish real estate industry. Increased international investment in the Irish real estate market has resulted in a degree of negative media attention due to tax policies that allowed income and gains on Irish real estate arising in certain Irish investment entities to accumulate effectively tax-free. As a result, there have been changes to the legislation applying to commonly used special-purpose vehicles, most notably the introduction of Irish real estate funds ("**IREF**") withholding tax on certain regulated funds.

The concept of an IREF withholding tax significantly affected investment in Irish real estate through a qualifying investment fund, which has become a popular investment vehicle in previous years. Despite the 20% withholding tax on distributions made to foreign investors, the Qualifying Investor Alternative Investment Fund ("**QIAIF**") is still a prevalent vehicle for large-scale projects in excess of approximately €50 million, as it remains exempt from tax at fund level.

The main action contained in ATAD that should impact investors operating in the Irish real estate market is the interest limitation/borrowing costs deductibility rules (discussed in the "The year ahead" section below). The interest limitation/borrowing costs limitation provisions seek to discourage multinational enterprises from reducing their tax base through inflated debt financing.

Policy changes have also been introduced to effect domestic corporate investors. The key recent changes for domestic real estate investors are those to the taxation of landlords, the shortening of the seven-year capital gains tax exemption. The year 2018 represented the first full year since the increase in stamp duty on non-residential property from 2% to 6%, which came into force on 11 October 2017. The vacant site levy was increased from a maximum 3% to a maximum 7% on 19 July 2018.

Ireland maintains a favourable tax regime when compared to other states who are also subjected to similar international changes. Combined with a high demand and continuing high yields, Irish real estate remains a very attractive investment for international private equity.

Aviation finance

Ireland's position as a global leader in aviation leasing is firmly based on the highly advantageous tax regime strategically targeted towards supporting this sector. The long-term reliability of this regime is underpinned by Ireland's extensive network tax treaty partners. The majority of the double tax treaties that Ireland is party to provide for 0% withholding tax on inbound lease rentals, and this is coupled with the fact there are no withholding taxes on outbound lease rentals.

Historically Revenue granted, on a concessionary basis, an extension of the exemption from stamp duty whereby the transfers of aircraft are exempt from stamp duty, to apply to the transfer of shares in "aircraft owning entities" where certain conditions were met. During the course of 2018, Revenue indicated that this concessionary treatment would no longer be

permitted (following the general withdrawal of Revenue opinions and confirmations over five years old).

Asset management

Ireland has become a domicile of choice for investment funds. Ireland was one of the first countries to adapt its legislation for the tax-efficient implementation of the UCITS IV regime. Ireland's tax rules also permit redomiciliations, mergers and reconstructions of investment funds without giving rise to adverse Irish tax consequences for investors in funds.

Ireland is the largest centre for administration of hedge fund assets (over 40% of global hedge fund assets are administered in Ireland). As of September 2018, there were €4.5 trillion total assets under administration in Ireland, €2.5 trillion of which were funds domiciled in Ireland and €2 trillion outside of Ireland.

The year ahead

The Minister for Finance has indicated in 2018 Tax Strategy Papers that this year's Irish Budget will be prudent to prepare for the consequences of Brexit. With the international spotlight continuing to focus on Ireland in respect of its tax regime, it remains to be seen what measures the Irish government will make in respect of a number of tax regimes. The mandatory disclosure scheme is one area which may come under scrutiny, designed to counteract aggressive tax-planning strategies employed by certain taxpayers. Under the scheme, where tax advisors or similar professionals give advice to clients on tax planning, which falls outside the scope of ordinary tax advice, they must disclose the nature of this advice to Revenue. However, there are many exemptions under this rule which are designed to relieve the vast majority of tax advisors of reporting duties. This has resulted in low levels of participation in the scheme in the past, and so Ireland may come under pressure to widen the scope of application of the scheme.

ATAD also requires EU Member States to introduce ratio-based interest limitation rules, designed to limit the ability to deduct borrowing costs when calculating taxable profits. The rules are intended to prevent the use of excessive interest payments as a means by which BEPS by multinational companies can occur. The interest limitation rules in ATAD operate by limiting the allowable tax deduction for net interest costs in a tax period to 30% of Earnings Before Interest, Tax, Depreciation and Amortisation.

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Italy

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Overview of corporate tax work

By way of background, Italian corporate tax practice focuses on the following main areas:

- assistance in the context of M&A transactions and reorganisations of multinational groups;
- recurring and non-recurring assistance with reference to domestic and international tax matters;
- pre-judicial assistance in the context of audits carried out by the Italian tax authorities;
- judicial assistance before the Italian tax courts and the Supreme court;
- transfer pricing assistance to multinational groups; and
- ordinary tax compliance (*e.g.*, filing of tax returns, payments of taxes due).

Furthermore, in the last few years, an important line of tax work has concerned the assistance to domestic and foreign financial intermediaries with respect to securitisation transactions and the assignment of non-performing loans ("**NPLs**").

In a post-BEPS world, the Italian tax authorities pay particular attention to cross-border structures challenging the possibility to deduct interest on intragroup loans and/or denying the applicability of withholding tax exemptions on outbound payments made in favour of foreign investors in relation to Italian-sourced income (*e.g.*, dividends, interest and royalties).

Moreover, the assessment activity of the Italian tax authorities has focused on verifying the possible existence on Italian soil of hidden permanent establishments ("**PEs**") of foreign companies, as well as to assessing the Italian tax residence of offshore companies having their legal seat abroad where their effective place of management is located in Italy.

In addition to the above, assessing the compliance of transfer prices applied in intragroup transactions with respect to the arm's-length principle is a hot topic in the context of tax audits *vis-à-vis* multinational groups having their headquarters in Italy, or also an Italian subsidiary.

Overview of the corporation taxation

Any profits arising from business activities carried out by a joint-stock company or limited liability company are considered business income and subject to corporate income tax ("**IRES**") at the ordinary rate of 24% (plus surcharges if applicable).

As a general rule, losses carried forward can be offset in the limit of 80% of the taxable income realised in a fiscal year ("**FY**"). Exceeding losses can be carried forward without any time limitation. Losses which occurred during the first three tax periods after the incorporation of the Italian company can offset the taxable income of the subsequent tax periods without any limitation.

In addition to IRES, a regional tax on productive activities ("**IRAP**") is levied at a rate of 3.9%, plus a potential additional rate up to 0.92%. Special rules apply for banks, financial intermediaries and insurance companies.

Significant deals of the Italian M&A market

In the first quarter of 2019, the strong slowdown of the M&A market at the global level is amplified in Italy due to the uncertainty of the political domestic framework and to the macroeconomic indicators that forecast a decrease of the growth rate in 2019. The first three months count 165 transactions, slightly lower than the same period of 2018, and an overall countervalue of EUR 4.2 billion, highlighting a decrease of 58% compared with the records of the previous year in the same period. This negative trend is consistent with the slowdown of the market recorded from the second half of 2018.

The major deals of the first months of FY 2019 (over EUR 1 billion) were the following:

- acquisition of Candy S.p.A. by Haier;
- acquisition of Generali Belgium SA (Generali Group) by Athora;
- sale by Generali Group of Generali Worldwide Insurance Company Limited based in Guernsey and the Irish company Generali Link;
- acquisition of Perseo by ERG;
- acquisition of Comecer Group by the Canadian ATS;
- investment of Equinox in Manifattura Valcismon, owner of the brands Sportful, Castelli and Karpos;
- acquisition of Magneti Marelli by the fund KKR;
- sale of Generali Leben to Viridium Gruppe;
- agreement between ADNOC ("**Abu Dhabi National Oil Company**") and ENI concerning the acquisition of ADNOC Refining;
- sale of Kellogg's cookies business to Ferrero; and
- IPO of Nexi S.p.A.

Key developments affecting tax law and practice

Abolition of the Allowance for Corporate Equity regime

The 2019 Italian Budget Law provides for the abrogation of the Allowance for Corporate Equity ("**ACE**") regime, which allowed a tax deduction for IRES purposes equal to a notional yield of the qualifying increases in the company equity as compared to the amount shown in the financial statements for 2010. The repeal of the ACE regime is effective for the tax period following the one ended on 31 December 2018.

However, the ACE excess accrued up to 31 December 2018 could be carried forward also in the following FYs without time limitations or converted into a tax credit to decrease IRAP.

Reduced tax rate on retained earnings

Article 2 of Law Decree No. 34/2019 introduces a reduced corporate tax rate applicable as from 2019 to retained earnings. For calendar year companies, the reduced rates are as follows: 22.5% for 2019; 21.5% for 2020; 21% for 2021; 20.5% for 2022; and 20% starting from 2023. The retained earnings benefitting from the reduced rate:

(i) do not include "non-disposable" reserves formed with profits that are booked in the profit and loss ("**P&L**") statement but not actually realised; and

(ii) may not exceed the accounting net equity increase calculated between 2018 and the relevant year for which the reduced rate should be applied, without considering the retained earnings that have already benefitted from the reduced rate in previous years' rules (the "**net equity increase cap**").

The retained earnings exceeding the net equity increase cap may be carried forward to subsequent tax years for the purpose of applying the reduced tax rate. The benefit of the reduced rate may be transferred to:

(i) the tax consolidation in case of election for such regime; or

(ii) corporate shareholders if the company that retains earnings has opted for being treated as fiscally transparent.

Transfer pricing rules

Domestic transfer pricing rules apply to all cross-border transactions carried out between related parties. The definition of "related parties" is quite extensive: in broad terms, parties are deemed "related" for transfer pricing purposes when one of them participates, directly or indirectly, in the management, control or capital of the other, or when another person or group of persons participate in the management, control or capital of the parties.

Under the Italian tax perspective, the value of the transactions carried out between related parties shall correspond to the conditions and prices that would have been agreed between independent parties acting on an arm's-length basis and in comparable circumstances, under the OECD principles.

In order to benefit from the transfer pricing penalty protection regime, Italian companies shall check the box of the income tax return reporting to the Italian tax authorities ("**ITA**") that transfer pricing documentation has been pre-arranged. Such documentation is not mandatory according to the Italian tax legislation.

Patent Box regime

The Patent Box regime is an elective regime granting a 50% exemption from IRES and IRAP of the income derived from the direct exploitation, licensing or disposal of the following qualifying intellectual property ("**IP**"):

- software protected by copyright;
- patents;
- legally protectable designs and models; and
- legally protectable processes, secret formulas and industrial, commercial or scientific knowledge (know-how).

The regime is eligible for taxpayers that perform research and development ("**R&D**") activities. Moreover, in order to determine the benefit, there must be a direct nexus between R&D activities and qualified IP, as well as a direct nexus between qualified IP and qualified income.

The Patent Box regime requires the taxpayer to obtain an *ad hoc* advance tax ruling from the ITA, whose submission is mandatory for determining the amount of eligible income for the 50% exemption arising from the direct exploitation of the eligible IP.

Conversely, the ruling procedure is optional to determine the income where the qualifying IP is licensed to related parties in exchange for royalties or if it is transferred to a related party. In case the eligible IPs are licensed to third parties, an advance tax ruling cannot be requested to the ITA.

In spite of the foregoing, with the aim of simplifying the procedures connected to the Patent Box regime, Article 4 of Law Decree No. 34/2019 provides that taxpayers engaged in business activities are allowed to benefit from the Patent Box regime and determine the portion of eligible income directly by filing the relevant tax return, *in lieu* of being required to activate the advance tax ruling procedures.

According to the new rules, the benefit is divided into three equal annual instalments to be reported in the tax return relating to the tax period in which the option for the application of the regime is exercised, and in the following two tax periods.

In the event that – as a result of a tax audit – the ITA challenge the amount of the eligible income, penalties are not applied as long as the taxpayer provides the ITA with proper documentation supporting the methodology applied to determine the eligible income.

New cooperative compliance procedure for PEs of foreign multinationals

On 16 April 2019, the ITA issued implementing provisions of the cooperative compliance procedure for PEs introduced by Law Decree No. 50 of 24 April 2017.

Such procedure is targeted at large multinationals with PE exposure in Italy in FYs still open to tax assessment. In these circumstances, foreign multinationals are now allowed to determine, jointly with the ITA, whether a PE in Italy exists, and, if so, the profits attributable to such PE.

In case of successful completion of the procedure, the taxpayer will be discharged from criminal penalties related to the omitted filing of the tax return and administrative penalties will be reduced to half of their amount (*i.e.*, to ⅙ of 120% of the higher taxes due).

New China-Italy Double Tax Treaty

On 23 March 2019, the Chinese and Italian Governments signed a new treaty for the avoidance of double taxation and the prevention of fiscal evasion (the "**Treaty**"). The Treaty, once in force and effective, will replace the current double taxation treaty between the two countries, concluded on 31 October 1986.

The implementation of the Treaty, which aims at promoting and developing the bilateral cooperation between The People's Republic of China and Italy, will strengthen the communication and coordination on fiscal, financial and structural reform policies to create and foster a favourable economic and financial environment. Contrary to the majority of the double tax treaties concluded by Italy, the Treaty shall apply to taxes on income (including taxes on capital gains) and not to taxes on capital.

Implementation of Anti-Tax Avoidance Directives ("ATAD")

Legislative Decree No. 142/2018, implementing Council Directives (EU) 2016/1164 and 2017/952 (so-called ATAD 1 and 2) was published on 28 December 2018.

New provisions amended the following aspects of the Italian corporate income tax law:

(i) interest barrier rule;

(ii) the exit and entry taxation;

(iii) hybrid mismatches;

(iv) controlled foreign companies ("**CFC**") regime;

(v) foreign dividends and capital gains rules; and

(vi) new definitions of financial intermediaries and holding companies.

Implementing provisions concerning aspects under indents (iv) to (vi) will be discussed in the section "*Main developments concerning Italian holding companies*".

Interest deduction under the amended ordinary barrier rule

Interest expenses are subject to the ordinary interest-barrier rule. More in detail, interest expenses can be deducted up to an amount equal to the sum of:

(i) interest income of a given FY; plus

(ii) any excess of interest income carried forward from prior FYs (without time limitations); plus

(iii) an amount equal to 30% of the annual EBITDA ("**30% EBITDA Capacity**").

A 30% EBITDA Capacity exceeding interest expenses of a given FY can be carried forward, increasing the maximum amount of deductible interest expenses of the following FYs. The 30% EBITDA Capacity can be carried forward only up to the subsequent five FYs. A FIFO principle applies with respect to the offset of the 30% EBITDA Capacity arising from previous FYs.

The amount of interest expenses of a FY that is not deductible according to the abovementioned rules can be carried forward without any time limitation and be deducted in the following FYs provided that the company has sufficient 30% EBITDA Capacity.

Moreover, the 30% EBITDA Capacity will be no longer computed based on the accounting values resulting from the P&L statement of the company, as it shall be rather determined on the basis of the tax value of each income and expense component.

Exit and entry taxation

The main implementing ATAD provisions concerning the exit tax provide that:

(i) gains subject to the exit tax will be determined based on the deemed sale of the transferred assets and liabilities at their arm's-length value by applying transfer pricing rules;

(ii) taxpayers may elect to defer the payment of the exit tax or to pay it in five equal yearly instalments; and

(iii) special rules apply to tax losses which carry forward in cases of outbound transfers.

For inbound transfers, the tax basis of assets and liabilities transferred to Italy must be determined according to transfer pricing rules. However, this rule applies to inbound transfers from a country, whether within the EU or not, that effectively exchanges information with Italy.

If the inbound transfer is from a jurisdiction that does not exchange information with Italy, the tax basis of the assets and liabilities is their market value only in case the taxpayer and the ITA have concluded a unilateral advance pricing agreement. Conversely, the tax basis of the assets is the lower – or the higher for liabilities – of (a) the purchase cost, (b) the book value, and (c) the arm's-length value.

Hybrid mismatches rules

The implementing provisions of the ATAD also introduced the anti-hybrid rules. The new anti-hybrid rules will apply to FYs starting on or after 1 January 2020, except for the reverse-hybrids rules, which will apply to FYs starting on or after 1 January 2022.

Main developments concerning Italian holding companies

New definitions of financial intermediaries and holding companies

A new definition has been provided for financial intermediaries, financial holding companies and non-financial holding companies.

According to Italian law, the distinction between financial and non-financial holding companies is relevant for both IRES and IRAP purposes (*e.g.*, a 3.5% IRES surcharge and higher IRAP rates apply to financial intermediaries and financial holding companies).

CFC regime

The Italian CFC regime has been recently revised in order to implement the ATAD provisions. In particular, the CFC regime applies to Italian resident persons that control non-resident entities if these entities meet the CFC test and the "safe harbour" does not apply. CFC rules will apply also to Italian PEs of non-resident persons if the PE effectively holds controlling equity interests in foreign entities.

The notion of "control" is defined by reference to the legal concept of control under Article 2359 of the Italian Civil Code, which requires that the Italian resident person exercises a dominant influence over the foreign entity through voting rights or contractual relationships. Moreover, an Italian resident person will also control the foreign entity if it holds, directly or indirectly, more than 50% of the profit participation rights in the foreign entity.

Under the control requirement, a controlled foreign entity would be subject to the CFC regime if the following tests are jointly met:

(a) the effective tax rate of the foreign entity is lower than 50% of the effective tax rate applicable if that entity were an Italian tax resident; and

(b) more than ⅓ of the total revenues realised by the foreign entity are represented by interest, royalties, dividends and capital gains on sale of shareholdings, revenues from financial leasing; revenues from insurance, banking and other financial activities, revenues from selling goods or supplying a service of nil or low-added value according to transfer pricing rules.

If the CFC tests are met, the income of the foreign entity subject to the CFC regime is attributed on a *pro rata* basis to the Italian controlling person. Such income would be computed based on Italian IRES rules, and is kept apart from the other income of the Italian person being taxed separately with no possibility to utilise tax losses different from those realised by the foreign entity.

In case the non-resident entity satisfies the CFC tests, the CFC regime does not apply if the shareholder can prove that the foreign entity carries out an effective economic activity supported by human resources, equipment, assets and offices (so-called "safe harbour").

Tax regime of foreign dividends and capital gains

Under domestic law, on one hand, Italian companies could benefit from a partial exclusion from the taxable base equal to 95% of the received dividends. On the other hand, a 95% exemption of capital gains upon the sale of shareholdings by Italian companies applies if certain requirements are met.

However, the above-mentioned regimes do not apply with respect to foreign dividends and capital gains realised by an Italian parent company if the non-resident subsidiary is located in a low-tax jurisdiction.

In particular, two different criteria apply in order to qualify a low-tax jurisdiction depending on whether the Italian shareholder controls the non-resident entity or not (for the definition of control, please see the "CFC regime" section):

(a) for controlling shareholdings: the effective tax rate of the foreign controlled entity is lower than 50% of the effective tax rate applicable if that entity were tax resident in Italy; or

(b) for non-controlling shareholdings: the nominal foreign tax rate (as established by also taking into account special tax regimes) is lower than 50% of the nominal Italian tax rate.

This being said, dividends distributed by controlled foreign entities are not taxed in the hands of the Italian shareholder up to the amount of profits that have already been taxed in Italy under the CFC regime.

With respect to capital gains upon the sale of shareholdings in foreign entities subject to the CFC regime, the tax basis of those shareholdings is increased by the amount of profits that have already been taxed in Italy under the CFC rules.

Dividends from entities located in low-tax jurisdictions and capital gains realised upon the sale of these entities can benefit from the 95% exemption if the taxpayer proves that the investment in the foreign entity did not achieve the result of shifting income to low-tax jurisdictions. For capital gains, the taxpayer must prove that this condition is met (i) in the five-year period before the sale if the buyer is a third party, and (ii) for the taxpayer entire holding period if the buyer is a related person.

Conversely, in case the taxpayer does not prove that the investment in the foreign entity did not achieve the result of shifting income to low-tax jurisdictions and the foreign entity carries out a substantive economic activity supported by employees, equipment, assets and offices, (i) only 50% of the dividends paid to the Italian resident company are included in the IRES taxable base, and (ii) an indirect tax credit is granted to the Italian parent company for the corporate income taxes levied on the foreign entity income.

Industry sector focus

Provisions related to business combinations transactions

Article 11 of Law Decree No. 34/2019 provides for the possibility to benefit from a tax-free step-up of the higher values booked as a result of mergers, demergers and contributions of going concerns (or business units) carried out from 1 May 2019 until 31 December 2022.

The purpose of this provision is to encourage business combinations in order to foster the dimensional increase of Italian companies. The benefit at hand applies insofar as the party resulting from the business combination is an Italian tax resident company. No specific condition is required by the new provision with reference to the other parties which can be involved in the business combination; therefore, it seems that the latter may also involve non-resident entities or resident entities different from corporations, such as sole proprietorships.

The value of goodwill and the values attributed to tangible and intangible fixed assets is recognised, for both IRES and IRAP purposes, at an overall amount not exceeding EUR 5,000,000. Such a recognition starts as of the tax period following the one in which the business combination has occurred.

For the purposes of applying the new provision, the entities taking part in the business combination should:

(i) have been operative for at least two years preceding the transaction;

(ii) not be part of the same group of companies;

(iii) not be linked by a shareholding relationship higher than 20%; and

(iv) not be controlled, even indirectly, by the same entity.

These conditions must be met at the time when the business combination is carried out and uninterruptedly in the previous two financial years.

Moreover, Law Decree No. 34/2019 also provides for a forfeiture of the benefits in a scenario where, in the first four tax periods following the business combination, (a) the company which resulted from the transaction carries out further extraordinary transactions, or (b) the assets booked as a result of the transaction are sold. In order to prevent the recapture of the benefits in the above-mentioned cases, taxpayers are allowed to submit a tax ruling to the ITA. In case the benefits are recaptured, the taxpayer is required to pay the higher amounts due for IRES and IRAP purposes referred to the previous tax periods, but no penalties or interest for late payment apply.

Provisions related to securitisation transactions

Article 23 of Law Decree No. 34/2019 made significant changes to the tax treatment of securitisation transactions disciplined by Law No. 130 of 30 April 1999.

In particular, Article 23 has clarified that, in the context of securitisation transactions carried out through the sale of impaired receivables, a number of supporting vehicle companies can be set up with the purpose of carrying out the management and the valorisation of real estate assets, registered movable assets as well as any other assets and rights consisting of securities for the receivables (including assets part of leasing contracts, even if terminated, possibly together with the relative contractual relationships).

From a direct tax standpoint, the new Article 7.1, paragraph 4, of Law No. 130 of 30 April 1999 provides that the assets, the rights and any sums deriving therefrom as well as any other rights acquired under the securitisation transaction represent a segregated pool of assets with respect to the other assets held by the supporting companies. In light of the effective segregation, the tax neutrality for IRES and IRAP purposes provided for securitisation companies should now also be applicable to support companies.

With regard to indirect taxation, the new Article 7.1 provides for the application of registration, mortgage and cadastral fees at a fixed rate:

(a) to the deeds and transactions relating to the transfer of assets and rights, including the acceptance of debts in relation to securitisation transactions, in favour of the support companies, which occurred for any reason and even in court or bankruptcy;

(b) to guarantees of any kind provided at any time and by anyone on the assets and rights acquired by the support companies, as well as for connected deeds (subrogation, postponement, splitting, assignment of receivables, and so forth);

(c) to deeds of subsequent transfer of the immovable properties to persons carrying on business activities, provided that the purchaser states in the relevant deed that it intends to re-transfer such properties within five years as of the date of acquisition; and

(d) to deeds of transfer of the properties carried out in favour of individuals fulfilling the conditions to benefit from the "*prima casa*" regime.

Law Decree No. 34/2019 also provides that the tax provisions laid down for leasing companies equally apply to the supporting companies that are the assignees of financial leasing contracts and of the assets deriving from such leasing activity. It is also specified that the fixed rate provided for indirect taxation upon the sale of real estate properties deriving from leasing contracts is applied to the supporting companies in all cases in which the contract is or was originally terminated or ceased due to default by the user or following the latter's submission to bankruptcy proceedings.

The year ahead

The Italian legislation framework has recently seen significant changes which affect the day-to-day activities of both taxpayers and the tax administration. This process will also take place in the next year ahead.

Indeed, one of the main targets of the Italian political establishment is to renew and streamline the Italian tax framework in order to reduce tax compliance and to provide a more favourable business environment aiming to reinforce and support the competitiveness of the Italian enterprises.

One of the measures already announced will be represented by a rationalisation of the existing tax expenditures so as to introduce more effective incentives for enterprises and to avoid the increase of VAT rates.

Moreover, it is expected that the Italian Government will be focused particularly on personal income taxation. In this respect, it has been anticipated that the personal income tax will be revised by introducing new measures in order to reduce the effective tax burden in favour of the middle class.

On 10 October 2017, the Council of the European Union approved (EU) Directive 2017/1852 on tax dispute resolution mechanisms in the European Union. It shall apply to any complaint submitted from 1 July 2019 onwards relating to questions of dispute relating to income or capital earned in a tax year starting on or after 1 January 2018.

Member States shall bring into force the domestic laws to implement this Directive by 30 June 2019 at the latest.

Its implementation will ensure that a solution is found to all disputes within the EU relating to the application of bilateral double taxation conventions on income and capital.

Even beyond the deadline laid down in the Directive, Italy will likely implement the Directive in the next few months in order to tackle international tax controversy across EU Member States by also adapting domestic litigation procedural rules.

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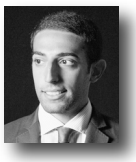

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Japan

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Introduction

In conjunction with the efforts of the Organization for Economic Co-operation and Development ("OECD") to finalise the Base Erosion and Profit Shifting ("BEPS") Action Plans, the Japanese government has implemented several legislative measures to meet the requirements of the BEPS Action Plans. Those legislative measures include:

- Transfer Pricing Rules have been made applicable to indirect affiliate transactions (2014).
- Double non-taxation of dividends paid from foreign subsidiaries has been precluded from the foreign dividend exemption system (2015).
- An exit tax has been introduced (2015).
- Consumption tax has been made applicable to internet digital content services from foreign countries (2015).
- Transfer price taxation documentation requirements have been strengthened (2016).
- Rules regarding inheritance taxation on overseas assets have been strengthened (2017).
- Controlled Foreign Corporation ("CFC") Rules have been strengthened (2017).
- The definition of permanent establishment ("PE") has been amended (2018).
- The CFC Rules have been additionally amended (2018).
- Earnings Stripping Rules have been strengthened (2019).
- Transfer Pricing Rules have been amended (2019).
- The CFC Rules have been re-amended (2019).

This chapter will summarise the three legislative measures which occurred in 2019 – amendments to the Earnings Stripping Rules, the Transfer Pricing Rules, and the CFC Rules.

Amendments to the Earnings Stripping Rules

Outline of Earnings Stripping Rules and Amendment under the 2019 Tax Reform

In Japan, since around 2008 there has been an increase in cases where corporations pay an excessive amount of interest for borrowings from foreign related parties (foreign parent companies, foreign subsidiaries, etc.) and include these interest payments in their deductible expenses so as to reduce their Japanese tax liability. In order to prevent these companies from claiming excess interest deductions, the Earnings Stripping Rules were introduced under the 2012 Tax Reform in Japan (stipulated in Section 66-5-2 of Special Measures Concerning Taxation).

Prior to the 2019 Tax Reform, the Earnings Stripping Rules provided that in a corporate fiscal year where the Net Interest Payments to Related Persons exceeded 50% of Adjusted Taxable Income, that excess cannot be claimed as deductible expenses. For the purposes of this calculation:

- Net Interest Payments to Related Persons means the amount remaining after deducting the total Eligible Interest Payments (i.e. the total interest received, calculated through fixed apportionment calculations) from the total Interest Payments to Related Persons.
- Interest Payments to Related Persons means interest paid to related persons of the corporation (which is not included in the taxable income of the related persons who received the interest). They do not include any amounts paid in relation to certain specified bond repurchase transactions.
- Adjusted Taxable Income means the amount of income (calculated according to a fixed formula) to be compared with Net Interest Payments to Related Persons.

Under the 2019 Tax Reform, the Earnings Stripping Rules have been amended to align with BEPS Action 4, via (among other changes) (i) amending the scope of interest payments, (ii) amending the definition of Adjusted Taxable Income, (iii) lowering the benchmark fixed ratio from 50% to 20%, (iv) amending the exemption thresholds, and (v) amending to the threshold for the carrying over of non-deductible interest expenses. The amendment is applicable to corporate tax payable for fiscal years commencing on or after April 1, 2020.

Amendments to the scope of interest

The interest payments subject to the Earnings Stripping Rules are "Net Interest Payments to Related Persons" before the 2019 Tax Reform. Post-reform, the relevant payments will be "Net Interest Payments". The calculation of Net Interest Payments starts with total interest payments, not only interest payments to related persons. The Net Interest Payments for the purposes of the Earnings Stripping Rules are defined as total interest paid (excluding any Excluded Interest Payments, summarised below) minus the corresponding total amount of Eligible Interest Payments.

Excluded Interest Payments is defined as follows:

1) For interest payments other than Specified Bond Interest (defined below), interest payments:
   (a) subject to Japanese taxation in the possession of the recipient (this means interest payments receipts which are declared as income in income/corporate tax returns in Japan);
   (b) to certain public benefit companies; and
   (c) under bond transactions with a repurchase agreement in which the borrowing transactions clearly correspond with the lending transactions.
2) For interest on Specified Bond Interest (meaning interest on bonds issued by the corporation and paid to unrelated parties, excluding where the number of owners of the bonds falls below a certain threshold):
   (a) interest payments subject to withholding taxation at the point of payment, or interest payments included in Japanese taxable income for those who receive the Specified Bond Interest, and interest payments paid to certain public benefit companies; and
   (b) either of the following, depending on the classification of bonds:
      I. bonds issued in Japan: 95% of Specified Bond Interest; or
      II. bonds issued outside Japan: 25% of Specified Bond Interest.

Amendments to the definition of Adjusted Taxable Income

Prior to the 2019 Tax Reform, when calculating Adjusted Taxable Income, dividends received that were excluded from gross revenue and dividends received from foreign subsidiaries that were excluded from gross revenue would be added to the income for the fiscal year. Under the 2019 Tax Reform, however, the exclusion of received dividends from gross revenue and the exclusion of dividends received from foreign subsidiaries will no longer be added to the company's income for the fiscal year.

Limitation of deduction

Under the 2019 Tax Reform, if Net Interest Payments exceed 20% of Adjusted Taxable Income in a given fiscal year (as opposed to the current threshold of 50%), the excess amount will not be included in the calculation of deductible expenses. This amendment is based on the recommendation set forth in the BEPS final report for Action 4: that the benchmark fixed ratio should be set within the range of 10% to 30%.

Exemption thresholds

Under the 2019 Tax Reform, the Earnings Stripping Rules will not apply to a company meeting either of the following criteria: (a) Net Interest Payments in a given fiscal year is 20 million (currently 10 million) yen or less; or (b) the total amount of Net Interest Payments on a Japanese corporate group basis (where there is more than a 50% capital relationship) is 20% or less of the total Adjusted Taxable Income (on the same group basis).

Prior to the 2019 Tax Reform, the Earnings Stripping Rules did not apply to a company if the company's aggregated Interest Payments to Related Persons was 50% or less of total interest payments. However, after the 2019 Tax Reform, this exception will be abolished.

Carry over of non-deductible interest expense

After the 2019 Tax Reform, when a company's Net Interest Payments are less than 20% (as opposed to the previous threshold of 50%) of Adjusted Taxable Income for a given fiscal year, the non-deductible interest incurred in the past seven years under the Earnings Stripping Rules is deductible in that fiscal year, up to the 20% threshold.

Amendments to the Transfer Pricing Rules

Under the 2019 Tax Reform, the Transfer Pricing Rules were amended in line with BEPS Action 8 and the revised OECD transfer pricing guidelines. This amendment is applicable to corporate taxes for fiscal years commencing on, or after, April 1, 2020.

Clarification of the definition of intangible assets

Although the Transfer Pricing Rules did not clearly define intangible assets before the 2019 Tax Reform, the definition of intangible assets subject to the Transfer Pricing Rules has now been clarified under the 2019 Tax Reform. According to the 2019 Tax Reform, the term "intangible assets" is defined as assets owned by a corporation, other than tangible assets and financial assets (i.e. cash, deposits, securities, and so on), for which consideration should be paid between independent parties on ordinary business terms.

Amendments to methods for calculating arm's-length pricing

Under the 2019 Tax Reform, the discounted cash flow method ("DCF method") is included as one of the methods for calculating arm's-length price. This was done on the grounds that the OECD Guidelines recognise the utility of the DCF method in ascertaining an arm's-length price for intangible assets for which no comparable transactions exist.

Due to this amendment, the addition of the DCF method would allow the Japanese tax

authorities to use the DCF method based on the information available to the Japanese tax authorities at the time of the controlled transactions with foreign related parties, in cases where the documents required to determine an arm's-length price have not been submitted.

Introduction of the Price Adjustment Measure to HTVI transactions

Where the actual outcomes differ from the *ex ante* pricing arrangement for the arm's-length price of transactions involving hard to value intangibles ("HTVI"), Japanese tax authorities will have the power to make a tax assessment based on the arm's-length price determined by the most appropriate method to reach an arm's-length price for the HTVI transactions (after taking into account factors such as the likelihood of the result and the reason for the difference). It should be noted that this measure will not be applied if the difference between the post-assessed price and the original price does not exceed 20%.

HTVI are defined as intangible assets that meet all of the following requirements: (i) the assets are unique and have significant value; (ii) the arm's-length price is calculated based on future income projections; and (iii) assumptions used in valuing the arm's-length price are uncertain.

The above Price Adjustment Measure will not be applied if the following documents are submitted by the taxpayer within a certain period of time starting from the date of a request made by Japanese tax authorities:

(a) (i) Documents containing details of the projections used in the calculation of the arm's-length price, and (ii) documents containing evidence which proves that the event that caused the discrepancy between the projection and the actual outcome was a disaster (or similar event) that could not have been foreseen at the time the transaction was priced, or that the arm's-length price was appropriately determined taking into account the possibility of the event that caused the discrepancy between the projection and the actual outcome.

(b) Documents containing evidence which shows the ratio of the difference between the actual income and the projected income for five years from the beginning of the fiscal year in which the first revenues received from unrelated parties for the use of the HTVI is 20% or less.

Extension of the statute of limitations

The 2019 Tax Reform extended the statutory limitation period for both assessment by the Japanese tax authorities, and taxpayers requesting corrections. This limitation period was increased from six years to seven years.

Further reform of Japan's CFC Rules

The 2019 Tax Reform makes further additional amendments to the CFC Rules, which were already amended in the 2017 and 2018 Tax Reforms. Although there are several amendments under the 2019 Tax Reform, this chapter briefly describes the amendments to the definition of a "paper company".

Outline of Japan's CFC Rules

If (a) a domestic corporation holds no less than 10% of any subsidiary in a foreign country, and (b) the domestic corporation, other domestic corporations and/or Japanese residents hold in aggregate more than 50% of the shares of the subsidiary, that subsidiary is categorised to a "foreign related company". Then, if the foreign related company falls within the definition of a "specified foreign related company" (being (i) a paper company, (ii) a company deemed

to be an "actual cash box", or (iii) a company located in a blacklist country, though no country has been designated as a blacklist country as of May 31, 2019), the profit of the subsidiary will be included in the domestic corporation's gross revenue for Japanese tax purposes. However, this does not apply if the tax burden rate in the foreign country is 30% or more. Further, even if the foreign related company does not fall within the definition of a "specified foreign related company" when the tax burden rate is less than 20%, the income of the foreign related company will be included in the domestic corporation unless the "economic activity standard" is satisfied. Even if the foreign related company meets the "economic activity standard", fixed passive income of the foreign related company will be fully included in the domestic corporation's income (partial summation system).

Amendments to the definition of a "paper company"

In December 2017, the tax system reform under the Trump administration in the United States ("Tax Cuts and Jobs Act 2017") reduced the federal corporate tax rate from 35% to 21%, and the corporate effective tax rate, including state taxes, often dropped to less than 30%. As a result, an entity such as a limited liability company ("LLC"), limited partnership ("LPS"), or a blocker corporation located in the United States is likely to be subject to Japan's CFC Rules since the corporate person may fall under the definition of a "paper company". A "blocker corporation" means an entity established to file tax returns in the United States in order to avoid direct taxation by the United States of the Japanese corporation, where a Japanese corporation has a pass-through entity in the United States.

Under the 2019 Tax Reform, the definition of a "paper company" has been amended to take into account the changes made by the Tax Cuts and Jobs Act 2017. Specifically, under the 2019 Tax Reform (i) certain foreign related companies which are holding companies, (ii) certain foreign related companies relating to the ownership of real estate, and (iii) certain foreign related companies relating to resource development projects, are excluded from the definition of a "paper company".

Category (i) above usually means a foreign related company which holds shares of subsidiaries (a subsidiary being a foreign company located in the same jurisdiction as the foreign related company and in which the foreign related company holds at least 25% of the equity) (a) where more than 95% of the foreign related company's total asset value consists of shares of subsidiaries and certain monetary assets, and (b) more than 95% of the foreign related company's total revenue comes from dividends paid by those subsidiaries and interest on deposits. As a result, blocker corporations are excluded from the definition of a "paper company" and are excluded from being subject to Japan's CFC Rules.

Category (ii) above mainly means either a foreign related real estate holding company, located in the same jurisdiction as the head office of the foreign related company, or a foreign related company which holds shares of specified subsidiaries (a specified subsidiary is a foreign related company controlled and managed by a management company located in the same jurisdiction of the real estate holding company). To fall under this definition, the latter type of company must be (a) controlled and managed by a management company located in the same jurisdiction, (b) perform functions essential to carrying out the real estate business of the management company in the same jurisdiction, (c) have more than 95% of its total assets value consist of real estate, shares of the specified subsidiaries and certain monetary assets, and (d) have more than 95% of its total revenue derived from real estate, specified subsidiaries, and/or interests on deposits. The amendment assumes this category of companies to be intermediate holding companies set up to conduct a joint real estate business venture.

Category (iii) above means a foreign related resource development project company which holds shares of specified subsidiaries (a specified subsidiary is a foreign related company located in the same jurisdiction, in which the resource development project company holds 10% or more of the equity, and which performs functions essential to carrying out the resource development or social infrastructure development project by a management company in the same jurisdiction), provides funding raised from unrelated parties to the specified subsidiaries, or holds real estate located in the same jurisdiction as the resource development project company. Such companies must be (a) controlled and managed by a management company located in the same jurisdiction, (b) perform functions essential to carrying out the resource development or social infrastructure development by the management company in the same jurisdiction, (c) have more than 95% of the foreign related company's total asset value consisting of shares of the specified subsidiaries, loans to the specified subsidiaries, real estate and monetary assets, and (d) more than 95% of the foreign related company's total revenue is derived from dividends paid by the specified subsidiaries, interest on the loans to the specified subsidiaries, revenue from real estate and interest on deposits.

The amendments are applicable to the fiscal years of domestic entities ending on or after April 1, 2019 and to the income inclusion taxation for foreign related companies whose fiscal years began on or after April 1, 2018.

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Korea

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Overview: the concept of beneficial owner and substantial attribution in treaty shopping prevention

The principle of Actual Taxation is stipulated in Article 14, Section 1 of the Framework Act on National Taxes in Korea, which states that if any ownership of an income, profit, property, act or transaction which is subject to taxation is nominal, and there is another person to whom such income, etc., belongs, the other person shall be liable to pay taxes and any tax-related Acts apply accordingly. This principle is also applicable to the interpretation of tax treaties which have the same effect as the domestic law as long as there is not a special regulation to exclude it.

Actual Taxation has far-reaching implications, even for persons dealing with a variety of cases on tax avoidance by means of 'Treaty Shopping'. Korea presently has Double Tax Avoidance Agreements (DTAAs) with more than 90 countries. A DTAA is a tax treaty signed between two or more nations to protect taxpayers from paying double taxes on the same income. For example, a DTAA becomes applicable in cases where an individual is a resident of one nation, but earns dividend income allocated by a company in another foreign state. In this case, a government that is a party to a DTAA typically protects its own taxation power, as well as their residents who earn such dividend income, from double taxation by limiting the tax rate applied by the foreign party of the DTAA.

The limited tax rate varies in each treaty because every DTAA is affected by many factors, such as differing bargaining powers between two parties, socio-economic circumstances, etc. At this point, 'Treaty Shopping' comes in. For example, suppose you invest in a specific country and it has a DTAA with a third country, which imposes a very low tax rate against that country which your resident country does not have. If you are not able to become a resident of the third country, you have no choice but to appoint or establish some special purpose vehicle – such as a company or partnership – as a resident of the third country to take advantage of that low rate. These kinds of activities are often regarded as an unlawful manipulation of the DTAA scheme all over the world. Therefore, tax treaties have elaborately devised and developed the concept of 'beneficial owners' to prevent this sort of treaty shopping. Notably, the Organization for Economic Co-operation and Development (OECD) provides a 'Model Tax Convention on Income and on Capital' for its member countries' tax administration in this regard.

Korean courts also have used this concept when they interpret and apply tax treaties. According to their terminology, this is described as 'beneficial owners' or 'substantial attribution of income'. Recently, one key decision of the Supreme Court of Korea has gained international attention, specifically among foreign investors eyeing the Korean asset market.

This court decision dealt with important legal issues concerning the taxation of dividend income earned by Lone Star Fund IV as a shareholder of the Korea Exchange Bank. This court ruling presents a clear guideline by which we can determine who is the beneficial owner in a case of 'treaty shopping' for all the potential investors who seek financial opportunities in the Korean economy. Therefore, this chapter will discuss this important judicial precedent and some following developments.

A recent example of treaty shopping in Korea: Lone Star Fund IV

Lone Star Funds is a private equity firm that has been investing globally in distressed markets since 1995. Lone Star creates various partnership-type private equity funds, each fund containing unique investments based on markets suffering from economic crises. Among the many Lone Star Funds created, it was 'Lone Star Fund IV' that was involved in this case. Lone Star Fund IV was formed as a vehicle for receiving dividend income and transfer income from the Korea Exchange Bank, which the fund took over by acquiring more than half of the shares. Members of Lone Star Fund IV included: Lone Star Fund IV (U.S.) L.P.; Hudco Partners IV Korea, Ltd.; Lone Star Fund IV B Korea I L.P.; Lone Star Fund IV B Korea II L.P.; KEB Investors I L.P.; KEB Investors II L.P.; KEB Investors III L.P.; and KEB Investors IV L.P. These members are named as the top eight investors in this case, and all the investors except for Lone Star Fund IV (U.S.) and Hudco Partners IV Korea, Ltd. are named as the top six investors. Moreover, all of the investors except for Lone Star Fund IV (U.S.) are Bermuda partnerships.

LSF-KEB Holdings SCA, a subsidiary of Lone Star Fund IV, was established under Belgian law on Aug. 21, 2003 as a Belgian corporation. The agreement regarding the Korea Exchange Bank shares acquisition was signed immediately after that, on Aug. 27, 2003. The top eight investors held 99.9% of LSF-KEB Holdings SCA's shares and LSF-KEB Holdings SCA was a nominal party to the share acquisition agreement.

LSF-KEB Holdings SCA received in total more than KRW 1 trillion from the Korea Exchange Bank as dividend income after they acquired their shares of the Korea Exchange Bank stock. Citibank Korea, the plaintiff, was the property custodian of LSF-KEB Holdings SCA, which held all the shares of the Korea Exchange Bank stock. The bank, on behalf of LSF-KEB Holdings SCA, had paid corporate taxes by applying the limited tax rate of 15% under Article 10, Section 1 of the Korea-Belgium Tax Treaty, and the remaining balance had been remitted to LSF-KEB Holdings SCA. Citibank Korea, which paid the dividend income to a foreign corporation, considered LSF-KEB Holdings SCA as a beneficial owner, and thus withheld corporate tax at a rate of 15% as designated by the Korea-Belgium Tax Treaty.

However, the defendant, the Chief of the National Tax Service, in the Namdaemun District Office in Seoul, believed that LSF-KEB Holdings SCA was not a beneficial owner but merely a conduit company set up for tax evasion. Therefore, it claimed that the limited tax rate under the Korea-Belgium Tax Treaty could not be applied to the dividend income. It rectified the tax rate accordingly and notified Citibank Korea that LSF-KEB Holdings SCA should pay KRW 103.1 billion as corporate tax under the withholding tax rate of 25% or 20% based on the domestic corporate income tax law. Citibank Korea brought the lawsuit to seek the cancellation of this administrative decision.

Rulings of the Supreme Court of Korea on the Lone Star Fund IV case

A. On the concept of 'beneficial owners'

The Supreme Court ruled that LSF-KEB Holdings SCA was nothing more than a conduit company set up to obtain residential status in Belgium to avoid taxation on stock dividend income. The reasons are as follows:

In this case, Belgium was used as a tax haven by the multinational investment agency because of the low limited tax rate in the Korea-Belgium Tax Treaty at the time of the acquisition of the stock. Lone Star Fund IV established LSF-KEB Holdings SCA in Belgium on Aug. 21, 2003, just before signing the acquisition contract for the shares on Aug. 27, 2003. Even though the acquisition contract for the shares was done under the LSF-KEB Holdings SCA's name, this deal was planned and executed according to Lone Star Fund IV's investment and governance structure. Furthermore, the investment fund for the acquisition contract was financed by the top eight investors. Lone Star Advisors Korea and Hudson Advisors Korea, the asset management companies of Lone Star Fund IV, took the lead on completing the acquisition contract. LSF-KEB Holdings SCA only played a superficial role as a holding company for Lone Star Fund IV's investment; there was no evidence of any other business activities. It did not have any affiliated employees and therefore did not pay any salaries, rent, maintenance costs, etc. Of the total assets held by Lone Star Fund IV, 99% were the shares purchased in the acquisition and the rest was composed of credit and cash related only to its investment companies by playing an interim role when the dividend income was ultimately allocated to the top investors.

B. Who were the beneficial owners in the Lone Star Fund IV case?

On this premise, the Supreme Court ruled that the top eight investors were the beneficial owners because they substantially held rights and obligations independent of their members. The Supreme Court also held that under the Korean Corporate Tax Act, those top eight investors were also classified as eight foreign corporations where the dividend income should be attributed and taxed. The reasons are as follows:

All the top investors had their own individual purpose for investing – to obtain and distribute the dividend income from the above purchased shares. They carried out their own individual business and each top investor consisted of various limited liability partners and a single unlimited liability partner named 'Lone Star Partners IV (Bermuda)'.

The Supreme Court came to a conclusion that the dividend income was vested in the eight top investors. The resident country for the top investors was Bermuda, except for Lone Star Fund IV (U.S.) L.P. Because there was no tax treaty between Bermuda and Korea, the concerned portion of the dividend income attributed to the top seven investors in Bermuda should have been subject to the tax rate under the Korean Corporate Tax Act. In the same manner, the Korea-U.S. tax treaty did not apply to the dividend income from shares held by Lone Star Partners IV (Bermuda), which was a Bermuda corporation and a member of Lone Star Fund IV (U.S.) L.P. Therefore, only the dividends from the shares owned by the other members of Lone Star Fund IV (U.S.) L.P. should have been subject to the 15% limited tax rate under the Korea-U.S. tax treaty because they were residents of the U.S.

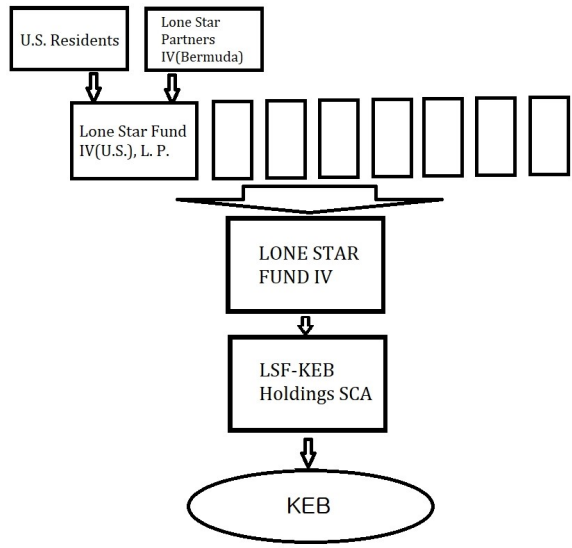
C. Was Citibank Korea, the property custodian, liable for a penalty of additional tax?

Are those who should pay withholding tax on domestic source income as property custodians, on behalf of their clients, supposed to investigate who should be regarded as a real beneficial owner from the perspective of the Supreme Court of Korea? If it is impossible to know who is an actual attributable person (or corporation) despite a sincere and thorough

investigation, the concerned property custodian does not have an obligation to withhold the corporate tax based on that substantial attribution. However, in this case, Citibank Korea did not investigate to determine if LSF-KEB Holdings SCA was a beneficial owner even though they could have found who was actually a substantial attributable corporation through an investigation. Therefore, Citibank Korea, the withholding agent, had an obligation to withhold the above-mentioned dividend income on the basis of substantial attribution, but failed to do so and is thus liable.

D. Result of the Lone Star Fund IV case

In sum, the application of the 20–25% tax rate to the Belgian corporation named 'LSF-KEB Holdings SCA' – wholly owned by Lone Star Fund IV – under the Korean Corporate Tax Law was legal, except for the part relating to the investment of U.S. residents who were members of Lone Star Fund IV (U.S.) L.P.



Share ownership diagram of Lone Star Fund IV case (simplified)

Implications for foreign investors eyeing the Korean market

A. Risks of treaty shopping

The concepts of beneficial owners and substantial attribution are frequently used in the Korean courts regarding corporate tax issues for capital gains and dividend income. Korean courts typically interpret these concepts strictly in deciding who is a beneficial owner and how substantial attribution works; especially when foreign investors try to avoid taxation by abusing tax treaties, the Korean courts seem to interpret those concepts strictly in order to protect the government's power of taxation. Through the lens of basic taxation principles, nobody can object to the idea that a beneficial owner who gets real monetary benefit from an investment project has to pay taxes from that benefit. The Supreme Court of Korea's judgment in this case indicates the overall stance of the Korean tax system when approaching various issues regarding corporate tax from capital gains and dividend income. If multinational investment companies want to do business, get stocks, and share profits in and

from Korea, they should be aware of the latest statutes and precedents prevailing in the Korean tax system. Every investor needs to scrutinise who would be classified as a beneficial owner in case of a tax dispute before devising their investment structure.

B. One more notable development in 2018

Until this point, we have used the two terms beneficial ownership and substantial attribution interchangeably. However, this terminology may not conform to the stance of the Supreme Court of Korea, because on Nov. 15, 2018, the Court ruled that these two concepts should be legally differentiated and introduced the so-called 'two-tiered testing' model. Under this model, even though some entities will be regarded as beneficial owners according to the internationally accepted interpretation practices of the OECD's Model Tax Convention on Income and on Capital, Korean courts might not consider it as an entity, which concerned income is substantially attributed to. Of course, this is to avoid the potential abuse of the concept of 'beneficial owner'. In these kinds of cases in the future, the Supreme Court of Korea might still significantly impact even sophisticated investors who learned the lesson of the Lone Star Fund IV case.

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Luxembourg

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Overview of corporate tax work over last year

Types of corporate tax work

In a moving and evolving global tax situation, Luxembourg is still very popular to international investors thanks to its flexibility, stability and business-friendly approach.

We have noticed a strong appetite for not only the Luxembourg regulated vehicle, but also the unregulated vehicle. The Soparfi is still a very popular holding vehicle, and the reserved alternative investment funds ("**RAIF**") and the special limited partnership ("**SCSp**") still satisfy a large proportion of sponsors and private investors.

Luxembourg advisors were busy last year with the consequences of the law implementing the EU Anti-Tax Avoidance Directive I ("**ATAD I**"), which was voted in on 19 December 2018. Similarly, as across Europe, the new legislation, which is applicable as from tax years starting on or from 1 January 2019, relates mainly to:

- Interest limitation rules.
- Controlled foreign company ("**CFC**") rules.
- Intra-EU anti-hybrid rule.
- General anti-abuse rule ("**GAAR**").

These rules were largely anticipated by Luxembourg, but some practical aspects are still to be clarified by the legislator or the tax authorities. The law implementing ATAD I did not cause, as a consequence, a great escape abroad of investors, since the jurisdiction offers usually effective solutions in most cases.

Substance is still under scrutiny by Luxembourg's partner states, but the European Court of Justice seems to consider that substance requirements imposed by European States should, in broad terms, remain anciliary to the main European principles, such as free movement of goods and persons within the EU.

Due to a global trend and the forthcoming Directive 2017/952 ("**ATAD II**"), we have also assisted in a reorganisation of the financing of several groups, getting rid of their so-called famous hybrid instruments, such as the CPECs, IPPECs, PECs, etc. or the MRPS. We have also noticed an important part of companies moving in or out of Luxembourg through transfer of seats, but also cross-border mergers which are well-trodden paths and which work in a fairly efficient way.

Transfer pricing has slowly replaced the advance tax agreement practice which led to a diversification of service providers and a decrease of the costs related thereto.

Although tax disputes are still slightly increasing, tax authorities show a pragmatic approach during pre-litigation phases and when well-handled solutions are frequently found.

Significant deals and themes

- Several interventions on the corporate and tax aspects of bonds and notes issuances by an international group active in the field of commodity trading and logistics houses and a mid- and downstream oil company.
- Assistance on the Luxembourg tax and corporate aspects of the winding-up of the Luxembourg structure of a US client active in real estate, further to the sale of a Luxembourg entity owning a £160 million real estate property in London.
- Assistance to a high-net-worth individual who owns intellectual property rights in Luxembourg through a Luxembourg public limited liability company, for a VAT litigation against the Luxembourg VAT authorities; the authorities sued a Luxembourg entity to have it declared bankrupt pursuant to the issuance of an *ex officio* taxation, the amount of each was more than 10 times the amount of VAT due and is clearly abusive.
- Ongoing tax and corporate assistance to a Swedish-based client active in the field of publishing in order to merge two of its Luxembourg companies, implying the cancellation of hybrid instruments in place for several years (MRPS).
- Corporate and tax assistance for a company acting mainly as a holding company and also as a consultant in the real estate sector, to assess, from a tax perspective, the feasibility of a restructuring of the company's shareholding and then to implement the corporate side of the restructuring (involving the performance of "donation-transfers" of shares by French resident shareholders to their heirs for transmission purposes).

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

Implementation of the anti-tax avoidance directive in Luxembourg internal law

Luxembourg transposed ATAD I in Luxembourg internal law through the law of 21 December 2018. ATAD I provides notably for the interest deductibility limitation, GAAR, CFC rules, hybrid mismatches and exit taxation.

- Interest limitation rule

  The law introduces a new Article, 168*bis* Income Tax Law of 4 December 1967, which limits interest deductibility for interest expenses exceeding income (exceeding borrowing costs ("**EBC**"), defined as the tax deductible borrowing costs that are in excess of the taxable interest revenues and other economically equivalent taxable income of the taxpayer) to 30% of the taxpayer's taxable earnings before interest, tax, depreciation and amortisation (taxable "**EBITDA**"). It has to be noted that tax-exempt income (such as dividends from qualifying shareholdings or certain foreign branch profits), as well as expenses economically related to such tax-exempt income, will be excluded from the EBITDA.

  The EBITDA-based limit will not apply if EBC do not exceed EUR 3 million. In other words, the taxpayer will be able to deduct the highest amount of interest corresponding to 30% EBITDA or EUR 3 million.

- Controlled foreign company rules: if a control test, an effective tax rate test ("**ETR**") and a non-genuine arrangement test are all passed, the stake of the Luxembourg fully taxable corporation in a foreign entity or a foreign permanent establishment will qualify as a controlled foreign company ("**CFC**"). As a result, the non-distributed income of the CFC should be included in the taxable profits of the Luxembourg

corporation, but this should be limited to the amounts generated through assets and risks linked to significant people functions assumed by the Luxembourg corporation as determined by Luxembourg transfer pricing rules.

- Intra-EU anti-hybrid rule: the rule deals with hybrid instruments or entities allowing for double non-taxation between EU Member States. Hybrid mismatches with third countries are included in ATAD II and the latter will be implemented in 2019 with effect from 1 January 2020.
- GAAR: the current anti-abuse rule will be slightly amended, allowing Luxembourg income tax authorities to ignore non-genuine arrangements for tax purposes.

New corporate income tax measures

On 25 April 2019, the Luxembourg Parliament approved the Budget Law for 2019, which has been filed by the Luxembourg Government with the Luxembourg Parliament as bill n°7450 (the "**2019 Budget Law**").

Prior to the 2019 Budget Law, the corporate income tax rate was 18%, so the aggregate income tax rate for a company established in Luxembourg City amounted to 26.01%.

The 2019 Budget Law provided for a decrease of the corporate income tax rate from 18% to 17%. This rate is applicable if net profits exceed EUR 200,000. Consequently, from the 2019 fiscal year, the aggregate income tax rate for a company established in Luxembourg City amounts to 24.94%.

As far as the reduced 15% CIT rate is concerned, the 2019 Budget Law provides for widening the scope of application of this rate. Indeed, the reduced 15% CIT rate, which was, prior to the 2019 Budget Law, applicable if net profits did not exceed EUR 25,000, is now applicable if net profits do not exceed EUR 175,000. Accordingly, the aggregate income tax rate for a company established in Luxembourg City whose net profits do not exceed EUR 175,000 amounts to 22.80%.

If net profits are above EUR 175,000 but do not exceed EUR 200,000, the 2019 Budget Law introduces an intermediate rate of EUR 26,250 plus 31% of the net profits between EUR 175,000 and EUR 200,000.

These changes have been largely welcomed.

The 2019 Budget Law has been applicable from 1 May 2019, with some provisions applicable from 1 January 2019.

Amendment of the tax consolidation regime

The interest limitation rules implemented into Luxembourg domestic tax law by the law of 21 December 2018 provide that EBC are, in principle, only deductible up to the higher of 30% of the taxpayer's EBITDA or EUR 3 million.

When transposing the ATAD, the Luxembourg Government did not use the option provided by the ATAD under which the interest limitation rules could be applied at the tax consolidated group level, instead of at the level of each entity belonging to the tax consolidated group.

The 2019 Budget Law remedies this by modifying the Luxembourg fiscal unity regime foreseen in Article 164*bis* of the Luxembourg income tax law, with retroactive effect from 1 January 2019, to give the taxpayer the option to apply the interest limitation rules at the level of the tax consolidated group.

This is an option for the taxpayer, such that the taxpayer can choose to apply the interest limitation rules either at the level of the tax consolidated group or at the entity level. Depending on the amount of the EBC of each entity of the tax consolidated group, the

application of the interest limitation rules at the entity level may be the most favourable option for the taxpayer.

Finally, it is worth noting that the taxpayer's chosen option is binding until the end of the tax consolidation.

Adoption of Luxembourg-France double tax treaty

On 2 July 2019, the Luxembourg Parliament approved bill n°7390, the aim of which was to ratify the new double tax treaty (the "**DTT**") and accompanying protocol between Luxembourg and France, signed in March 2018.

The new DTT is in line with BEPS requirements and implements the new approaches and principles derived from OECD and BEPS initiatives, as included in the 2017 version of the OECD Model Tax Convention or in the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("**MLI**").

The main changes brought in the new DTT concern the following items:

- redefinition of a permanent establishment's criterion;
- new rules regarding taxation of cross-border payments (dividends, interest, royalties);
- access and benefit of the DTT for undertaking for collective investments; and
- taxation of cross-border workers, even if this topic remains to be clarified as there are still significant uncertainties in the interpretation of the DTT.

Since France already ratified this new DTT on 14 February 2019, and assuming that the exchange of the instruments required for completing the ratification between Luxembourg and France takes place before the end of the year 2019, this new DTT should quite probably enter into effect on 1 January 2020.

VAT measures

The 2019 Budget Law also contains other tax measures, including, in particular, the implementation of EU Directive 2018/17136 regarding the application of a super-reduced VAT rate of 3% on books, newspapers and periodicals, in physical and/or electronically supplied form, as well as certain feminine hygiene products. These VAT changes were applicable from 1 May 2019.

European – CJEU cases and EU law developments

On 25 May 2018, a new Directive amending the Council Directive 2018/822/EU on administrative cooperation in the field of taxation ("**DAC 6**") introduced an obligation on intermediaries to disclose potentially aggressive tax planning cross-border arrangements ("**Arrangements**") and to subsequently exchange the information between EU tax authorities.

EU Member States shall implement the said Directive by 31 December 2019, and it will be effective as of 1 July 2020. However, information on Arrangements, of which the first step was implemented between the date of entry into force (20 days after the publication of DAC 6 in the gazette) and the date of application (1 July 2020), will also have to be reported by 31 August 2020. This means that certain Arrangements implemented in 2019 shall have to be reported one year later.

BEPS

On 1 July 2019, the MLI entered into force, which essentially allows the tax-related measures of the OECD/G20 BEPS project to be introduced in the existing DTTs of the signatories' convention, eliminating the need to renegotiate every bilateral DTT separately.

Luxembourg has decided that all of its DTTs currently in force will fall within the scope of the MLI. Luxembourg mainly implemented the minimum standards to remain BEPS-compliant, including the principal purpose test ("**PPT**").

In this respect, the PPT provides that:

"*Notwithstanding any provisions of a covered tax agreement, a benefit under the covered tax agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object*."

The year ahead

The main changes expected in the future mainly derive from international developments and are related to BEPS.

Over the course of 2019, ATAD II amending ATAD I should be transposed in Luxembourg internal law. The main changes consist of the extension of the scope of the provisions on hybrids from EU Member States to third countries.

The aim of the provisions of ATAD II against the so-called "hybrid mismatches" is to eliminate and prevent a situation of double non-taxation, which would be possible because of the use of certain hybrid instruments or entities.

Generally, it is considered that a hybrid mismatch exists if an instrument (or as the case may be, an entity) benefits from different treatment from a tax point of view in two different jurisdictions. As a result of these mismatches, there may be either a double deduction or a deduction of the payment in one country without there being a record of the payment in the other country.

The Government also announced that a global tax reform is part of the coalition agreement of the current Government. The current Finance Minister indicated that "*a progressive generalisation, coupled with the introduction of a new tax table, will guarantee a fiscal model which is neutral in relation to the style of life of the individual*", introducing the possible following changes:

- introduction of a single tax class instead of the current classes which depend on the family situation of the taxpayer (married or single, in a partnership ("*pacsed*"), divorced, with or without children); and
- restatement of the tax scale determining the tax rates applicable to the taxpayer.

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Netherlands

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Overview of corporate tax work over last year

Types of corporate tax work

In 2018, the Dutch M&A market was stunning, and this trend has continued in the first part of 2019 consistently, despite the political and economic uncertainties caused by trade wars and Brexit.

The Dutch M&A market can be described as a sellers' market. Competition among buyers is pushed by low interest rates and an abundance of funds for parties who want to buy. With the help of the Dutch government, which is promoting foreign investments by introducing rules which improve the attractiveness of the tax environment, prospects are continuously favourable.

Of course, there are threats that could break this positive trend. European tax measures, geopolitical concerns, monetary policy, volatility in capital markets and high valuation levels are factors that could contribute to a downturn in deals and affect the Dutch M&A market.

The introduction of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS ("MLI"), recent case law of the Court of Justice of the European Union ("CJEU") and the adoption of the EU Anti-Tax Avoidance Directives aimed at preventing the use of artificial structures have created some uncertainty on the current and future application of the EU Parent Subsidiary Directive and tax treaties by international holding and financing companies and an additional focus on substance and beneficial ownership. This is in line with international developments. The Netherlands remains an attractive jurisdiction for international businesses and especially for companies actively engaged in operational activities.

Significant deals and themes

Returns of value to shareholders

One of the most significant developments in Dutch taxation was the cancellation of the proposed replacement of the current Dividend Withholding Tax Act 1965 ("DWTA"), with a withholding tax on dividends to low-taxed and blacklisted jurisdictions. The reason for cancellation was the lack of political support for this proposal. The Dutch government took other measures to improve the Dutch tax climate. An example is the gradual reduction of the corporate income tax rate from 19% (for taxable income up to and including EUR 200,000) to 16.5% by 2020 and 15% by 2021, and to 25% (for taxable profits exceeding EUR 200,000) to 22.55% by 2020 and 20.5% by 2021.

Real estate transactions

As per 1 January 2019, the depreciation of buildings has been limited to the property value as annually determined by the municipality (the so-called "*WOZ-waarde*"). Previously, the

depreciation of buildings used by an enterprise was allowed up to 50% of the property value (depreciation of buildings leased out to third parties was already limited to 100% of the property value).

Funding

Based on the implementation of the Anti-Tax Avoidance Directive I ("ATAD I"), as of 1 January 2019 the Dutch earning stripping rules will limit the deduction of excessive interest expenses related to intra-group and third-party payables for Dutch corporate income tax purposes. Under these rules, the starting point is to determine the Dutch tax payers' so-called interest expense excess. This is the amount by which the Dutch tax payers' tax deductible interest expenses exceed the taxable interest income. The deductibility of the interest expense excess is limited to (i) 30% of the tax payer's EBITDA (carving out tax exempt income), and (ii) a safe harbour threshold of EUR 1 million, whichever is higher. Interest disallowed under the earnings stripping rule can be carried forward to later years without limitation in time.

M&A

Significant issues for the M&A practice were the abolishment of the limitation of interest deduction rules for participation debt (Article 13l of the Dutch Corporate Income Tax Act 1969, "CITA") and acquisition holding debt (Article 15ad CITA) and the rules limiting the carrying forward of losses by holding and financing companies (Article 20.4 CITA) in connection with the introduction of the earning stripping rules.

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

Fiscal unity regime

On 23 April 2019, the Dutch parliament adopted a legislative proposal changing Dutch fiscal unity rules retroactively effective from 1 January 2018. Under the new rules, several provisions included in the CITA and the DWTA must be applied as if the Dutch tax consolidation regime were non-existent.

The government has announced that the Dutch fiscal unity regime will be replaced in its entirety by a new tax grouping regime. In this respect, a public consultation will take place in the year 2019.

Introduction interest and royalty withholding tax

Currently, the Netherlands does not levy a withholding tax on interest and royalty payments. However, the government has announced that a withholding tax on interest and royalty payments will apply from 1 January 2021 onwards. The applicable rate is expected to be 20.5%. The withholding tax would apply to intra-group interest and royalty payments by Dutch resident companies to related entities residing in jurisdictions with no or low statutory tax rates (i.e. most likely less than 9%), in jurisdictions that are on the EU blacklist of non-cooperative jurisdictions or in abusive situations.

Reduction of maximum period of loss carry-forward facility

On 1 January 2019, the maximum period in which tax losses can be carried forward was reduced from nine to six years. Tax losses incurred in 2018 and earlier can still be carried forward for a maximum of nine years.

Case law on acquisition and disposal costs

On 7 December 2018, the Dutch High Court issued an important decision on the tax treatment of acquisition and disposal costs. As a general rule, costs related to the acquisition

or disposal of shares of subsidiaries that qualify for the participation exemptions are non-deductible for Dutch tax purposes. The Dutch High Court clarified that costs not directly linked to the actual acquisition or disposal of participations are deductible (for example, the costs in relation to unsuccessful transactions). Further to the Court's decision, it is essential to earmark all costs in relation to the transactions in advance and to specify the reason why they have been incurred. This applies both to directly attributable internal and external costs made.

European – CJEU cases and EU law developments

On 26 February 2019, CJEU ruled in six cases (the Danish cases *T Danmark* (C-116/16) and *Y Denmark* (C-117/16), *Luxembourg 1* (C-115/16), *X Denmark* (C-118/16), *C Danmark* (C-119/16) and *Z Denmark* (C-29916)). In these cases, the CJEU provided the following indications that there are artificial arrangements or transactions involving an intermediary holding company receiving a dividend, including:

- All or almost all of the dividends received by the intermediary holding company are, very soon after receipt, passed on to entities which do not fulfil the conditions of the dividend withholding tax exemption.
- The sole activity of the intermediary holding company is the receipt of dividends and their transmission to the beneficial owner or to other conduit companies. The absence of actual economic activity must, in the light of the specific features of the economic activity in question, be inferred from an analysis of all the relevant factors relating, and in particular, to:
  1. the management of the company;
  2. its balance sheet;
  3. the structure of its costs and to expenditure actually incurred;
  4. the staff it employs; and
  5. the company's premises and equipment.
- The existence of various contracts between the companies involved in the financial transactions, the way in which the transactions are financed, the valuation of the intermediary companies' equity and the conduit companies' inability (legal or factual) to have economic use of the dividends received.
- Dividend withholding tax is avoided due to the interposition of the intermediary holding company between the company that pays dividends and the company in the group that is their beneficial owner.
- The existence of conduit companies which are without economic justification and the purely formal nature of the structure of the group of companies, the financial arrangements and the loans.

In addition, the CJEU ruled that national authorities and courts should consider a general EU anti-abuse principle by which the benefits of the EU Parent Subsidiary Directive and EU Interest & Royalty Directive should be denied in case of abusive practice, even in the absence of anti-abuse provisions in domestic law or tax treaties.

Currently, the Dutch dividend withholding tax exemption and non-resident corporate income tax rules include substance requirements for intermediate holding companies. If these substance requirements are met by an intermediate holding company, there is no artificial arrangement that would result in the non-application of the anti-abuse rules under the Dutch dividend withholding tax exemption and non-resident corporate income tax rules. The State Secretary of Finance announced the inclusion of a legal provision in the Dutch dividend

withholding tax exemption and non-resident corporate income tax rules on 1 January 2020. Pursuant to that provision, Dutch tax authorities will have the possibility to demonstrate that an abusive situation exists even if the relevant substance requirements have been met.

Implementation of ATAD II

The Netherlands will implement the Anti-Tax Avoidance Directive II ("ATAD II") preventing hybrid mismatches related to non-EU countries no later than by 31 December 2019. The proposed legislation was announced on 2 July 2019, the date of writing of this chapter.

BEPS

On 29 March 2019, the Netherlands deposited its instrument of ratification for the MLI with the OECD. Therefore, the provisions of the MLI will (partly) apply to Dutch tax treaties as per 1 January 2020.

Tax climate in the Netherlands

The Dutch government's current view of the tax climate is detailed in the 2019 fiscal policy agenda dated 27 May 2019 and includes the following goals:

Reduction of tax evasion and tax avoidance

Although the Dutch Ministry of Finance emphasises that tax evasion and tax avoidance are international phenomena that can best be addressed by unilateral measures by the EU and OECD, the Netherlands aims to take the lead in the international process to combat both. Besides previous measures (such as the implementation of ATAD I, the MLI) the Ministry of Finance envisages to implement ATAD II, introduce a conditional withholding tax on interest and royalty payments, and increase transparency by implementing (i) a policy for international ruling practice (see further below), and (ii) an increase in the substance for intra-group financing and licensing companies.

Increase appeal for companies engaged in operational activities

Besides the reduction of corporate income tax rates (see above), the Dutch Ministry of Finance aims to further increase the Dutch tax system's appeal by introducing new rules related to the levy of wage tax and personal income tax in respect of option plans for start-ups and scale-ups. The proposal seeks to defer the moment of levying taxation from the time of exercise of the options to the sale of the shares. The new rules should enter into force on 1 January 2021. In addition, a specific limitation of interest deduction rule for banks and insurance companies will be introduced in the form of a minimum equity rule. The new legislation should enter into force on 1 January 2020.

Other goals

Other policy goals are reducing taxes on employment, increasing the "greening" of the tax system in view of global climate goals and increasing the efficiency of taxation.

Developments affecting the appeal of the Netherlands to holding companies

CFC legislation

The Netherlands has one of the best holding company regimes in the world. The Dutch participation exemption provides for a full exemption of income (e.g. dividends, capital gains, liquidation proceeds) derived from share interests in qualifying participations. The conditions for the application of the Dutch participation exemption are relatively easy to meet compared to similar regimes in other jurisdictions (e.g. no minimum holding period, low minimum share interest of 5% or more).

Based on the implementation of ATAD I, controlled foreign company ("CFC") rules apply as from 1 January 2019. Under the CFC rules, the participation exemption does not apply to profits from passive portfolio investment activities of direct or indirect subsidiaries or permanent establishments established in jurisdictions with no or low statutory tax rates (i.e. less than 9%), or in jurisdictions that are on the EU blacklist of non-cooperative jurisdictions included in a blacklist issued by the Dutch Ministry of Finance. Only interests of 50% of Dutch tax payers together with related companies are targeted. The CFC rules do not apply if subsidiaries or permanent establishments have a certain level of substance (including office space and payroll expenses of generally at least EUR 100,000).

Abolition of limitation of loss carry-forward rules for holding and financing companies

On 1 January 2019, the rules limiting the carry forward of losses by holding and financing companies were abolished. Losses incurred in 2018 and before are still subject to the former rules under a grandfathering regime.

Limitation of deduction of liquidation losses

On 16 April 2019, three members of parliament who are not part of the ruling coalition published an internet consultation based on which the deduction of liquidation losses will be limited. In essence, under the proposed rules' liquidation losses related to subsidiaries (or permanent establishments) will be deductible for Dutch corporate income tax purposes only if (i) the tax payer holds an interest of more than 25% in the subsidiary, (ii) the subsidiary is a tax resident of the EU or EEA, and (iii) the liquidation is finalised in ultimately the third year after the calendar year in which activities of the subsidiary have been discontinued or the decision was made to liquidate the subsidiary. In response, other members of parliament, including members of parties of the ruling coalition, requested the Dutch parliament to establish an advisory committee to create a fairer tax system while ensuring that the Netherlands remains attractive to head offices.

Policy update for international ruling practice

On 1 July 2019, the new Decree on the Dutch international ruling practice ("Decree") entered into force, replacing the previous version of the Decree. The Decree includes rules on the application procedure for international tax rulings, the specifics of that procedure, conditions for applicants (which should be met for the Dutch tax authorities to take applications under consideration) and certain transparency considerations. The most important changes concern stricter conditions for applicants for an international tax ruling. Under the proposed rules, the Dutch tax authorities will consider a ruling request only if:

1. the Dutch tax payer has sufficient "economic nexus";
2. the main or principle reason for the transaction is not to mitigate Dutch or non-Dutch taxes; and
3. the transaction should not involve a jurisdiction included in the Dutch list of low-taxed jurisdictions.

An anonymised summary of all rulings with an international character will be published, including a description of the relevant facts and main conclusions from transfer pricing reports or other documents and an analysis of the relevant legislation (where applicable). In addition, summaries will be published of ruling requests with an international character (which have been discussed with the Dutch tax authorities during preliminary consultations) that have not been honoured and the reasons why.

In view of the anticipated change in the Dutch dividend withholding tax exemption and non-resident corporate income tax rules on 1 January 2020 as described above, new rulings on

these topics will furthermore be subject to the additional requirement that no abusive situation exists.

Impact of developments on migration trends

Based on newly adopted rules, the Netherlands became generally more attractive to international businesses, especially to companies engaged in active operational activities.

The introduction of various anti-abuse rules over the last few years affected some holding companies with limited presence in the Netherlands. As a consequence, some groups decided to increase their presence in the Netherlands.

Industry sector focus

Property

The introduction of the earnings stripping rules particularly affected the Dutch tax position of entities engaged in the exploitation of real estate. In general, entities engaged in the exploitation of real estate tend to be heavily debt-funded and usually do not own substantial receivables. As a consequence, such entities often have large interest expense excess resulting in an increased risk for limitation of interest deduction under the earning stripping rules.

Start-up and scale-up companies

Companies in start-up or scale-up phases are usually in loss-making positions. The reduction of the maximum period of loss carry-forward facility to six years particularly affects these companies, as their chances to apply the loss carry-forward facility will be reduced.

The year ahead

Future tax developments are described in the above paragraphs.

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Nigeria

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Overview of corporate tax work over last year

Types of corporate tax work

VOARS filing

The Voluntary Offshore Assets Regularization Scheme (VOARS) was introduced by the Federal Government of Nigeria to combat tax evasion and regularise offshore assets owned by persons resident in Nigeria for tax purposes. Similar to the recently concluded the Voluntary Assets Income Declaration Scheme (VAIDS), the VOARS Scheme applies to all persons, entities and their intermediaries who hold offshore assets and are in default of their tax liabilities, including those who are not already under investigation by law enforcement agencies in Nigeria or any other country and have not been charged with any crimes, or who own offshore assets (such as liquid assets, stocks and bonds held in portfolio, etc.) but are yet to declare them to relevant authorities, amongst others.

The VOARS Scheme provides a one-year window which commenced in October 2018. During this period, affected taxpayers can declare their offshore assets and income from sources outside Nigeria that relate to the preceding 30 years of assessment, regularise their tax status and ensure full compliance.

To participate, eligible taxpayers must voluntarily make complete and verifiable disclosures of their offshore assets and income through the Voluntary Offshore Assets Regularization Facility in Switzerland (VOARFS) to be set up by the Federal Government of Nigeria (FGN). Such taxpayers are also expected to, amongst other things, pay a one-time levy of 35% of their offshore assets to the FGN in *lieu* of all outstanding taxes, penalties and interest, and ensure full tax compliance on their residual offshore assets after accessing the Scheme. In exchange, qualified taxpayers shall obtain permanent immunity from criminal prosecution for tax offences and offences related to offshore assets.

Any eligible taxpayer who fails to take advantage of the opportunity provided by the Scheme shall, upon its expiration, be liable to pay in full the principal tax liability due (inclusive of interest and penalties). The taxpayer may also be subject to a comprehensive tax audit, investigation, charges and enforcement procedures concerning the offshore assets.

Significant deals and themes

Transfer pricing

The Federal Inland Revenue Service (FIRS) released the revised Transfer Pricing (TP) Regulations in August 2018, which repealed the 2012 TP Regulations. The revised TP Regulations incorporated some of the updates from the Organization for Economic Co-operation and Development (OECD) 2017 TP Guidelines, as well as some recommendations from the African Tax Administrators Forum (ATAF). However, the TP Regulations will be

applied to the basis period commencing after 12 March 2018. The Revised TP Regulations introduced major changes aimed at encouraging compliance and providing certainty on appropriate TP treatment of related party transactions.

The revised TP Regulations expands the scope of TP in Nigeria to cover certain aspects of capital gains tax (CGT) and value-added tax (VAT). By implication, transactions involving the disposal of tangible assets between related parties should be guided by the arm's-length principle (ALP) to ensure that the costs of assets disposed and sales proceeds mirror similar transactions between independent parties.

Another interesting inclusion in the revised TP Regulations is the guidelines on the pricing of intangible transactions. In addition, the new Regulations limit allowable deductions for payments for transfer of rights to intangibles to 5% of earnings before interest, tax, depreciation and amortisation (EBITDA).

Tax disputes

The Tax Appeal Tribunal (TAT or the Tribunal) is an administrative body established by the Federal Inland Revenue Service Establishment Act of Nigeria to hear and resolve tax disputes arising from all federal tax legislation. These include the Companies Income Tax Act, Personal Income Tax Act, Petroleum Profits Tax Act, Value Added Tax Act, and the Capital Gains Tax Act, amongst others. The Tribunal is the first forum for aggrieved persons (taxpayers or tax authorities) to litigate before approaching the High Court.

On 12 July 2018, the Federal Government of Nigeria appointed commissioners who were to serve as the tax appeal tribunal. Prior to the appointment, no cases were heard at the Tribunal; however, the registries remained operational for taxpayers to file appeals pending the reconstitution of the Tribunal. The reconstitution of the TAT is expected to aid the speedy resolution of existing and fresh tax disputes.

Key developments affecting corporate tax law and practice

Tax administration

In the year 2018, the FIRS recorded a total tax revenue collection of about ₦5.32tn. Of the revenue generated, the oil component stood at 46.38% while the non-oil component stood at 53.62%. In 2019, the FIRS has a revenue target of ₦8.3tn from the collection of various taxes. The ease of paying taxes in Nigeria has also improved. This improvement may be as a result of regulatory reforms such as the introduction of ICT initiatives aimed at improving the tax system and making the payment of taxes easier and simpler.

The VAIDS, which was originally introduced in July 2017, was extended till 30 June 2018. The extension was given to achieve the overall objective of increasing compliance and generating additional revenue which would accrue to the Government. Upon conclusion of the VAIDS, the FIRS undertook an exercise to track non-compliant taxpayers with an annual banking turnover of ₦1bn and above.

The Federal Government also launched the VOARS in October 2018, offering a 12-month window allowing taxpayers with undisclosed offshore assets and income within the past 30 years to voluntarily declare their assets and pay the corresponding taxes on such assets/income.

Tax legislation and policy

The Federal Government of Nigeria released the Income Tax (Country-by-Country Reporting) Regulations, 2018 (the CbC Regulations) giving effect to the Country-by-Country

Multilateral Competent Authority Agreement signed on 27 January 2016 and ratified on 3 August 2016. The CbC Regulations, which were published in an official gazette dated 8 January 2018, require multinational enterprises (MNEs) headquartered in Nigeria which meet the specified threshold of global revenue to provide tax authorities with information about their global activities, profits, and taxes. This is to better assess international tax avoidance risks, improve transparency in the tax practices of the MNEs, and prevent tax evasion or avoidance through base erosion and profit shifting.

Tax climate in Nigeria

The FIRS of Nigeria, in a bid to effectively achieve its objective of ensuring voluntary compliance, came up with various technology-driven initiatives aimed at increasing the number of taxpayers and reducing their tax burden by making tax payment more convenient.

Some of these initiatives were the deployment of electronic payment channels for registration, filing, payment, receipt and tax clearance certificates to facilitate the easy remittance of taxes by taxpayers. The service also came up with the concept of information exchange for third-party databases which was implemented in collaboration with government agencies, such as the Nigeria Customs Service and the Corporate Affairs Commission, among others.

The service has also intensified its tax compliance strategies through collaboration with public and private sector organisations. For instance, the FIRS has appointed banks in Nigeria to act as collection agents of taxpayers considered to be in default of tax payments. Also, the FIRS has issued letters to all commercial banks in the country requesting a list of companies, partnerships and enterprises with a banking turnover of ₦10bn and above. This initiative was aimed at ascertaining those companies that were compliant with the tax laws and those yet to fully comply.

Developments affecting attractiveness of Nigeria for holding companies

The Federal Executive Council (FEC) of Nigeria approved the Tax Laws Reform (TLR) which seeks to remove obsolete, ambiguous and contradictory provisions in the tax laws as well as increase Government revenue. Included in the approved reform is the amendment of Section 19 of the Companies Income Tax Act (CITA). The amendment of Section 19 reduces double taxation of retained earnings on which tax has been paid, and also excludes exempt profits from excess dividend tax.

Industry sector focus

Road transport sector

The Federal Government of Nigeria, on 25 January 2019, signed Executive Order (EO) 007 on the Road Infrastructure Refurbishment and Development Tax Credit Scheme (Scheme). The Scheme provides a platform for private companies to undertake the construction and refurbishment of eligible road infrastructure projects. The Scheme also guarantees the full and timely recovery of private companies' project costs through a tax credit mechanism.

Following detailed negotiations and relevant consultations with the relevant parties, the Scheme has now metamorphosed into a more robust project. The new Scheme appears to have addressed most of the major shortcomings of similar past initiatives such as financing, enlistment for participation, incomplete cost recovery as well as the multi-agency/regulatory interface, etc.

The introduction of the Scheme has the potential to improve road infrastructure while easing the tax burden of companies. Companies with manufacturing entities, especially those within

major industrial hubs, can pool funds to participate in the Scheme for the benefit of their companies and the overall growth of the economy, albeit in the long run.

Notwithstanding the foregoing, the success of the Scheme is hinged on the ability of the Government to build the right level of trust with the private sector.

The year ahead

Country-by-Country and Transfer Pricing Regulations

In 2018, the Federal Government introduced the CbC Regulations and revised TP Regulations (the Regulations). Both Regulations give effect to a number of the Organisation for Economic Co-operation and Development's (OECD) guidelines. The Regulations also impose stiff penalties for non-compliance with TP rules.

Following the release of the Regulations, the FIRS issued a notice indicating that it will begin to enforce compliance by imposing the stiff penalties (as contained in the Regulations) on defaulting taxpayers, beginning January 2019.

It is therefore expected that the FIRS would intensify TP audits in the year 2019. The implementation of the revised TP Regulations will drive greater compliance on the part of taxpayers. Thus, MNEs that have previously arranged their affairs to shift profits to low-tax paying jurisdictions would have to ensure that they carry out sufficient economic activities in such jurisdictions, otherwise they may find that they would have to face significant TP adjustments that would impact their tax liabilities.

In addition, the Nigerian Government has taken a major step in implementing the OECD automatic exchange of information programme by issuing the CbC Regulations. This would afford the Nigerian Government access to information on the activities of MNEs in various jurisdictions.

Focus on value-added tax

The 2019 revenue projections indicate an 11% increase in the estimated revenue from VAT. The projected increase in VAT collection is in line with the National Tax Policy and the Economic and Growth Recovery Plan (2017–2020), which projects an increase in the VAT rate for luxury items from 5% to 15% from 2018, while improving CIT and VAT compliance to raise ₦350bn annually.

In addition, the FIRS has in recent times focused their tax audits more on VAT and withholding tax issues as opposed to types of tax. This move is in line with the government's overall objective of improving VAT collections in the year 2019. Furthermore, the Value Added Tax Act (Amendment) Bill, which is currently before the National Assembly, expands the scope of the application of VAT to include intangible property. It also includes an obligation on resident beneficiaries of VATable services to deduct and remit VAT to the FIRS in cases of transactions with non-resident entities.

Tax Appeal Tribunal

In 2018, the TAT was reconstituted after over two years of inactivity. It commenced its sittings in November 2018 by attending to existing appeals filed from the year 2015 while entertaining new appeals. Given the FIRS's commitment to raise ₦8tn in revenue collections in the year 2019, it is expected that there would be a significant number of disputes between the taxpayers and tax authorities which would result in increased appeals before the TAT in the course of the year. It is hoped that the process will be improved to ensure speedy resolution of tax disputes.

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Overview of corporate tax work

In the year of the parliamentary elections, corporate taxes have become a significant part of the political agenda. Since the VAT gap has been substantially reduced over the past few years, Polish tax authorities' attention is particularly focused on corporate income tax and base-eroding multinational enterprises. That is why major changes introduced within the last 12 months are aimed at cross-border payments (new definition of beneficial owner, reform of WHT system, changes in TP) and cross-border structure (mandatory disclosure rules – "**MDR**").

Poland is the one of the first countries to implement international initiatives. In recent years, Poland was one of the first countries to adopt the OECD Multilateral Instrument, and in 2019, Poland was the first EU country to implement the DAC 6 Directive.

On the other hand, in 2019 the Polish government introduced some beneficial solutions, notably aimed at small and medium-sized enterprises and for companies in the R&D sector:

- Preferential CIT rate of 9% for new companies (in the first tax year) and small companies (revenue, including VAT, does not exceed EUR 1.2m).
- IP Box.
- Tax preferences applicable in special economic zones are not available regardless of location of business.
- Domestic participation exemption will be available for Alternative Investment Companies ("**AICs**").

Key developments affecting tax law and practice

New definition of beneficial owner

From 1 January 2019, the domestic definition of beneficial owner has been changed. As of today, the beneficial owner is a recipient of payment that jointly meets all the following conditions:

- receives a payment for its own benefit, can decide how the received payment should be utilised, and bears an economic risk associated with the loss of this receivable (or its part);
- is not legally or actually obliged to transfer the payment (or its part) to another entity; and
- conducts actual business activity in the country of its seat (the test would be the same as for Controlled Foreign Company ("**CFC**") purposes).

Until the end of 2018, the business substance requirement was not part of the definition of beneficial owner. The amended regulation leads to certain doubts, in particular in relation to holding companies and financing companies. The situation is even more complicated given the outcome of recent Court of Justice of European Union ("**CJEU**") jurisprudence on beneficial ownership. Having in mind the major reform of the WHT system (details below), there is a lot of confusion among taxpayers as to the assessment of beneficial ownership.

Withholding tax reform

The previous practice of applying WHT exemptions and reduced WHT rates for dividend, interest and royalty payments as well as for certain intangible services ("qualified payments") was significantly amended by partially replacing the relief at source rule with a refund upon request.

Undoubtedly, new solutions have a significant impact on cash flow and impose additional administrative burdens on WHT agents. On top of that, new rules introduce additional responsibilities on board members, and rigorous liability both on companies and board members.

Under the new WHT settlement rules, there are two simultaneous WHT regimes applicable depending on whether the total amount of qualified payments (dividends, interest, royalties, service charges) transferred to a single recipient in one tax year exceeds a PLN 2 million equivalent.

If the total amount of qualified payments does not exceed PLN 2 million equivalent in a tax year, the WHT agent is entitled to trigger the standard WHT regime by applying a WHT exemption or reduced WHT rates provided that the WHT agent assures due diligence in verifying the correctness of reduced WHT rates or WHT exemption applicability.

For qualified remittances exceeding PLN 2 million, the WHT agent is obliged to charge WHT on the excess of qualified payments over PLN 2 million at statutory rates amounting to 19% for dividend payments and 20% for other qualified payments.

The recipient of the payment or WHT agent (if gross up applies) is entitled to apply for a WHT refund by submitting the required documents to the relevant tax office. The WHT should be refunded within six months.

However, the WHT agent may still benefit from the WHT exemption or reduced WHT rates applicable, also to the excess of over PLN 2 million, provided that one of the following requirements is fulfilled:

I. The WHT agent should submit a statement to the relevant tax office confirming that the WHT agent has the documentation required under tax law for the WHT exemption or reduced WHT rates. The WHT agent is also required to verify, with due care, the correctness of WHT exemption/reduced WHT rates applicability. The WHT agent should also confirm that it is not aware of any circumstances excluding application of the WHT exemption or reduced WHT rates in a given case.

   This statement should be lodged prior to making qualified payments and signed by the head of the entity (usually by all the management board members).

   In case of misrepresentation, lack of required verification or verification that is not sufficient given the nature or scale of the WHT agent's business or if the submitted statement turns out to be untrue, the WHT agent is generally liable to a fine amounting to 10% of the taxable amount of payment taxed with the reduced WHT rate or exempted from WHT, in addition to any tax that may be otherwise payable.

Additionally, any management board member whose representation is false or conceals the truth may be held liable for committing a fiscal penal crime punishable by a fine of up to approx. PLN 21 million, imprisonment or both.

II. The WHT agent may apply for a WHT clearance opinion from the Polish tax authorities entitling it to benefit from WHT exemption stemming only from domestic tax rules implementing the Parent-Subsidiary Directive and Interest-Royalties Directive (the clearance opinion does not apply to double tax treaty preferences).

The WHT clearance opinion should be generally issued within six months. It is valid for 36 months unless the status of the case changes in due course. Nonetheless, tax authorities may refuse to issue such opinion if they assess that the recipient does not actually operate business activity in its country of residence, does not act as beneficial owner of such payments or due to the application of SAAR/GAAR.

The initial plan was that the new WHT rules would come into force from 1 January 2019. This date was later postponed effectively to 1 January 2020. Even though amended provisions are not in force yet, it is clear that it would significantly affect the cash flow position of Polish companies as it is now becoming market practice that headquarters of multinational groups tend to shift all negative tax consequences of new provisions onto Polish subsidiaries (for instance, by incorporation of gross up provisions).

Mandatory disclosure rules

On 1 January 2019, Poland introduced laws pertinent to information on tax arrangements (MDR). These laws partly transposed the DAC 6 Directive by introducing a set of rules governing the reporting of cross-border tax arrangements. Additionally, the new law deals with tax arrangements other than those that meet the definition of a cross-border tax arrangement.

The Ministry of Finance published Guidelines which constitute a general explanation of tax law. If the obliged party complies with the Guidelines, a special protection regime will apply as appropriate and will mitigate the consequences of changes in interpreting law.

The reporting obligation will apply if the arrangement meets the definition of a tax arrangement. Arrangements other than cross-border tax arrangements must additionally meet the criterion of qualified beneficiary. An arrangement is an activity or combination of activities (including planned activity or activities) where at least one of the entities involved is a taxpayer, or which have or may have an impact on the existence or nonexistence of a tax liability. Polish implementation of DAC 6 also extends the scope of reporting obligations to domestic transactions (whereas the purpose of EU legislation is to identify cross-border arrangements).

New rules on mandatory disclosure impose additional reporting obligations not only on taxpayers but also on so-called promoters. This category includes not only tax and legal advisors: as we see in practice, in certain situations banks, leasing companies or even holding companies may be considered promoters responsible for reporting. To some extent, new regulations affect the professional secrecy guaranteed by attorney-client privilege.

Changes in TP

The Ministry of Finance has decided to significantly revise TP regulation. The major purpose of this reform was to simplify complex provisions applicable from 2017 and to reduce administrative burdens, especially in relation to small and medium-sized enterprises.

The major changes introduced from 1 January 2019 include:

- A new, wider definition of related parties.

- Thresholds for local file are increased (generally, PLN 10 million for sale and purchase of tangible assets and financing, PLN 2 million for other transactions, including sale and purchase of intangibles). Accordingly, the threshold for master file documentation has been raised to PLN 200 million.
- Benchmark analysis is now obligatory for each transaction described in local file, except for those to which safe harbours apply.
- Board members are obliged to file an annual statement (under penal liability) that transactions with related parties are in line with the arm's-length rule.
- The safe harbour rule is introduced in relation to low-value-added services and to certain intra-group loans.

From a tax procedure perspective, tax authorities are now able to re-characterise or even disregard a related party transaction. As a result, assessment of arm's-length remuneration may be based on a different transaction of terms that, in the tax authority's opinion, could have been applied by unrelated parties.

Exit tax

The essence of exit tax is taxation of unrealised gains associated with the taxpayer's transfer of assets or tax residency to another state. The exit tax will apply to situations where Poland loses the right to tax the increase in the value of certain assets that was effectively generated before the transfer.

More specifically, the exit tax will apply to the following situations:

- Transfer of an asset outside Poland, as a result of which Poland loses, in whole or in part, the right to tax a gain on the sale of an asset, while the transferred asset remains the property of the same entity (the act contains an open list of examples of such events).
- Change of tax residency by a taxpayer subject to unlimited tax liability in Poland, as a result of which Poland loses, in whole or in part, the right to tax the gain on the sale of an asset owned by the taxpayer, in connection with the transfer of the taxpayer's registered office or management board (CIT) or place of residence (PIT) to another state.

In the event of a change of residence referred to above, the exit tax will not apply to assets that, following the change of tax residency, remain associated with the foreign taxpayer's establishment in Poland.

Income from unrealised gains is the difference between the market value of an asset, determined on the date of its transfer, or on the day before the change in tax residency, and its tax value. The tax value is the value not previously recognised as a tax-deductible cost which would have been recognised as such by the taxpayer if the taxpayer had sold the asset for consideration. The act also provides for situations where taxpayers do not determine the tax value of assets.

The CIT Act will impose only one rate of exit tax, 19%.

IP Box

Starting from 2019, a preferential 5% CIT rate applies to income from qualified intellectual property rights created, developed or improved by a taxpayer as a part of R&D activities. The pool of qualifying intellectual property includes:

- Patents and additional protective rights.

- The right for a utility model, industrial design or circuit topography.
- Additional protection rights for medical products or plant protection products.
- Rights from registration of medicinal/veterinary products/new plant varieties or animal breeds.
- Right to a computer program.

For IP Box purposes, the tax basis is determined based on the product of income from qualified intellectual property rights and the factor is determined based on costs actually incurred on development and acquisition of R&D works.

Polish investment zone

Since the mid-90s, a significant part of foreign greenfield investments in Poland has been located in Special Economic Zones ("**SEZ**"). The major benefit for investors in SEZ is the CIT exemption calculated based on investment expenditures. Over the years, SEZ (covering less than 0.1% of Polish territory) attracted over PLN 100bn of new investments and more than 350,000 workplaces.

In 2018, the government decided to implement a major reform of the SEZ system (so-called Polish Investment Zone). Since the end of June 2018, the exemption for new investors is not limited to the territory of SEZ. Currently binding SEZ permits will remain in force until 2026.

The maximum amount of relief available under the new exemption is determined based on eligible costs and location of investment.

The eligible costs are:

- Capex expenditures, including in particular land acquisition costs, costs of purchase, development or modernisation of fixed assets, and costs related to acquisition of intangible assets.
- Two-year labour costs for newly-hired employees.

The location criterion favours regions with a higher unemployment rate (mostly eastern regions). An additional benefit is granted to medium and small/micro-enterprises and the R&D sector.

The exemption is granted based on a decision issued to the investor.

After almost one year since the Polish Investment Zone was introduced, it is clear that the new mechanism was a door-opener for small and medium-sized enterprises. Under SEZ rules, an investor had to buy SEZ situated land to benefit from tax exemption. Also, the minimum threshold for relief has decreased.

On the negative side, provisions on Polish Investment Zones replicated a lot of practical doubts that arose under SEZ rules. This relates in particular to the split of revenues/costs between exempt and taxable activity, the methodology for calculating eligible costs, etc. Also, one may say that the actual benefit is deferred in time until the investment is profitable, thus it has relatively small impact on financing the investment (unlike EU grants for new investments).

Tax climate

The Polish tax administration remains tireless in eliminating loopholes in the tax system. The consequence of these efforts is the imposition on taxpayers of constantly increasing administrative burdens.

The other effect of the government's activities is the increased liability of board members for tax reconciliations. Under new rules introduced in 2019, fiscal penal liability (including imprisonment) was imposed on board members of companies acting as WHT agents or entering into intra-group transactions. Managers of Polish subsidiaries of multinational enterprises are walking a tight rope stretched between the expectations of their headquarters and increasing tax regulatory pressure.

It is also noticeable that the tax administration invests a lot of resources in targeting tax optimisations executed before the introduction of anti-avoidance instruments, in particular before the implementation of the general anti avoidance rule. Several high-stake cases are currently at court level. These cases will most likely set precedents and will determine the tax authorities' approach to past restructurings.

The intense pace of legislative works results in a large number of loopholes in new provisions. In recent months, the Ministry of Finance has issued a large number of explanatory notes. Some of them are extensive (for instance, the explanatory note on MDR is 100 pages long). Formally, such explanatory notes (which were not adopted by Parliament) could not be considered a source of law. However, in practice the tax authorities tend to treat notes as quasi-laws and even specify such notes as a part of the justification in the decision-making process.

Development affecting the attractiveness of Poland for holding companies

After years of discussion, Poland introduced a (very limited) participation exemption in 2019. The exemption applies to income recognised by AICs on capital gains realised on the sale of shares and stocks. For the exemption to apply, an AIC must hold at least 10% of the shares for an uninterrupted period of two years.

AICs are regulated investment entities that fulfil certain formal criteria. Among others, the AIC manager should be registered with the Financial Supervision Authority. Still, the regime applicable to the AIC is much more flexible than in case of investment funds.

Industry sector focus

In recent years, the Polish Ministry of Finance identified two industries that, in the tax authorities' opinion, are particularly vulnerable to base erosion: the real estate industry; and retail sector.

Minimum tax on commercial property

Taxpayers owning or co-owning a fixed asset, being a building located within the territory of Poland which has been given for use in full or in part under a contract of lease or another contract of a similar nature, may be obliged to pay income tax on revenue from such fixed asset ("minimum tax"). This tax, introduced in 2018, focuses particularly on owners of commercial property (warehouses, shopping malls, office buildings). This minimum tax can be deducted from "standard" CIT.

Until the end of 2018, the CIT Act provided for a tax-free quote of PLN 10 million (approx. EUR 2.4 million) calculated on a standalone basis. From 2019, if a capital group invests in real property in Poland, a tax-free quote is allocated. A tax-free quote is determined in the same proportion as the proportion of the revenue to the total amount of such revenues from that taxpayer's buildings and the entities related to that taxpayer.

Retail sales tax

In May 2019, the CJEU annulled the decision of the European Commission regarding the retail sales tax. The retail sales tax was adopted in 2016 with the aim of taxing large retail networks (mainly multinational supermarket chains). The tax was progressive (0.8% rate applicable to PLN 170 million sales, 1.4% on the excess over PLN 170 million).

Shortly after adopting the new law, the European Commission initiated proceedings against Poland, claiming that the proposed rules violate EU law. As a result, the Polish government suspended the introduction of the retail sales tax until 2020.

Given that the court ruling is not final, the fate of the new tax is uncertain, yet it is expected that the decisions in this respect will be made in the second half of 2019.

The year ahead

Even though the Ministry of Finance has been tireless in recent years, we can expect more initiatives in the following months. Probably the most important one is the introduction of a digital tax. Although the Ministry has not shared any details on a new tax as of yet, it is assumed that its implementation may take place as soon as 2020.

Poland continues to implement EU legislation on anti-avoidance; it is assumed that draft legislation on hybrid mismatches will be adopted shortly.

The Ministry of Finance has also confirmed that it is continuing to work on long-term projects: an entirely new Tax Code and major revision of income tax regulations. In particular, the Tax Code reform might cause considerable change due to its unprecedented plans to introduce friendly settlement mechanisms in relations between the taxpayer and tax authorities.

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Overview of corporate tax work over last year

Types of corporate tax work

Due to the improvement of the Spanish economy, the Spanish market is experiencing a growth of M&A transactions involving private equity funds. Also, in 2018 and during the first semester of 2019, there has been a boost in real estate transactions. Favourable special regimes envisaged for real estate entities such as Spanish Real Estate Investment Trusts (SOCIMIs) and companies engaged in the rental of properties have contributed to the growth of companies within this sector.

Also, relevant tax credits available for companies associated with R&D and IP activities are contributing to the allocation of innovation hubs in Spain, and also to the investment in R&D activities by Spanish companies.

On the other hand, the Spanish tax authorities are increasing their scrutiny of the following matters:

(i) Effectiveness of substance requirements required by the anti-abuse Spanish regulations on non-resident entities recipient of payments derived from interest, royalties and dividends from Spanish entities; i.e., business purpose test of non-resident entities benefitting from tax incentives derived from EU Directives or Double Taxation Treaties.

(ii) In the field of transfer pricing within the scope of multinational corporate groups, the tax authorities are focusing on: (i) the review of the correct allocation of profits by Spanish entities according to the risks and functions assumed and performed, respectively by the Spanish entity; (ii) re-characterisation of business models adopted by Spanish entities according to the real functions and risks; and (iii) determination of PEs in Spain derived from the functions carried out by dependent commercial agents (e.g. substantial functions *vs.* ancillary or auxiliary functions).

(iii) Taxation derived from operating via a company without their own means and resources by individual professionals due to the different rates for corporate tax and personal tax purposes.

(iv) Review of the requirements to consolidate tax according to the horizontal fiscal unity regime.

Incorporation of Spanish holding entities due to the tax measures introduced recently, such as the participation exemption regime, have also contributed to the increase of restructuring transactions such as exchange of shares.

Key developments affecting tax law and practice

Domestic law

During the most difficult years of the Spanish economic crisis, there was a significant decrease in the income collected through corporate income tax, since the majority of Spanish-based companies were experiencing a significant reduction in profit, and some of them serious losses, which generated tax credits against the Spanish Treasury.

In addition, the former tax system encouraged Spanish companies to borrow money to benefit from a flexible tax regime on the deductibility of interest payments with no limitation.

Consequently, to revert the situation, Spanish corporate income tax was profoundly amended, following these principles: (i) simplifying the provisions set out in the law in order to reduce tax litigation by including recent judicial and administrative resolutions; (ii) providing the tax system with legal certainty; (iii) reducing tax rates and abolishing tax allowances; and (iv) introducing legal measures oriented toward cash repatriation (participation exemption) and measures to strengthen the equity of companies.

The most relevant developments of corporate income tax in Spain are the following:

(i) New participation exemption regime on dividends and capital gains.

(ii) New tax horizontal consolidation regime.

(iii) Success of the Spanish SOCIMI.

(iv) Amendments to the rollover regime on company restructurings.

(v) Special measures focused on reducing the public deficit.

(vi) Introduction of the capitalisation reserve and other tax credits.

Participation exemption regime on dividends and capital gains

The participation exemption regime was introduced in Spain following a resolution from the European Commission which focused on two main issues: (i) to give an equivalent treatment to dividends and capital gains arising from qualified resident and non-resident companies; and (ii) to set an exemption method to avoid double taxation in order to increase competitiveness and internationalisation of European companies.

Following the European Commission's resolution, Spain passed a participation exemption method for dividends and capital gains arising from qualified resident and non-resident companies. This participation exemption regime has eliminated the former imputation method to internal source dividends and capital gains, which will only now apply for internationally sourced dividends and capital gains.

Accordingly, Spanish companies are entitled to benefit from the participation exemption regime on qualifying resident and non-resident companies on the distribution of dividends and capital gains. In addition, Spanish companies with non-resident subsidiaries may choose to apply for the participation exemption regime or the imputation method, deducting withholding tax in accordance with the applicable tax treaty provisions.

In order to qualify for the participation exemption regime, the following requirements should be met: (i) the shareholding in the subsidiary must be of at least 5% or, alternatively, it must have a minimum value of at least €20 million (participation requirement); and (ii) it has to be held uninterruptedly for at least one year (holding requirement). In this sense, the holding requirement might be met at the company group level.

In addition, if more than 70% of the subsidiary's income consists of dividends or capital gains deriving from other subsidiaries, it would be required that the holding meets the above-

mentioned participation and holding requirements in the indirectly controlled subsidiary. Nevertheless, the precedent rule would not be applicable if dividends have been included in the tax base of the directly or indirectly owned entity in entities not allowed to apply for an exemption scheme or a double taxation tax credit scheme.

This exemption also applies to foreign-source dividends and capital gains if the above-mentioned participation and holding requirements are met and the subsidiary has been subject to (and not exempt from) a tax equivalent to Spanish corporate income tax at a nominal rate of at least 10%. In this regard, the "*equivalent tax*" requirement will be met when the subsidiary is resident in a jurisdiction that has concluded a tax treaty with Spain which includes an exchange of information provision. Besides, the indirect shareholding requirement would also apply to foreign-source dividends and capital gains.

The exemption does not apply to dividends or capital gains deriving from the transfer of shares in entities with tax residence in a tax haven jurisdiction in accordance with the Spanish legislation.

Conversely, in order to apply symmetric treatment, tax losses derived from the transfer of qualified participations as defined above are not deductible. Capital losses derived from the sale of non-qualified participations may be deductible, but reduced by, if any, the amount of tax-exempt dividends received by the subsidiary since 2009 and by the amount of exempt gains recognised by a related-party seller in a previous transfer of the Spanish subsidiary.

Lastly, in case of foreign PEs (e.g. branches, etc.), the Spanish Head Office is not allowed to apply the participation exemption on profits generated by the PE until such profits do not exceed the amount of tax losses computed and deducted before 2013.

Horizontal tax consolidation regime

In line with several EU Court cases, effective from 1 January 2015, Spanish legislation extended the scope of the tax group in order to allow the application of the tax consolidation regime to the following cases:

- Spanish subsidiaries held indirectly through a foreign intermediary company can form part of the tax group.
- Horizontal tax consolidation is allowed in the sense that Spanish direct or indirect subsidiaries of a common foreign parent company are able to form a Spanish tax group.

Until that date, only Spanish entities directly participating in another Spanish entity were allowed to form part of a tax unity in Spain.

This amendment has required multinational groups or private equity funds to revisit the corporate tax treatment of their portfolio of Spanish subsidiaries given that, according to the previous law, when Spanish subsidiaries were commonly participating in a non-Spanish entity, they could not belong to the same tax group of companies. On the contrary, with the new regulations, Spanish entities with a common parent company can form part of a group of companies, irrespective of the country of residence of the parent company.

Special rules were envisaged for specific situations such as two or more already existing tax groups which, according to this new rule, must be integrated within a sole tax group.

Due to the vast variety of situations, this new rule generated considerable uncertainty in relation to the effects derived from (i) the creation of new tax unities, (ii) the extinction of previous tax groups, or (iii) the integration of several tax unities into a sole one. As a result, a relevant number of rulings of a binding nature were issued by the Spanish tax authorities during 2017.

New groups of companies may opt to be taxed on a consolidated basis if their election to operate under this regime is carried out before the beginning of the tax year in which the regime is going to be applied.

For applying the tax consolidated regime, several requirements must be met, amongst others: the dominant entity must hold directly or indirectly at least 75% of the dependent entity; such ownership must be maintained for the entire year of consolidation; the Spanish companies must not be subject to special regimes such as Temporary Business Alliances or be tax-exempt companies; and the companies must not be taxed at a different rate to that of the parent company, etc.

Amendment to the rollover regime on company restructurings

The Spanish tax system foresees a special tax regime which allows the deference of both direct and indirect taxation arising from a restructuring transaction which has valid economic reasons. In line with the recommendations of the European Union, the aim of this regime is to eliminate tax barriers arising from mergers, spin-offs, contributions of assets, swap of securities and other restructuring transactions.

This regime is expressly configured as the general regime to be applied to restructuring transactions. Previously, the Spanish rollover regime was applied only if the taxpayer decided on such. Although the rollover regime is currently applied by default, there is a general obligation to notify the Spanish tax authorities of the existence of a restructuring transaction which must respond to valid economic reasons to defer direct and indirect taxation derived from the disposal of assets.

The applicability of the rollover regime requires valid economic reasons for its application. If the taxpayer fails to prove valid economic reasons when applying this regime, the restructuring transaction would not qualify to apply for such regime. In this regard, one of the main amendments was the reformulation of the legal consequences enforceable when the valid economic reason requirement was not met. The former regime foresaw that if the restructuring transaction did not qualify for the regime due to a lack of valid economic reasons, it triggered taxation for all capital gains arising from the transaction. Under the current regime, if the valid economic reason is not met, the legal consequence would be only to lose any tax advantage gained with the restructuring.

Special measures focused on reducing the public deficit

To date, the Government has maintained tax measures passed in 2016 directed at reducing the public deficit and adjusting imbalances in the Spanish economy, designed to increase revenues by (i) eliminating the deduction of losses on investments in other companies and bringing forward the reversal of provisions recorded at an earlier date, and (ii) by placing limits on, and deferring, the use of net operating losses and double taxation credits.

The main tax measures are summarised below:

- Limits on the use of tax loss carry forwards apply depending on the net revenue of the taxpayer. In that sense, for large companies with net revenues equal to or above €20 million in the first 12 months before the beginning of the taxable period, the following limits are laid down: (i) up to 50%, wherein the 12 months before the starting date of the taxable period, the company's net revenues are equal to or above €20 million but below €60 million; and (ii) up to 25%, wherein the same 12-month period the company's net revenues are equal or to above €60 million.
- For other companies, no amendments have been made. Consequently, the 70% limit remains for them.

- Limit on the use of domestic and international double taxation credits. For companies having net revenues equal to or above €20 million in the 12 months before the beginning date of the taxable period, a limit has been placed on their use of domestic and international double taxation credits, whereby the aggregate amount of both types of credits that they use cannot exceed 50% of the gross payable for the year.
- Change in control rules for entities with net operating losses. The use of net operating losses of an acquired entity will be disallowed under certain circumstances, including (among others) where the acquired entity has been dormant in the past three months (currently, six months) or where, within the two years after the acquisition, the acquired entity carries out different (or additional) activities from the activities it carried out before the acquisition that generate turnover that exceeds more than 50% of its average turnover for the two years prior to the acquisition.
- Write-down of participations deducted before 2013 must be recaptured in a maximum period of five years commencing from the fiscal year 2016, or in a shorter period if the value of the portfolio is recovered in a shorter period of time, or if the participation is sold before the end of the five-year period.

Capitalisation reserve reduction and other tax credits

The capitalisation reserve aims to strengthen Spanish entities' net equity by keeping retained earnings undistributed in line with the principles inspiring the amendments to the corporate income tax, and allows a tax deduction for 10% of the increase in net equity in a particular tax year, provided the company maintains the net equity increase during the following five years (except in the case of accounting losses). A non-distributable reserve for the same amount must be booked. The deduction may not exceed 10% of the taxable base before the deduction, adjustments for deferred tax assets and the use of net operating losses. The excess may be carried forward for the following two years, subject to the applicable limit for each year.

Spain has never allowed the carry back of tax losses and this principle remains unchanged. However, since 1 January 2015, an allowance consisting of a tax levelling reserve has been applicable.

Thus, small and medium-sized companies (companies with a turnover in the previous tax year of below €10 million) are allowed to deduct 10% of their taxable profits and allocate them to that special reserve. This reserve must be used to offset the losses incurred by the company within the five-year period following its creation. When this reserve is released, the tax deduction must be recaptured, diminishing or even cancelling the tax losses of that year. If during the five-year period the company does not incur any tax losses, the reserve must be released – and the tax deduction recaptured – at the end of the period. The deduction is limited to an annual limit of €1 million.

BEPS

Spain signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI) on 7 June 2017 together with 67 other jurisdictions.

On 13 July 2018 the Spanish Council of Ministers approved the MLI as a starting point of the internal ratification process following to which it will be deposited to bring the MLI into force for its covered tax treaties.

Spain has played an active role in the discussions on the BEPS Action Plan. In particular, the Spanish Tax Authorities have participated in several negotiations in international forums regarding the content and implementation of the BEPS programme, resulting in a package of 15 measures to be implemented in both European and domestic legislation.

As a result, and despite the fact that the BEPS Actions can be considered soft law – the OECD final reports on each action are legal recommendations to States – Spain has intended to transmute most of the BEPS Actions into domestic legislation.

In general terms, the majority of actions taken by Spain were reflected in the last reform of corporate income tax in 2015. In this sense, the most important amendments to Spanish domestic legislation are the following:

- Tax planning disclosure (DAC6). Spain has published draft legislation and will pass before 31 December 2019 the implementation of the measures included within the Council Directive (EU) 2018/822 of 25 May 2018, as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements.
- List of tax havens. The Spanish tax system foresees an important number of anti-avoidance rules in relation to the use of "*tax havens*". The concept of "*tax haven*" is solely Spanish and it does not necessarily compare with other EU jurisdictions.
- Tax treaty abuse. Spain's current tax treaty policy is to negotiate the inclusion of limitation on benefits clauses.
- CFC rules. Before the implementation of the BEPS Actions, Spain already had important provisions in this regard. However, following the OECD recommendations, Spain has strengthened its CFC rules by making them more restrictive.
- Interest deductibility. Spain has already introduced a limitation on interest deductibility linked to the earnings before interest, tax, depreciation and amortisation (EBITDA) with the company.
- PEs. Spain has not passed or amended any current law in this regard. However, the Spanish tax authorities have been applying in practice a more economic approach to the PE definition, very close to the broader PE rule established within BEPS.

Within this environment, the Spanish Government introduced for Spanish corporations the obligation to file the Country-by-Country Report for fiscal years commencing as of 1 January 2016.

Country-by-country reporting is required from:

- Entities resident in the Spanish territory that are the parent in a group, defined in the terms established in corporate tax law and which are not dependent on another resident or non-resident company, when the net business turnover of the group of persons or entities forming part of the group, in the 12 months prior to the start of the tax period, is at least €750 million.
- Entities resident in the Spanish territory, which are direct or indirect subsidiaries of a non-resident company in Spanish territory that is not, at the same time, a subsidiary of another, or PEs of non-resident companies when, likewise, the net business turnover of the group of persons or entities that form part of the group, in the 12 months prior to the start of the tax period, is at least €750 million, provided that one of the following circumstances exists:
  - Entities designated by their non-resident parent entity to prepare this information.
  - There is no obligation for country-by-country reporting or similar as set forth in this section regarding the aforementioned non-resident entity in its country or the territory of its tax residence.
  - There is no agreement for automatic exchange of information, with regard to this information, with the country or territory in which this non-resident entity has its tax residence.

- That, with the existence of an agreement for automatic exchange of information with regard to this information with the country or territory in which this entity has its tax residence, there has been a systematic non-compliance of the same that has been notified by the Spanish tax agency to the subsidiary entities or to the permanent resident companies in Spanish territory.

However, country-by-country reporting will not be required by entities in the event that the country-by-country reporting has taken place through a subrogated parent country, complying with the conditions set forth in the Council Directive 2016/881 of 25 May 2016.

Any entity resident in Spanish territory that forms part of a group obliged to carry out country-by-country reporting must notify the Tax Administration of the identification and the tax country or residence of the entity obliged to prepare this information. This notification must be made every year before the end of the tax period to which the information refers and must include the identification of the entity obliged to report it and whether this is carried out depending on the parent entity, obliged affiliate entity or subrogating entity.

VAT Immediate Supply of Information System

2018 has been the first complete fiscal year of application of the Immediate Supply of Information system according to which VAT taxpayers are required to file electronically and in real time the information related to invoices issued or received from their activity. Due to this system, the tax authorities have all the information related to the operations carried out by Spanish entities, meaning a strengthening of the existing electronic control systems in the hands of the tax authorities.

This special regime is mandatory for VAT taxpayers with a revenue exceeding €6 million, for VAT groups, and for taxpayers applying voluntarily the VAT monthly refund.

Tax climate

The corporate income tax regulations underwent a sound reform in 2015 with the approval of a new corporate income tax law, which implied (i) a broadening of the taxable base derived from the elimination of certain tax allowances such as the portfolio impairment, (ii) a reduction of the tax rate from 30% to 25%, and (iii) the removal of most of the available tax credits. Since then, the government has been reluctant to approve further corporate income tax incentives other than the capitalisation reserves and other minor incentives analysed above. No changes to the corporate tax rate are expected.

According to the last State Budget Bill, the potential implementation of certain measures aimed at increasing tax revenues cannot be discarded, amongst others: (i) limitation to the participation exemption regime for dividends and capital gains to 95%; (ii) introduction of a minimum tax for corporate income tax purposes for taxpayers with a turnover exceeding €20 million or tax groups; (iii) the reduction of the tax rate for very small entities; (iv) the increase of the interim payments on account of the final corporate tax due; or (v) amendments to the SOCIMI regime.

In 2018 and at the beginning of 2019, Spain remains active at an international level, signing, negotiating or renegotiating Double Tax Agreements with Azerbaijan, Belgium, Cape Verde, China, Finland, Japan and Romania.

During 2018, the tax authorities toughened their campaign to increase control over fraud and the submerged economy. Amongst others, the tax audit campaign was focused on the review of high-net-worth individuals, fraud in the digital economy and tax evasion from multinational groups based on the risk areas foreseen by BEPS policies, in particular: the analysis of the

aggressive tax planning structures; hybrid structures with different tax treatment in Spain *vs*. abroad; unnatural generation of financial expenses; abusive utilisation of transfer pricing policies; and taxation of transactions with entities resident in tax heavens, etc.

The Control Tax Plan from the tax authorities for the fiscal year 2019 also foresees special control on companies with a low level of activity, on companies owning offshore assets or with international activity, or on new business models, such as logistic and distribution activities related to electronic commerce. Operations with cryptocurrency will also be in the focus of the tax authorities.

Within the scope of the climate of control, Spain passed on 29 December 2018 legislation by way of transposition of EU Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, whose objective is to identify risk in order to improve sustainability and the confidence of investors, consumers and society in general.

According to the above, Spanish companies exceeding certain thresholds (e.g. 500 employees, value of assets exceeding of €20 million, etc.) and public interest entities as defined by the law shall report and disclose the following tax information in their annual accounts and management reports: profits obtained in each country; tax paid on profits; and public subsidies received.

Developments affecting the attractiveness of Spain for holding companies

Holding companies

Spain offers a very attractive tax regime for holding companies with non-resident subsidiaries. In particular, this structure has been commonly set up to benefit from the important network of tax treaties between Spain and Latin American jurisdictions and its participation exemption regime.

Any Spanish entity may opt to apply for the ETVE regime ("*Entidad de Tenencia de Valores Extranjeros*" or "Foreign Securities Holding Company") as long as certain requirements are met.

Under this regime, ETVE companies will be entitled to apply for a full exemption on dividends and capital gains from foreign subsidiaries and no withholding tax would apply on the distribution from the ETVE company to its shareholders. In particular, the main benefits of this regime are:

(a) Full exemption applicable to dividends and capital gains obtained by the ETVE from its shareholding in non-resident subsidiaries.

(b) The non-Spanish taxation applicable to ETVE non-resident shareholders.

The main requirements to apply for this regime are as follows:

- The company's corporate purpose shall include the management and administration of foreign shareholdings through the appropriate human and material resources. However, the corporate purpose may also include other activities in Spain or overseas.
- The Spanish entity must hold a minimum participation of at least 5% either directly or indirectly in the foreign subsidiaries. This requirement may be replaced by an acquisition cost of the subsidiary's shares equal to or greater than €20 million. In case of holding shares in a subsidiary acting as a holding company, its income should derive from more than 70% of dividends and capital gains, and the mentioned 5%

participation has to be indirectly met by the Spanish entity in the lower-tier subsidiaries or, otherwise, certain other requirements must be met.

- The shareholding in which the minimum participation requirement has been met must have been held for at least one year prior to the date on which dividends and capital gains eligible for the participation exemption regime are received.
- In the case of dividends, this minimum holding period may be completed after the dividend distribution takes place. The period of time during which other members of the group have held the subsidiaries is also taken into account to calculate the holding period.
- Subject to tax test. Foreign subsidiaries held by a Spanish holding company must have been subject to an equal or similar tax to the Spanish corporate income tax at a statutory rate of, at least, 10% (it is allowed for the effective tax rate to be lower due to the application of any reductions or allowances in the subsidiary). This test is considered to be met for subsidiaries resident in a country which has signed a Double Tax Treaty with Spain with an agreement on exchange of tax information. For capital gains purposes, this test has to be met during the entire holding period.
- The participation exemption will not apply in case the dividend distribution constitutes a tax-deductible expense in the subsidiary.
- The subsidiary cannot be resident in a Spanish listed tax haven unless the jurisdiction is within the EU and the taxpayer proves that it has been incorporated for sound business reasons and it performs an active business.

Any capital gains derived from the transfer of shares of the ETVE by non-resident shareholders, other than those that are tax haven-based or with a permanent establishment in Spain, will not be taxable in Spain provided the gain is derived from non-Spanish qualifying source income.

Industry sector focus

Real estate. One of the symptoms of the Spanish economic recovery is the significant increase of real estate transfers and rentals. A large number of real estate transactions have taken place in 2018, following the trend of the last few years.

Success of the Spanish SOCIMI

SOCIMIs were introduced in Spain on 26 October 2009. However, the earlier regime was not attractive for foreign investments and it was not until the latest amendments, which took place in 2012, that the SOCIMIs started to be attractive for foreign investors.

SOCIMIs (also known as Spanish real estate investment trusts (REITs)) are Spanish listed companies whose main purpose is the acquisition and development of real estate of an urban nature for the purpose of renting or holding of shares in other SOCIMIs or foreign REITs.

In 2012, the Spanish government introduced several amendments to the legal and tax regime of SOCIMIs in order to attract foreign investment in Spain through this vehicle. The main feature of this regime is the SOCIMI 0% corporate income tax rate if certain requirements are met, competing with other REITs in different jurisdictions.

This preferential tax regime for SOCIMIs partly relies on the shift of taxation from the SOCIMI to the investors, whose final taxation will depend on its legal form and its tax residence. Nevertheless, SOCIMIs will be taxed at 0% provided the shareholders owning at least 5% of its capital are taxed on the dividends received at a minimum nominal tax rate of 10% ("*minimum taxation test*"). If the shareholders are entitled to apply for an exemption, or subject to a nominal tax rate of less than 10%, SOCIMIs will be taxed at a 19% tax rate

on the dividends distributed to those qualified shareholders. It is important to clarify that this 19% tax rate will be paid by the SOCIMI and it will not be considered as a withholding tax on the dividends distributed.

As per the corporate requirements to apply for the special tax regime, the Spanish legislation requires SOCIMIs to have a minimum share capital of €5 million, which must be fully paid-up and meet important investment requirements.

At least 80% of the value of the SOCIMI's assets must be invested in qualifying assets or shares, and at least 80% of its income must derive from the rental income or dividends distributed by companies devoted to the rental of real estate.

However, there is no requirement with regards to the number of properties or shareholdings in companies, which in practice means a SOCIMI could apply for the special tax regime holding on property as long as it is held for a minimum period of three years. Nevertheless, the Spanish National Securities Market Commission establishes certain control over the launching of SOCIMIs with minor shareholders.

SOCIMIS are required to distribute at least 80% of their profits arising from real rental income and complementary activities, 50% of profits from the disposal of assets or shares and 100% of profits arising from qualifying shares.

Automotive, pharmaceuticals, chemical, life & science, engineering, R&D

The automotive industry is one of the key drivers of the Spanish economy, being one of the main employment-generating sectors. Its contribution to the Spanish GDP in 2016–2017 was around 12%, and its production is growing every year in a very consistent manner, reaching in 2017 maximum historic values of production.

Due to the strong bet by the Spanish government on R&D incentives in connection with corporate taxes (i.e. R&D credit and the Patent Box regime), including generation of tax credits of between 25% and 42% of the R&D expenses and the possibility to monetise such tax credits up to an amount of €5 million, several multinational groups have decided to allocate their R&D activities in Spain. The pharmaceuticals, life sciences, chemical and engineering industries are also amongst the sectors to most benefit from the R&D incentives.

The year ahead

It is expected that there will be continuous efforts by the government to increase the revenue from corporate income tax, as has been discussed above in this chapter, by the way of amendments on the corporate income tax law, or by the way of tax review works primarily focused, for instance, on the field of transfer pricing for multinational entities.

In addition, it is expected that Spain will pass a new Digital Services Tax since a bill has already been sent to Parliament to be voted on. The purpose of this tax is to subject to taxation certain services, following a new approach, according to which Spain has the right to impose taxation when it is the source country of the data, or when the user participation is essential for the creation of the value of the company. In particular, the Digital Service Tax will impose a 3% rate on gross income derived from the following digital services: online advertising; online intermediation; and online data transfer services. In general terms, the service will be deemed as supplied (and therefore taxable) in Spain when the user is situated in that territory.

This tax will be passed as a transitory regulation until an EU Directive is finally approved. In principle, it would be applicable to companies with a worldwide revenue exceeding €750 million per year, and the gross income derived from taxable digital services exceeds €3 million.

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Overview of corporate tax work over last year

Types of corporate tax work

M&A

The amount of outbound and inbound M&A transactions continued to grow in 2018. The record-breaking 493 transactions involving Swiss companies and investors were reported with a transaction value amounting to USD 132.9bn. 2018 also saw an increasing number of transactions involving private equity funds, with the deal value increasing by 97%. The key transactions include the sale by ABB Ltd of its power grids business to Hitachi for USD 11bn and the acquisition by Worldline SA of SIX Payment Services for USD 2.9bn as part of their cooperation strategy. On the private equity side, the acquisition by Partners Group (Zug) together with Caisse de dépôt et placement du Québec (Quebec City) and Ontario Teachers' Pension Plan (Toronto) of the German Techem for USD 5.4bn stands out.[1] For the current year, it is assumed that M&A activity will remain strong.

Tax litigation

In 2018, a large number of cases regarding international requests for administrative assistance have been judged by the Swiss Federal Supreme Court. The Federal Supreme Court will only hear administrative assistance cases if the legal question to be decided is of fundamental importance. The fact that the Supreme Court decided 10 administrative assistance cases out of 20 in 2018 despite the restricted access shows that there are many outstanding, mostly procedural questions to be clarified in the field of administrative assistance. In September 2018, the Federal Tax Administration (FTA) transmitted bank account details to its Automatic Exchange of Information (AEOI) partner states for the first time. Hence, we expect a considerable amount of tax litigation work regarding AEOI in 2019.

IPOs

During 2018, 12 companies (IGEA Pharma N.V., Fundamenta Real Estate AG, SIG Combibloc Group AG, ObsEva SA, Blackstone Resources AG, Lalique Group SA, Klingelnberg AG, Polyphor AG, CEVA Logistics AG, Medartis Holding AG, Sensirion Holding AG and ASMALLWORLD AG) were listed on the Swiss stock exchange. With a placement volume of CHF 1,708m and an implied total market capitalisation of CHF 3,937m, SIG Combibloc Group AG, a leading company in the packaging industry, was the largest among the 12 companies.[2] It is expected that 2019 will also be an interesting IPO year with three IPOs as of the end of April 2019.[3]

Significant deals and themes

M&A

The following deals stood out in 2018 and early 2019, all requiring tailored corporate tax advice for the transaction itself, the integration or the debt financing:

- **DSV's merger with Panalpina**: On 1 April 2019, DSV A/S and Panalpina Welttransport (Holding) AG announced that they have reached an agreement on the terms and conditions of a combination by way of a public exchange offer to all Panalpina shareholders. The transaction has an enterprise value of approximately CHF 4.6bn.
- **Liberty Global's sale of UPC Switzerland to Sunrise**: On 27 February 2019, Liberty Global announced that it has reached a binding agreement to sell UPC Switzerland, the largest Swiss cable operator, to Sunrise Communications Group AG. Liberty Global will sell UPC Switzerland for a total enterprise value of CHF 6.3bn. Sunrise will acquire the business inclusive of indebtedness with an aggregate value of approximately CHF 3.7bn as of 31 December 2018.
- **ABB's divestment of its power grids business to Hitachi**: On 17 December 2018, ABB Ltd announced that it entered into an agreement to divest its power grids business to Hitachi. The transaction values the power grids business at an enterprise value of USD 11bn.
- **GETEC's acquisition of Infrapark Baselland**: On 19 November 2018, Clariant announced that it has agreed to sell Infrapark Baselland AG, Muttenz, and its business operations on the Schweizerhalle site near Basel, Switzerland, to GETEC, a Germany-based group of energy service providers and operator of industrial parks. In addition, GETEC is acquiring infrastructure facilities and service operations of Novartis at the same site.
- **Canada Pension Plan Investment Board and TCV's acquisition of Sportradar**: In July 2018, Canada Pension Plan Investment Board and Silicon Valley-based growth equity firm TCV signed an agreement to acquire a stake in Sportradar from private equity firm EQT and certain minority shareholders. Sportradar, valued in this transaction at EUR 2.1bn, is the global leader in the provision of sports data. The company provides leagues, news media, consumer platforms and sports betting operators with sports data.
- **Takeover battle over Sika**: On 11 May 2018, Sika and Saint-Gobain have announced the signing of agreements terminating all disputes around the purchase by Saint-Gobain of a controlling stake in Sika. Sika purchased from Saint-Gobain and Schenker-Winkler Holding AG a 6.97% stake in its own shares for a total consideration of CHF 2.08bn. This amount includes a CHF 795m premium to compensate Saint-Gobain for the loss of control over Sika. Sika will cancel these shares and introduce a one-share, one-vote governance structure. Saint-Gobain will, as a consequence, indirectly hold 10% of the capital and votes in Sika and will become its largest shareholder.

Reorganisations

- **Spin-off of the Alcon eye care devices business**: On 9 April 2019, Novartis completed the carve-out and spin-off of Alcon, a global leader in eye care and the largest eye care device company in the world, with complementary businesses in surgical and vision

care. The Alcon shares were successfully listed on the SIX Swiss Exchange Ltd. and the New York Stock Exchange with Alcon's market capitalisation reaching CHF 28bn at close of trading on SIX Swiss Exchange. They are also included in the Swiss Market Index (SMI), which comprises the 20 largest Swiss listed stocks. The spin-off was structured as a tax-neutral demerger for Swiss tax purposes.

Financing

- **Holcim Finance's issue of EUR 500m subordinated fixed rate resettable notes**: On 5 April 2019, Holcim Finance (Luxembourg) S.A. issued EUR 500m Subordinated Fixed Rate Resettable Notes, guaranteed on a subordinated basis by LafargeHolcim Ltd. The Notes will be listed on the Luxembourg Stock Exchange.
- **Santhera share placement and debt financing**: On 4 April 2019, Santhera Pharmaceuticals Holding AG announced that it had raised new liquid funds of up to CHF 22.1m through a private placement of an aggregate of 500,000 new shares and a syndicated credit line facility in the amount of up to CHF 15m.
- **Listing of Bitcoin (BTC)-linked exchange traded products**: On 26 February 2019, Amun AG (Amun), a Zug-based special purpose issuance vehicle of the fintech group Amun, successfully listed its second series of crypto-linked Exchange Traded Products (ETPs) on the SIX Swiss Exchange. The underlying asset of this second series is Bitcoin (BTC) held by or on behalf of Amun through an independent custodian.
- **ARYZTA rights offering**: On 19 November 2018, ARYZTA, a global food business with a leadership position in speciality bakeries, completed a capital increase by way of a rights offering structured as a volume underwriting in the amount of approximately CHF 900m.
- **Vontobel placement of CHF 450m tier 1 bonds**: On 27 June 2018, Vontobel Holding AG successfully completed the placement of CHF 450m perpetual additional tier 1 subordinated bonds. The additional tier 1 subordinated bonds were issued at 100% of their nominal amount with an interest of 2.625% until 2023. The proceeds of this capital market transaction will be mainly used to finance the acquisition of Notenstein La Roche Private Bank.
- **Swiss Re USD 500m offering of exchangeable notes**: On 20 June 2018, Swiss Re has completed an offering of USD 500m, six-year senior exchangeable notes.
- **USD 1bn bonds for the largest thermoelectric plant in Latin America**: Centrais Elétricas de Sergipe S.A. has successfully issued bonds for approx. USD 1bn equivalent in local currency at a fixed, long-term rate in international capital markets. The innovative bond issue is guaranteed by the Swiss Export Risk Insurance, the export credit agency of Switzerland. The bonds are part of a financial package to finance the development, design, construction, operation and maintenance of a thermoelectric power plant by CELSE in the state of Sergipe in the northeast region of Brazil. Besides the bond issue, the transaction includes a USD 200m loan from the International Finance Corporation and a financial package of the Inter-American Development Bank in the amount of approx. USD 300m.

Key developments affecting corporate tax law and practice

Domestic legislation

The Federal Act on Tax Reform and AHV Financing (TRAF)

Since 2014, Switzerland has been under increasing international pressure to abandon its privileged cantonal/federal tax regimes for corporate taxpayers. It has been looking for a

solution which would bring the Swiss corporate taxation system in line with international standards, while remaining an attractive business location. The first proposal, 2015 Corporate Tax Reform (CTR III), was rejected in a referendum in February 2017. On 28 September 2018, the Parliament passed, with a number of amendments, a replacement legislative proposal – Tax Proposal 17 – later renamed the Federal Act on Tax Reform and AHV (social security) Financing (TRAF). The TRAF retains most of the provisions previously proposed as part of the CTR III and Tax Proposal 17.[4] The TRAF was recently approved in a referendum on 19 May 2019 and will enter into force on 1 January 2020.

Like the previous packages, the TRAF repeals the privileged tax regimes, i.e. holding, mixed and domicile companies at the cantonal level, and finance branch and principal companies at the federal level. As compensation, the new legislation introduces a mandatory OECD-compliant patent-box regime and an optional super deduction for R&D expenditures. Both instruments will be implemented at cantonal level only. A number of the cantons intend to make use of the maximum allowed deduction of 90% for the qualifying income from patents and similar rights (e.g. Zurich and Zug). Others plan more restricted deductions in the range of 10–50% (e.g. Geneva with a maximum allowed deduction of 10% and Neuchatel with a maximum deduction of 20%).[5] At the same time, most of the cantons will significantly lower corporate tax rates. For example, the effective corporate tax rate (including federal tax rate) in Basel City will decrease from 20.18% to 13% as of 2019 (already enacted) and from 2020 in Geneva from 24.16% to 13.99%, and depending on the cantonal legislative processes, in Zürich from 21.15% to 18.19% and in Zug from 14.62% to 12.03%.[6]

The TRAF re-introduced the notional interest deduction for the so-called "high-tax cantons", i.e. cantons where the main city has an effective cumulative cantonal tax rate of at least 13.5%. As Zurich is the only main city with an effective cumulative tax rate of more than 13.5%, the notional interest deduction will only be available in the canton of Zurich.

Further, the TRAF, similar to the Tax Proposal 17, foresees that individuals will be subject to a higher taxation of dividends from qualifying participations. The dividend inclusion will rise to 70% as opposed to the current 60% at the federal level and to at least 50% at the cantonal level. While the Tax Proposal 17 included the measure to increase the dividend inclusion not only at the federal level, but also to 70% at the cantonal level, this has been reduced to a minimum rate of 50% at the cantonal level in the TRAF. In the area of international taxation, the TRAF kept the provision entitling Swiss permanent establishments of foreign companies to receive foreign tax credits.

As an important change, the new provisions include a restriction on the capital contribution principle. Under the current rule, dividend distributions out of capital contribution reserves are neither subject to withholding tax nor to Swiss income tax for individuals. The TRAF introduced a 50:50 rule stating that distributions out of capital contribution reserves of companies listed in Switzerland will only benefit from the tax-free regime if the company makes a distribution out of taxable reserves of at least the same amount. A comparable rule applies in case of a share buy-back on the second trading line where at minimum the same amount of capital contribution reserves and other reserves must be used. Finally, the TRAF was also supplemented with a new CHF 2bn subsidy per annum for the Federal Social Security Scheme to ensure approval in Parliament.

Radio & TV fee

From 1 January 2019, the new device-independent fee will be collected from households and undertakings. It replaces the current device-dependent fee, which was levied until the end of 2018. In Switzerland, undertakings which are subject to VAT (registered office, domicile or

permanent establishment in Switzerland) and have a global turnover of CHF 500,000 or more are (irrespective of the VAT treatment as exempt or excluded turnover) automatically subject to the radio and television fee. These companies will automatically receive an annual bill from the FTA.[7] Given that foreign companies with a worldwide turnover exceeding CHF 100,000, which provide VAT-able services in Switzerland, have to register for Swiss VAT as of 1 January 2018, foreign companies might also be subject to the newly introduced radio & TV fee.

Automatic Exchange of Information (AEOI)

As previously planned, Switzerland exchanged collected information for the first time in September 2018. The information was exchanged with 36 states, including EU Member States, Australia, Guernsey, Japan, Jersey and South Korea. The FTA exchanged information about roughly 2m financial accounts.[8]

As expected, the first exchange of information in September 2018 led to an increased number of voluntary self-disclosures in the Swiss cantons. The FTA's opinion that the penalty-free voluntary disclosure could only be made prior to the September 2018 (respectively 2019, 2020 and 2021 for new AEOI partners) exchange certainly contributed to the raise in the voluntary self-disclosure numbers before this date. It should be pointed out that this cut-off approach is not shared in all cantons. In Zurich, for example, the penalty-free voluntary disclosure with regard to information covered by the AEOI (i.e. foreign bank accounts) can be filed up to the point when the competent tax authority compares the data received from the foreign tax administration under the AEOI with the tax declaration.

In May 2019, the Federal Council issued a proposal for the introduction of the AOEI with the following 19 states: Albania; Azerbaijan; Brunei; Dominica; Ghana; Kazakhstan; Lebanon; Macao (China); the Maldives; Nigeria; Niue; Oman; Pakistan; Peru; Samoa; Sint Maarten; Trinidad and Tobago; Turkey; and Vanuatu.[9] The proposal is currently under discussion in Swiss Parliament.

In February 2019, following recommendations made by the Global Forum on Transparency and Exchange of Information for Tax Purposes, the Federal Council began consultations on amendments to the Federal Act and Ordinance on AEOI. The material amendments concern non-profit associations and foundations. Non-profit associations and foundations, should they qualify as financial institutions, would need to comply with the reporting requirements. In addition, the previously existing reporting exceptions for non-profit associations' and foundations' accounts and accounts that qualify as excluded accounts under the laws of the account holder's country of tax residence will be removed. The capital contribution accounts remain in the excluded category, provided the incorporation, respectively capital increase, takes place within 90 days of the account opening.

The amended legislation, if approved, should come into force on 1 January 2021.[10]

Global Forum's recommendations

In 2016, the Global Forum issued a recommendation requiring Switzerland to ensure that appropriate reporting mechanisms are in place to effectively ensure the identification of the owners of bearer shares in all cases.[11] In response to this recommendation, on 21 June 2019, Parliament passed the Federal Act on the implementation of the recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes. The Act prohibits the issuance of bearer shares for non-listed companies, unless they are issued as intermediated securities held with a Swiss custodian. Notwithstanding several motions to allow companies which had complied with the previous regime to be grandfathered, Parliament decided to apply the abolition to already existing bearer shares as well. As a

result, existing bearer shares will need to be converted into registered shares, subject to the two limited exceptions for listed companies and certain intermediated securities. The Act provides for a transitional regime: the companies will have a period of 18 months to amend their articles of association and convert their existing bearer shares into registered shares.

We expect that that Act will enter into force as soon as October 2019 if no referendum is petitioned for.

Spontaneous exchange of tax rulings

See below under the heading BEPS.

International double tax treaties

Switzerland remains active in negotiating new or revising existing double tax treaties (DTTs). As of 1 January 2019, Switzerland has signed more than 100 DTTs, of which 62 contain a provision on the exchange of information according to international standards. In addition, Switzerland has signed 10 tax information exchange agreements, all of which are in force.

Revised DTTs, which entered into force or whose dispatch was submitted to Parliament for approval in March 2018–March 2019 include treaties with Ecuador, Zambia, Saudi Arabia and the UK (additional protocol, in line with Switzerland's position of the provisions under the BEPS multilateral instrument, see under BEPS below).

The legal basis to solve double tax issues between Switzerland and Brazil was significantly improved in 2018. In May 2018, Switzerland and Brazil signed, for the first time, a DTT, which also includes an exchange of information clause according to the OECD standard.[12] Further, on 4 January 2019, the tax information exchange agreement between Switzerland and Brazil came into force and is applicable to information requests as of 1 January 2020.[13]

Partial revision of the Value Added Tax Act

On 1 January 2019, a partial revision of the Value Added Tax Act regarding low-value goods purchases from companies abroad came into force. In Switzerland, no VAT is levied on imported goods if the VAT amount due is CHF 5 or less. Goods with the value of CHF 65 or CHF 200 depending on the applicable tax rate (low-value consignments) benefit from this rule. Before 1 January 2019, foreign companies only had to register and levy Swiss domestic VAT in case their turn-over in Switzerland exceeded CHF 100,000 per calendar year. As a result, such low-value purchases from abroad were not subject to Swiss VAT (neither import nor domestic VAT) and, therefore, domestic retailers were put at a disadvantage compared to the foreign companies sending products to customers in Switzerland.

According to the new legislation, if a foreign company generates at least CHF 100,000 turnover per year from low-value consignments, which it dispatches to Switzerland, it will become subject to Swiss domestic VAT, must be entered into the VAT register and will pay Swiss domestic VAT on its total sales in Switzerland (not only the turnover from low-value consignments).

In addition, in March 2019 Parliament approved a motion requesting the Federal Council to propose further measures ensuring the payment of VAT by foreign online platforms, such as Aliexpress, Wish and JD, selling goods or services to Switzerland.[14]

Amended rules for the refund of Swiss WHT

On 28 September 2018, the Parliament approved the amendments to the rules for the refund of the Swiss withholding taxes (WHTs) for Swiss taxpayers. According to the new rules, a negligent failure to declare the taxable income does not lead to the forfeiture of the entitlement to the refund. In this case, the Swiss taxpayer remains entitled to the refund if the missing declaration is discovered and corrected by the tax inspector before the tax assessment becomes legally binding. Under the previous rules, the right to refund was

forfeited as soon as the tax inspector discovered the failure to declare, even if the tax assessment was still pending. The new rules came into force on 1 January 2019.[15]

Domestic case law

BGer 2C_557/2017: Participation relief for distributions and capital gains, qualification as a hidden distribution of profits

Similar to most European countries, under Swiss domestic law, dividends paid to corporate shareholders as well as capital gains from the sale of minimum 10% of shares of subsidiaries benefit from the participation relief. Swiss tax law, however, does not treat the participation income as fully tax-exempt. Instead, the Swiss participation relief provides a rebate of the tax payable. The rebate is calculated by reference to the ratio between the net income from qualifying participation and the total taxable income earned within a tax year. In turn, the net income from qualifying participation equals the gross income decreased by the imputed financial expenditures and administration expenses. The imputed financial expenditure amounts to a portion of the total financial expenditure of the corporate shareholder calculated by reference to the ratio between the tax value of the underlying participation rights and total assets of the corporate shareholder.

In this case, the central question was the qualification of income from participation rights as capital gain or dividend income, which ultimately determines the participation to be used to calculate the net participation income and the resulting entitlement to the participation relief.

A Swiss company (Z) held a 28% stake in a Belgian company (B) and was the sole shareholder of another Belgian subsidiary (C). As part of an internal restructuring in 2008, Z sold to C its stake in B at the book value (EUR 88m below the market value). It emerged that in Belgium the difference to the market value was taxable at a rate of 34% with no participation relief. To avoid the negative tax consequences for the group, in 2009 Z and C agreed to retroactively increase the sales price by EUR 88m up to the market value. In its tax return for the year 2009, Z recognised EUR 88m as a capital gain in Switzerland and requested a tax rebate under the participation relief on the capital gain. The tax administration was of the opinion that no participation relief was applicable.

The reason for the difference laid in the qualification of the participation income as a capital gain on the sale of B-shares or a hidden profit distribution from the subsidiary C, respectively, because the subsequent increase of the purchase price payable by C to Z was deemed a commercially unjustified deemed dividend. In the first case, the imputed financial expenditure is calculated based on the tax value of the B-shares, whereas in the second case it is based on the tax value of subsidiary C. The subsidiary C's tax value was significantly higher than the tax value of the B-shares. The imputed financial expenditures based on the tax value of subsidiary C was actually higher than the EUR 88m participation income, resulting in the arithmetical net participation income being zero.

The Federal Supreme Court confirmed the view that the additional amount paid (difference between book value and market value) in the subsequent year (2009) qualifies as a hidden profit distribution by C and not as a capital gain. The Federal Supreme Court argued that the initial sale and the retroactive price increase have to be considered as two separate transactions. The price increase was found to constitute a hidden profit distribution from C to Z and led, due to the rule on the calculation of the imputed financial expenditure, to the forfeiture of the participation relief in respect of the EUR 88m participation income.

A-1951/2017: Withholding tax refund under CH-UK DTT, the concept of beneficial ownership (currently pending at the Federal Supreme Court)

Under Swiss domestic law, dividends are generally subject to a 35% withholding tax. Under

the Swiss-UK DTT, the withholding tax is limited to 15% provided that the beneficial owner is a resident of the other contracting state. As per Swiss practice, the beneficial ownership is denied if the recipient or payee is under a contractual, legal or factual obligation to pass on the dividends received to another person. The so-called double-interdependency test is used to determine the latter. Under this test, the FTA or the court reviews whether (1) there is a causal relationship between the payment of the dividend income to another person and the receipt of the dividend income by the payee, and (2) the obligation to pass on the dividend income is conditional on the payee actually receiving such income.

In the present case, the Federal Administrative Court further developed the double-interdependency test in the context of the swap transactions. A UK bank entered in a cash-settled over-the-counter equity derivative contract with a group of companies domiciled in the Cayman Islands, BVI and Cyprus. The reference assets included, among others, shares of a listed Swiss company (Z AG). Under the total swap conditions, the UK bank was under an obligation to pass to the counterparties any price increase in the value of Z AG shares and 65% of the gross amount of the dividends. In order to secure itself against the increase in value of the Z AG shares and possible dividends distributions, the UK bank bought 40m of Z AG shares in respect of which it received dividends in the gross amount of around CHF 100m.

For the Federal Administrative Court it was decisive that the purchase of Z AG shares, due to the high value of the transaction, was the most appropriate hedging strategy for the total swap contract. The UK Bank was, therefore, *de facto* compelled to purchase Z AG shares to limit its exposure should Z AG distribute profits or its shares appreciate in value.

The facts that the UK Bank was not contractually obliged to purchase Z AG shares and that the income contractually had to be paid to the contracting parties, even if no dividends were received, were not considered decisive.

BGer 2C_1000/2015, BGer 2C_648/2017, BGer 2C_819/2017: Request for administrative assistance under DTTs; use of stolen data

In these three cases dealing with administrative assistance requests in tax matters by France and India, the Federal Supreme Court laid down general principles for dealing with requests stemming from illegally obtained data.

In all three cases, the requests for administrative assistance presumably originated from data about a number of accounts opened with Swiss banks stolen from a Geneva branch office of an international bank, a criminal offence under Swiss domestic law. The treaties with India and France do not specifically deal with the issue of the origin of data laying the basis for a request for administrative assistance in tax matters. Under Article 7(c) of the Federal Act on International Administrative Assistance in Tax Matters (TAAA), the request for administrative assistance in tax matters shall not be granted if it violates the principle of good faith, particularly if it is based on information obtained through a criminal offence under Swiss law.

The Federal Supreme Court held that, unless otherwise agreed between the contracting parties, a request for administrative assistance can only be denied if the conduct of the requesting state violates the principle of good faith.

According to the Court, Article 7(c) TAAA codifies the internationally recognised principle of good faith. The use of information obtained through a criminal offence under Swiss law does not necessarily constitute a violation of the internationally recognised principle of good faith.

Whether the use of stolen data is incompatible with this principle is to be determined based on circumstances of individual cases. For example, the *purchase* of the stolen data by the state seeking administrative assistance in tax matters would violate the principle of good faith. In addition, any future use by other states of such tainted data would likewise violate the principle of good faith.

In the three cases, there was no evidence that France or India bought the stolen data. However, in the first case dealing with the French request, the French authorities publicly undertook not to use the data stolen in Geneva for the purposes of requesting assistance in tax matters. The subsequent request for administrative assistance based on this very data was, therefore, found to violate the principle of good faith and was rejected. Unlike France, India did not make similar guarantees towards Switzerland. Consequently, there was no violation of the principle of good faith and the requests for administrative assistance were granted.

In the aftermath of these decisions and in order to follow the recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes, the Federal Council issued a proposal amending the wording of Article 7(c) TAAA. The second part of this Article specifying that the use of the illegally obtained data as a foundation for an administrative assistance request was in breach of the principle of good faith was proposed to be deleted. However, the proposal was rejected by Parliament.

BGer 2C_102/2018: Tax deductible provision for confiscated proceeds of criminal activities

In this case, the Federal Supreme Court clarified its practice regarding the deductibility of confiscated proceeds from criminal activities. In 2012, a CEO of a Swiss company (Z AG) was convicted of bribery. He was accused of bribing an official of a pension fund of state employees in Zurich in 2009 in order to secure contracts for Z AG. As a result, the criminal court ordered confiscation of the proceeds of the corruptly acquired contracts under Article 71 (1) of the Swiss Criminal Code in 2012.

The Federal Supreme Court confirmed that a taxpayer could generally make a tax deduction in the amount of the proceeds of criminal activities confiscated under Article 71(1) of the Swiss Criminal Code. Although set forth in the Criminal Code, the confiscation is not a criminal penalty and, instead, represents a disgorgement of profits. For the Court, it was relevant that the same confiscated proceeds had been previously taxed.

The Court also ruled that the provision for the confiscation should have been built in the accounting period when the illegal activities took place; i.e. in the 2009 financial statements. The illegal acts were performed by the CEO of Z AG, who was simultaneously the Chairman of the Board and the founder of Z AG. Hence, Z AG could have recognised the possibility of the confiscation of the proceeds of criminal activities already in 2009–2010. The fact that the criminal proceedings were opened after the date of the financial statements (but before the date of the approval of the financial statements by Z AG) was, therefore, irrelevant.

Finally, the Court found that in such situation the mandatory provisions of the Swiss accounting rules required the recording of the provision in 2009. Consequently, the failure to record the provision in the financial statements could be corrected retroactively at any time before the Z AG 2009 tax assessment became final.

BEPS

Switzerland has actively participated in the OECD's BEPS initiative and will implement or has implemented the BEPS minimum standards, as follows:

Action	Topic	Method of implementation in Switzerland
5	Abolition of harmful tax regimes.	The TRAF abolishes favourable cantonal and federal tax regimes.
5	Requiring substantial activity for preferential regimes.	The patent box regime under the TRAF will follow the OECD standard.
5	Improving transparency, including the compulsory spontaneous exchange of information on certain rulings.	Agreement on OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters and revision of Swiss Federal Act on International Administrative Assistance in Tax Matters (see below).
6	Prevention of treaty abuse.	Inclusion of new abuse clauses in DTTs regarding treaty shopping.
13	Automatic exchange of country-by-country reports (CbCR; without Master and Local File).	Agreement on the multilateral CbCR convention and enactment of law regarding CbCR (see below).
14	Making the dispute resolution mechanism more effective.	Switzerland already offers access to the required dispute resolution mechanism; all new DTTs are in line with the OECD minimum standard (see below).
15	Multilateral Instrument.	Switzerland signed the BEPS convention and announced the adjustment of a number of DTTs by way of the MLI (see below).

BEPS Action 5: implementation of the spontaneous exchange of information on tax rulings

With regard to BEPS Action 5, Switzerland has implemented the spontaneous exchange of information in tax matters in its domestic legislation with effect from 1 January 2017. The regulations on the spontaneous exchange of tax rulings are included in the Tax Administrative Assistance Ordinance. The Ordinance provisions are closely based on the guidelines in the BEPS Action 5 report. The exchange covers Swiss tax rulings, which were granted after 1 January 2010 and are still in force as of 1 January 2018; i.e., the time when the actual exchange of tax rulings started in Switzerland. The new transparency should not change the Swiss ruling practice *per se,* except that in cases subject to exchange, the tax authorities now generally request that the template for the exchange is completed and submitted together with the tax ruling request. The information on relevant tax rulings will be submitted in electronic form (so-called BEPS templates) to the FTA which, in turn, will exchange these with the foreign states. In May 2018, the FTA has for the first time transmitted information on advance tax rulings to spontaneous exchange of information partner states. Information was sent to 41 states, including France, Germany, the United Kingdom, the Netherlands and Russia.[16]

BEPS Action No. 13: country-by-country reporting

Switzerland adopted the global minimum standard included in Action 13 of the OECD BEPS project for the international automatic exchange of country-by-country reports with quantitative as well as qualitative data of multinational enterprises (MNEs) with an annual consolidated turnover of the equivalent of CHF 900m. The relevant legal framework for the exchange of country-by-country reports entered into force on 1 December 2017. This includes the Multilateral Competent Authority Agreement on the Exchange of Country-by-

Country Reports (MCAA-CbCR), and the associated law (ALBA Act) including the ordinance (ALBA Ordinance). MNEs in Switzerland have been obliged to start drawing up a country-by-country report since the fiscal year 2018. In 2020, Switzerland will exchange country-by-country reports with 55 partner states (status as at 28 January 2019).[17] Prior exchanges for the period 2016 and 2017 are possible on a voluntary basis. In June 2018, the FTA sent, for the first time, 109 reports on the year 2016 to a total of 35 partner states.[18]

BEPS Action No. 14: making the dispute resolution mechanism more effective

Following the generally positive peer review report on the implementation of the BEPS Action 14 minimum standard, Switzerland committed to further improve the access to, and speediness of, the mutual agreement procedures.

The mutual agreement procedure in Switzerland covers both the situations dealing with the elimination of double taxation as such and transfer pricing cases. The first category of cases deals mostly with the issues of residency of individuals, the right of taxation for dependent personal services, differentiation between employment and self-employment and income from government services. The second category covers transfer pricing attribution/allocation cases and advance pricing agreements. The detailed guidelines governing the procedure as well as the necessary forms are publicly available and published on the homepage of the State Secretariat for International Finance (SIF). In 2017, altogether 264 mutual agreement procedures were initiated and 257 cases were closed. The average time taken to complete the mutual agreement procedure in Switzerland was 18 months and 24 months for transfer pricing cases.[19]

In addition, Switzerland strives to include the arbitration clause in its DTTs whenever possible. For example, the arbitration clause was incorporated into the new DTTs with Kosovo, Zambia and Pakistan, and the amending protocols to the DTTs with Ukraine and Latvia.

BEPS Action No. 15: developing a multilateral instrument (MLI) to modify tax treaties

On 22 March 2019, Parliament approved the Federal Decree approving the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS. The Federal Decree is subject to an optional referendum.

Switzerland has taken the approach to generally cover only the mandatory minimum BEPS standards when implementing the BEPS-Convention, including:

- modification of the preamble text to include an express statement condemning tax treaty abuse through double non-taxation, tax evasion or avoidance;
- anti-abuse provision in the form of principal purpose test provisions;
- provision preventing double non-taxation upon a conflict of qualifications; and
- dispute resolution understandings pursuant to Articles 16 and 17 of the BEPS-Convention.

In addition, Switzerland undertook to include the arbitration clause in its DTTs. The Swiss DTTs with the following countries will be modified by way of the MLI: Argentina; Austria; Chile; Czech Republic; Iceland; Italy; Lithuania; Luxembourg; Mexico; Portugal; South Africa; and Turkey. The Swiss Parliament approved this list in the 2019 spring session. Since Switzerland applies the so-called amending view – i.e., requires that new agreements reflecting the amended wording are concluded – modifications under the MLI require that the counterparties also accept this view.

In other cases, DTTs with other jurisdictions may be amended through bilateral negotiations.

On 22 March 2019, the Parliament approved the respective changes to the DTT with the UK, which also implement the BEPS minimum standard.[20] The new protocol to the DTT with Ukraine similarly implements the BEPS minimum standard.[21]

The anti-abuse provisions also now form a part of the Swiss standard DTT. For instance, the new DTT with Latvia includes a principal purpose test anti-abuse rule.[22]

Tax climate in Switzerland

Increasing tax transparency/transfer pricing disputes

Increasing tax transparency, which especially results from the implementation of the AEOI, has led to a flood of non-punishable voluntary disclosures during the last two years. In the corporate tax field, both the spontaneous exchange on tax rulings as well as the CbCR may increase the number of follow-up information requests from foreign tax authorities in the future. The Swiss tax authorities will also receive information from foreign tax authorities and will need to find a way to digest such information (on foreign tax rulings and CbCR). We do not expect a significant reduction of tax ruling requests in Switzerland due to the spontaneous exchange on tax rulings, since tax rulings are still a valid and useful tool to obtain upfront certainty on the application of the tax law to a specific case. Such certainty is a valuable asset for Swiss taxpayers in a complex tax environment.

As a result of the increased transparency, we expect that the amount of tax litigation and also tax arbitration in the field of transfer pricing is going to increase in the next few years.

TRAF

The reform of the current corporate tax system remains an important and urgent issue for both taxpayers and tax authorities. The pressure from the EU as well as the OECD to change the Swiss "harmful" tax practices has increased over time. The abolishment of the preferential regimes is an important part of the TRAF. At the same time, the reforms aim to find solutions to maintain Switzerland's fiscal attractiveness as a business location, with attractive tax rates, in particular in view of the current tax environment of globally declining tax rates (e.g. in the UK, the US, France) and to guarantee sufficient tax revenues, i.e. to find a balanced proposal.

Developments affecting attractiveness of Switzerland for holding companies

Currently, holding companies are exempt from cantonal and communal profit tax and pay only reduced capital tax at the cantonal/communal level, as well as a 7.8% profit tax (effective tax rate) at federal level. Such exemption will be abolished with the TRAF, at the earliest from 2020. The attractive participation deduction provisions for dividends and capital gains will remain unchanged. Switzerland currently has no intention to introduce controlled foreign corporations rules and generally remains, with its extensive DTT network, a beneficial holding location.

Industry sector focus

Technology industry/fintech

In December 2018, the Federal Council published its report on the legal basis, risks and challenged of the blockchain technology in Switzerland. The report shows that the Federal Council aims to create and develop Switzerland as a leading, innovative and sustainable location for fintech and blockchain companies.

The tax treatment of ICOs with respect to income tax on the corporate and individual level, stamp duties and VAT is being developed in close exchange between tax authorities, taxpayers and tax advisors, and certain tax authorities have already issued guidelines on several aspects of taxation.

The year ahead

With the approval of the TRAF in a popular vote on 19 May 2019, planning measures reflecting the reform of the corporate tax regime will be at the centre of attention during the year ahead. In addition to the TRAF, the cantonal implementation legislation and decisions on lowering cantonal corporate tax rates will be key. A few of the 26 cantons have already decided on significant tax rate reductions (Vaud, Basel, Geneva). The next global challenge, in particular for Switzerland as a small, export-oriented country, will be the new international developments addressing the taxation of the digital economy.

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Overview of corporate tax work over last year

Types of corporate tax work

In 2018, Turkish Lira depreciation, high inflation, rising borrowing costs and corporate indebtedness had a negative impact on the capital inflow; therefore, the main focus of Turkish tax work was to take measures to stop the depreciation of the currency, and to attract foreign investors by introducing new incentives or expanding the scope of already existing ones.

Despite the currency depreciation, M&A activities have been carried out by investors from various sectors and a total deal volume of approximately USD 12 billion has been generated through 256 deals, whereas USD 10.3 billion was generated through 295 deals throughout 2017.

After 2017, with only 3 IPOs, 2018 was expected to be the best year of the last decade for IPOs with the expectation of 18 companies offering their shares to the public for the first time and raising USD 4–5 billion collectively. Nevertheless, nine IPOs were conducted during last year with approximately USD 1.4 billion in proceedings, and a number of successful exists were accomplished through IPOs and trade sales by private equity firms and other financial investors.

Significant deals and themes

M&A

While only one M&A deal with a deal size over USD 1 billion was concluded in 2017, there were two transactions with such a deal size. The largest transaction of the year, amongst the transactions of which the deal sizes were announced, was the acquisition of 99.85% of shares of Denizbank by Emirates NBD Bank with a deal size of USD 3.2 billion, which represented 27% of the total deal volume of 2018. In addition to that, the acquisition of 99.80% of U.N. Ro-Ro by DFDS A/S in consideration of USD 1.2 billion was another significant transaction of the year.

As for the breakdown of M&A deals by sector, financial services provided the largest contribution to the total M&A volume and, in respect of the number of transactions, internet & mobile services and technology remained at the top of the list, as in 2017.

Financing

Although some companies, like Beymen and DeFacto, have cancelled their share issuance due to low investor demand, Sok Marketler, a grocery retailer, has gone through regardless and completed its IPO at an offering price of TRY 10.5 per share. The gross proceedings of the IPO to Sok Marketler will be approximately TRY 2.3 billion, which makes it one of the largest IPOs in the last decade. Other prominent IPOs were those involving Enerjisa and

MLP, with gross proceedings of approximately USD 1.5 billion and USD 1.4 billion, respectively.

Having noted the largest IPOs, retail, energy and healthcare sectors were the most active sectors for IPO activity in 2018.

Real estate transactions

In accordance with the statistics published by TUIK (Turkish Statistical Institute), a total of 1,375,398 properties were sold all over Turkey throughout 2018. A decrease in the number of real estate sales by 2.4% was noted along with an increase in real estate prices by 19.39% compared to 2017 statistics.

Furthermore, the minimum investment amount required for Turkish Citizenship application has been lowered, which has affected foreigners' attraction to real estate investments in Turkey. In connection with such amendments, real estate purchases by foreigners in Turkey have increased by 78% compared to the purchases made in 2017.

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

The Law on Amendments to Tax Laws and Other Laws No.7061 published in the Official Gazette dated December 5, 2017 and numbered 30326 introduced several amendments to the tax legislation of Turkey, the significant ones of which are listed below:

i. Corporate tax rate, which was previously 20%, was increased to 22% for the years 2018, 2019 and 2020; however, the president is authorised to reduce such rate to 20%.

ii. Corporate tax exemption rate on the gains derived from the sale of qualifying immovable property was reduced from 75% to 50% of the capital gains generated after December 5, 2017.

iii. The implementation period of additional investment contribution rate and reduced corporate tax practice, which was applied in 2017 for the holders of investment incentive certificates, was extended to be applied in 2018, as well.

iv. Article 16 of the Law on Financial Leasing, Factoring and Financing Companies No.6361 was amended and all special provisions allocated by financial leasing, factoring and financing companies are deemed to be expenses that are tax deductible in the fiscal year that such provisions were allocated.

v. The lump-sum expense rate, which is applied in case the taxation of the rental income is calculated with the lump-sum method, was reduced from 25% to 15%.

vi. The transfer of immovable properties and participation shares to banks, financial leasing and financing companies by the financial leasing and financing companies' debtors and guarantors in return of their debts, and the transfer of the such immovable property and participation shares by financial leasing and financing companies are now exempt from VAT.

vii. The implementation period of the VAT refund practice, which was applied in 2017 for the construction expenditures of investment incentive certificate holders that are in the manufacturing industry, was extended to include the year 2018.

The Law on Amendments to Tax Laws and Other Laws and Statutory Decrees No.7161 published in the Official Gazette dated January 18, 2019 and numbered 30659 made several amendments to the regulation of income tax, corporate tax, value added tax, special consumption tax and excise tax. Some of the key changes that have been introduced with said law are as follows:

i. Income and corporate tax exemption were determined to be applied for the income acquired through the disposal of product bills drafted under the Agricultural Products Licensed Warehousing Law until the end of 2018. Such implementation period was extended until the end of 2023.

ii. Within the scope of Provisional Article 9 of the Corporate Tax Law No.5520, the implementation period of the application of the beneficial legal ratios for the investment contribution rate and the reduced corporate tax rate for investment expenditures within the scope of the investment incentive certificate for the manufacturing industry was extended to include the year 2019.

iii. The construction of renewable and other energy facilities in the organised industrial zones and small industrial sites, goods deliveries and services performed for such facilities or economic enterprises created by them are now exempt from VAT.

iv. The delivery of books and periodical publications performed by the publishers with a publishing certificate issued by the Ministry of Culture and Tourism is now included within the scope of VAT exemption.

v. The foreign exchange rate differences to the components are now included in the VAT base.

vi. The implementation period of VAT refunds for the construction expenditures incurred as a result of investment in the manufacturing industry were extended to include 2019.

vii. The gains obtained by asset financing funds through transactions in capital markets are now exempt from the banking and insurance transaction tax.

BEPS

Along with the existing regulations in compliance with the BEPS Action plan, Turkey, as a signatory to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, has made several legislative changes to the digital economy, CFCs, interest deductions, transfer pricing and transfer pricing documentation in line with the BEPS Action plan.

For multinational enterprises, new transfer pricing reporting requirements were implemented with General Communiqué No.3 Disguised Profit Distribution through Transfer Pricing published in the Official Gazette dated December 7, 2017 and numbered 30263.

In accordance with Article 11/i of the Corporate Tax Law No.5520, a certain percentage up to 10%, which is to be determined by the president, of the interest, commissions, delayed interest, foreign currency losses and costs and expenses other than the ones added to the cost of investments shall not be deducted from the corporate income tax base for the companies whose external borrowings exceed their equity. For this provision to be applied, the percentage of the limitation was to be determined and announced by the president; however, such ratio has never been announced, which practically made such provision inapplicable.

In accordance with Article 7 of Corporate Tax Law No.5520 titled "Gains of Controlled Foreign Companies", the gains of non-resident subsidiaries, which are directly or indirectly controlled by fully responsible/resident taxpayer real persons or legal entities, individually or collectively, by having at least 50% of the capital, dividend income or voting rights, are subject to corporate tax, regardless of whether such gains are distributed. For this provision to be applied, such companies are required to satisfy all of the following conditions: (i) for 25% or more of gross proceedings of such subsidiary to be composed of passive income such as interest, dividend, rent, licence fee, real estate sales incomes apart from those that are outside the scope of commercial, agricultural or professional income; (ii) for the

commercial profits of such subsidiary to be subject to an effective tax rate lower than 10% in its country of residence; and (iii) for the annual total gross revenue of such subsidiary to exceed the foreign currency equivalent of TRY 100,000.

The Law on the Amendment of Certain Laws for the Improvement of the Investment Environment No.6728 published in the Official Gazette dated August 9, 2016 and numbered 29796 introduced several amendments with respect to transfer pricing. In line with such amendments, the following are introduced: (i) for a party to be considered as a related party within the scope of transfer pricing, partnership, voting rights or profit share should be at least 10%; (ii) the transactional net margin method and transactional profit split method are included in transfer pricing methods along with the comparable uncontrolled price method, cost plus method and resale price method; (iii) APAs can be applied retroactively by taxpayers; and (iv) a 50% discount shall be applied for taxes not accrued or accrued deficiently, provided that transfer pricing documentation obligations are fulfilled in the given time.

In accordance with the General Communiqué No.464 on Tax Procedure Law published in the Official Gazette dated December 24, 2015 and numbered 29572, internet service providers, banks, internet advertising agencies and cargo and logistics service companies operating in Turkey are required to submit information on digital sales of goods and services and payments for internet advertising and logistics services to the Data Collections Centre of the Tax Administration on a monthly basis.

Article 9 of VAT Law No.3065, which was amended by Law No.7061 on November 28, 2017 and effective as of December 1, 2017, states that VAT, which accrues for the services provided electronically to real persons that are not VAT taxpayers by those that do not have any residency, workplace, registered office or business centre in Turkey, shall be declared and paid by such service provider.

Tax climate in Turkey

With the increase in interest rates by the U.S. Federal Reserve, and the currency depreciation in developing countries in connection with this, the rising concerns about trade war and enhanced uncertainty have been the most significant developments in 2018, and Turkey has been considerably affected by the same. In addition to this, the continuity of political uncertainties and security problems in the Middle East still have an impact on several EU countries, and on Turkey in particular.

The most significant domestic developments in Turkey were the presidential elections, transition to the presidential system from the parliamentary system, the political tension that Turkey has experienced with the U.S. and some EU countries throughout the year and the Lira depreciation. Following the increase in the rates of interest and inflation due to this depreciation, the growth rate of Turkey for the second half of 2018 could not meet expectations.

Despite the above-mentioned developments, the Turkish tax climate seems to remain stable, as Turkish corporate tax legislation has noticeably clear, objective and harmonised provisions that are parallel to international standards.

Developments affecting attractiveness of Turkey for holding companies

Turkey has always been an attractive location for holding companies for many reasons. First of all, Turkey provides significantly efficient tax minimisation solutions for foreign investors carrying out business in Turkey. Furthermore, dividends received by foreign owners of

shares in Turkish companies are subject to tax exemptions and deductions, as Turkey has a broad network of double taxation agreements. In addition, an extensive protection of assets is offered for the shareholders of holding companies.

Industry sector focus

The largest M&A deal of the year was concluded in the financial services sector. As per the banking sector data announced by the Banking Regulation and Supervision Agency (BSRA), there are 29 private commercial banks, three state banks, 13 development and investment banks and six participation banks, which add up to a total of 51 actively operating banks in Turkey as of June 2019. More than 70% of the banking sector's total assets, loans and deposits are held by the top seven banks, including the three banks controlled by the state. Such fragmented structure is the main reason that such a large transaction was concluded in the banking sector.

On another note, the Turkish government has been offering extensive incentives for investors, especially for those that invest in energy facilities and the manufacturing industry, and is continuing to expand the scope of such incentives. Such incentives are mostly tax-related, such as custom duty exemption, VAT exemption, corporate tax deduction, VAT return, etc. Taking such incentives into consideration, both foreign and local investors have shown a great deal of interest in the energy and manufacturing sectors.

The year ahead

The Minister of Treasury and Finance, Mr. Berat Albayrak, declared that in the upcoming year, the Ministry is planning to simplify tax legislation to make the Turkish taxation system simpler, fairer, more effective and broad-based. He also stated that within the scope of income policies and a production model that is focused on exports and based on technology, the economy will be strengthened by supporting investments, value-added production, employment and growth based on exportation.

As for the M&A predictions for the year 2019, it is expected that the small and medium-scaled transactions will preserve their volume and some of the large-scaled deals, which have been expected to go through, will be concluded. Furthermore, the sales of the companies that have been transferred to the Savings Deposit Insurance Fund (SDIF) is another parameter that can affect the M&A volume in 2019. With regards to the private sector, energy, food, manufacturing and information sectors are the ones that are expected to be the most active. In respect of privatisations, the transactions concerning the companies that have been transferred to SDIF, the ports owned by the Turkish Maritime Organization, several electric generation facilities owned by EUAS and Spor Toto will be among the most prominent deals of the year, if they go through. Having noted the foregoing, the expectation for 2019 M&A volume is approximately USD 10 billion depending on whether the public sector transactions and large-scaled private sector transactions are concluded.

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Overview of corporate tax work over last year

Types of corporate tax work

The competence of the tax authorities has substantially increased over the past few years. Combined with the termination of the moratorium on tax audits of small and medium-sized businesses, the increased scope of tax audits during the last 12 months has resulted in more administrative (pre-litigation) and litigation corporate tax work.

One example is the aggressive review, during tax audits, of the depreciation of real estate as investment property. The tax authorities were aiming to deny the right to apply the method of "initial cost less accumulated depreciation" and insisted that the fair value model for accounting of investment property had to be applied in cases when the taxpayer carried out the revaluation of such property in the past, even before the respective "Accounting Standard for Investment property" was introduced in 2008.

Significant deals and themes

From its low point in 2016, Ukrainian M&A has recorded two consecutive years of double-digit growth, with the top 10 major deals dominating the metals & mining and agriculture sectors.[1]

It should be noted that information about some deals is not easily available in the public domain, while other deals are widely reported. As to the latter, substantial deals were concluded in the sphere of electricity production from renewable sources (with solar power plant projects dominating) and real estate and construction.

The year 2018 also saw a record volume of deals in the Ukrainian technology sector – IT companies and start-ups raised $323 million (excluding NDA deals). Thus, starting from 2013, Ukrainian IT companies have received a total of $1 billion in investments, which makes the country one of the top funding destinations in Central and Eastern Europe.[2]

Key developments affecting corporate tax law and practice

Ukrainian Parliament still rather frequently adopts laws amending the Tax Code, with roughly eight changes per year during the last three years.

The main changes related to CIT introduced in the Tax Code in 2018 and effective as of January 1, 2019 include:

- adoption of the "substance over form" principle in transfer pricing regulation; and
- prolongation of accelerated two-years' depreciation for machinery and equipment (group 4) purchased and put into operation in 2019.

Tax climate in Ukraine

The common perception is that the tax climate in Ukraine has improved over the past five years, especially with regard to tax administration, introduction of a transparent VAT refund system, and a more meaningful (as opposed to purely formal in the past) administrative procedure for the review of tax notification-decisions issued by tax authorities following tax audits.

Improvements in the review of tax audit results by the State Fiscal Service of Ukraine as the appeal body within the administrative procedure may also be attributed to the active work of the Business Ombudsman Council, funded through the Multi-Donor Account for Ukraine set up at the European Bank for Reconstruction and Development in 2014.

Developments affecting attractiveness of Ukraine for holding companies

While there is a special law regulating holding companies (the law "On Holding Companies in Ukraine"), the Tax Code does not recognise the special holding companies' regime. The relatively low flat CIT rate of 18% applies to all taxpayers, including those which in substance are holding companies. For CIT payers, investment income from other CIT payers and single taxpayers, including dividends from CIT payers, is excluded from taxable income. Investment losses in subsidiaries and joint ventures are not deductible for tax purposes.

For a number of reasons, Ukrainian investors often use offshore jurisdictions for establishing holding companies. However, two major recent changes in legislation may reduce such reasons, namely:

- adoption of a new law regulating limited liability companies (effective starting June 17, 2018, with the period for updating companies' by-laws until June 17, 2019) – the LLC law incorporates global best practices and provides regulation (including corporate governance, corporate/shareholders agreement, irrevocable PoA, flexible rules for shares transfers, prevention of hostile takeovers, etc.), that was earlier sought in other jurisdictions; and
- new law "On Currency and Currency Operations" (fully effective starting February 7, 2019) and subsequent regulations from the National Bank of Ukraine, aimed at lifting restrictions and liberalising foreign currency operations for both individuals and business entities.

The year ahead

The issues related to the future tax reforms have been subject to debate and constituted the cornerstone element of the election programmes of many Ukrainian political powers in 2018–2019. Currently discussed steps in the reformation of corporate taxation relate mainly to the following issues:

Exit Capital Tax ("ECT")

The most significant measure publicly discussed among political and business stakeholders is the tax on withdrawn capital aiming to replace the existing corporate income tax system. The main idea of the ECT (also referred to as the "Distributed Profit Tax") consists of making distributed profits taxable, namely income taken from the turnover of the enterprise in the form of dividends and equivalent operations rather than financial profits. Such fundamental changes in the corporate taxation system aim primarily to enhance the attractiveness of Ukraine for investment by decreasing both the general tax and administrative burdens. The

respective draft law was submitted to Parliament in July 2018 and was recommended by the special Parliament committee. Although the introduction of the ECT was one of the key measures of tax reform publicly declared and supported by the current President of Ukraine as part of his recent election campaign, as of today respective changes are still subject to debate. The main concerns are connected with the short-term fiscal impact of the CPT replacement, in particular the potential fiscal shortfall in the first years following the implementation of the ECT.

Implementation of BEPS Action Plan

In October 2018, the Ukrainian Ministry of Finance and National Bank of Ukraine announced the draft law on Implementation of the BEPS Action Plan in Ukraine ("BEPS Draft Law"). The BEPS Draft Law covers eight actions, including disclosure of holding in controlled foreign companies ("CFCs"), limitations for expenses in related-party transactions, preventing double tax treaties ("DTTs") abuse and further elaboration of transfer pricing control. It is anticipated that the BEPS Draft Law will serve not only as an effective instrument against tax abuses, but also as one of the crucial elements to be implemented within the liberalisation of the currency regulations under the new law "On Currency and Currency Operations". Thus, the lifting of the currently existing restrictions in the field of currency regulations, *inter alia*, the settlements deadline in goods export and import operations, is subject to the adoption of the BEPS counteraction law.

The BEPS Draft Law envisages the introduction of CFC taxation in Ukraine in order to prevent tax avoidance or evasion by means of international structuring. According to the wording of the Draft Law, the profits of a legal entity qualified as a CFC are subject to taxation in Ukraine proportionally to the individual's share interest in CFC capital. The Ukrainian resident natural person who controls the CFC undertakes to include the adjusted CFC's profits to his/her taxable income. Meanwhile, the individual will be qualified as controller if he/she (i) holds 50% or more of the shares in a CFC, (ii) takes *de facto* control over the foreign company, or (iii) holds a 25% share in a CFC and, jointly with other Ukrainian individuals, holds 50% or more of the shares in the CFC. The principle of taxation of CFC profits may also apply to entities having no legal personality, namely to funds, trusts, partnerships or other establishments.

Another issue that in the near future may significantly affect corporate taxation in Ukraine is the implementation of the MLI rules. The MLI was ratified by the Ukrainian Parliament on February 28, 2019. Ukraine included 76 DTTs to the list of treaties to be modified by means of the MLI (all DTTs except the treaty with Qatar, which was ratified this year). Ukrainian DTTs may be changed in regards to rules related to the definition of permanent establishment ("PE"), application of the principle purpose test, anti-abuse regulation for PEs situated in third jurisdictions and the 365-day rule for capital gains, as well as issues regarding the mutual agreement procedure ("MAP").

* * *

Endnotes

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Overview of corporate tax work over last year

Significant deals and themes

The following statistics are accurate as at July 2019.

Mergers & acquisitions (M&A)

The value of outward M&A in 2018 was £22.7 billion, which is considerably lower than the total outward M&A value in 2017 (£77.5 billion). There were no high-value deals above £10 billion in 2018 compared with two in 2017.

The total value of inward M&A in 2018 was £71.1 billion compared to £35 billion in 2017. The significant increase in value was due to a large acquisition that completed in 2018 when Comcast Corporation (US) acquired Sky PLC (UK) for just over £30 billion. In addition, the average value of inward M&A deals completed in 2018 by overseas companies was £17.8 billion compared with a smaller average value of £15.3 billion during 2017 to 2018.

The total value for domestic M&A during 2018 was £26.5 billion, the highest value recorded since 2008 (£36.5 billion). This increased value can be explained by a number of high-value transactions. One successful and high-valued transaction that occurred in 2018 was Tesco Plc (UK), which acquired Booker Group Plc (UK). A second very large-value domestic transaction that completed in 2018 was Melrose Industries Plc (UK), which acquired GKN Plc (UK). The average values of domestic M&A also saw a notable increase during 2018 (£6.6 billion) compared with an average value of £3.3 billion over 2013 to 2017.

In 2018, UK companies were involved in 272 acquisitions of foreign companies, primarily in Europe (141) and the Americas (92).[1]

Financing

In 2018, there were 79 IPOs listed in London (44 on the Main Market and 35 on AIM), raising £9.5bn. Aston Martin was the largest IPO to list in 2018, raising £1.1 billion of capital. This was followed by Smithson Investment Trust which raised £823 million. The year 2018 also saw 21 international companies list in London, raising £3.2 billion, which represents more international IPOs than all other major European exchanges combined.

The most active sectors for IPO activity in the UK in 2018 was financial services, with a 53% share of UK IPOs. Financials was also the leading sector by proceeds, accounting for 52% of funds raised, ahead of automobiles (11%) and software (11%).[2]

Real estate transactions

Total equity raised through REIT Equity Capital Market transactions in 2018 was approximately 45% lower than in 2017. However, there were several large real estate

transactions, the largest being a £315 million placing by Secure Income REIT plc. The largest IPO on the Main Market was the listing of Tritax Eurobox plc, valued at £300 million.[3]

Investment volumes for UK Commercial real estate reached £62.1 billion in 2018. This is 5.7% lower than 2017. Other than the leisure and alternatives sectors, all other real estate sectors saw a decline in investment. Alternatives and mixed-use real estate accounted for 29% of all investment, the highest proportion ever recorded.[4]

Transfer pricing and Diverted Profits Tax (DPT)

HMRC approximated that the annual amount of additional actual tax secured from transfer pricing challenges increased from £1,618 million in 2016/2017 to £1,682 million in 2017/2018.[5]

In addition, the Diverted Profits Tax yield figures published by HMRC have increased from 2016/2017 (£281 million) to 2017/2018 (£388 million). HMRC stated that the figures of DPT reflect amounts received "as a result of Diverted Profits Tax charging notices issued by HMRC, and additional amounts of Corporation Tax resulting from behavioural change". HMRC state that they continue to see a trend of businesses changing their structures or transfer pricing arrangements without an HMRC intervention occurring. This has resulted in additional corporation tax being paid instead of DPT at the higher rate.[6]

Key developments affecting corporate tax law and practice

The below section on UK tax law developments reflects a summary of the key developments in 2018, but it is not a comprehensive or detailed discussion of all tax measures in the past year. The legislation, case law and information stated below is accurate as at July 2019.

Domestic legislation

Digital taxation

The UK will introduce a digital services tax (DST) from 1 April 2020 as a temporary response to the tax challenges arising from digitalisation, with a proposed 2% tax on UK revenues (not profits) on specific digital businesses. Draft legislation of the DST has been included in the Finance Bill 2019–2020.

The DST will be levied on "in scope activities", namely: (a) social media platforms, i.e. targeting revenues from businesses that monetise users' engagement with the platform; (b) search engines, i.e. targeting platforms that generate revenue by monetising users' engagement with the platform and with other closely integrated functions; and (c) online market places, i.e. targeting businesses which generate revenue by using an online market place platform to allow users to advertise, list or sell goods and services on such platform. Certain businesses are specifically excluded from the definition of in-scope activities, including the provision of financial or payment services, the sale of own goods online and the provision of online content.

The DST focuses on the participation and engagement of users as an important aspect of value creation for digital business models. A key issue of the proposed approach will be how to determine user-created value and attribute profits to user participation. The attribution of profits will be difficult to calculate and further guidance will be required on the mechanical rules of apportionment. In addition, it will be challenging to allocate profits between the UK and different jurisdictions, particularly as international rules develop in relation to the taxation of digital services.

The DST is designed to ensure digital businesses pay tax reflecting the value they derive from the participation of UK users. User participation refers to the process by which users

create value for certain types of digital businesses through their engagement and participation. The proposed definition of "user" is broad and will include an individual, a company or any other legal person who participates with an in-scope business activity. As digital business models develop, it is expected that the range of business affected by the user participation concept will expand.

High financial thresholds are proposed for the DST. The DST will only be payable by businesses whose global revenues from the in-scope activities are at least £500 million. Tax will not be levied on the first £25 million of revenue from in-scope business activities linked to the participation of UK users. Additionally, there is a safe harbour provision for low margin and loss-making businesses, which allows for a reduced rate of tax to be paid. The thresholds are based on an expectation that the value derived from users will be more material for large digital businesses, which have established a significant UK user base, and generate substantial revenues from that user base. In addition, the thresholds are intended to ensure that the DST does not place unreasonable burdens on small businesses.

UK real estate tax – implications for funds

Background

The Government published a consultative paper in November 2017 proposing that non-resident investors in UK real estate should be brought within the scope of UK tax with effect from April 2019.

From April 2019, all non-UK resident persons will be taxable on gains on disposals of interests in any type of UK land or buildings. Changes introduced will apply not only to disposals of directly owned interests in UK land or buildings, but also to disposals of indirectly owned interests, i.e., the sale of interests in entities whose value is derived from UK land and buildings. All non-UK residents, whether liable to Capital Gains Tax (CGT) or corporation tax, will be taxable on gains on disposals of directly held interests in any type of UK land. Non-UK residents will also be taxed on any gains made on the disposals of significant interests in entities that directly or indirectly own interests in UK land. For tax to be imposed, the entity being disposed of must be "property rich", and the non-UK resident must be a "substantial investor".

A non-UK resident is a substantial investor in a property rich entity if, at the date of disposal or at any time within two years prior to disposal, the non-UK resident holds, or has held directly or indirectly, at least a 25% interest in a property rich entity. If the non-UK resident holds the 25% interest for an insignificant time period (relative to the total ownership within two years prior to the disposal), the 25% test will not be met. The 25% interest is determined by voting rights, income rights, rights on a winding up and rights to proceeds on a sale.

An entity is property rich if at least 75% of the gross market value of its qualifying assets at the time of disposal are derived from UK land. The legislation contains tracing and attribution of value provisions in connection with deriving the market value of a company.

The existing provisions of the Taxation of Chargeable Gains Act 1992 (TCGA) Part 1 have been amended, along with the introduction of a new charge to CGT or corporation tax on non-UK resident persons making gains on direct or indirect disposals of UK property.

Implication for funds

The above changes have a specific and significant impact on funds. The default position for collective investment vehicles (CIVs) will be that they are treated for capital gains purposes as if they were companies. The CIV definition in the legislation is broad, and should capture most UK property rich Jersey Property Unit Trusts (JPUTs) and Guernsey Property Unit Trusts (GPUTs), as well as widely-held offshore funds.

An investment in such a fund will be treated as if the interests of the investors were shares in a company, so that where the fund is UK property rich, a disposal of an interest in it by a non-UK resident investor will be chargeable to UK tax under the new rules. CIVs will be subject to corporation tax after April 2020 as a result of being treated as companies.

Non-UK resident investors in CIVs that are UK property rich will be chargeable on gains on disposals of an interest in a UK property rich CIV regardless of their level of investment. They will not benefit from the 25% ownership threshold.

The usual 25% substantial indirect interest test may be re-applied for certain funds where the CIV is only temporarily UK property rich. In these cases, the fund will need to meet a genuine diversity of ownership or non-close test, and be targeting UK property investments of no more than 40% of fund gross asset value in accordance with its prospectus or other fund documents.

Transparency and exemption elections

CIVs that are already treated as transparent for tax purposes will be able to elect (irrevocably) to be treated as a partnership for the purposes of capital gains (and related provisions), thereby ensuring that the investors are taxed on disposals of the underlying assets of the partnership.

An investor who is exempt from capital gains (e.g., pension funds and sovereign wealth funds) would therefore be able to directly claim exemption on the disposal of assets by the CIV. In the case of a fund existing at 6 April 2019, the election must be made by 5 April 2020.

Under the election for exemption, the CIV itself will not suffer tax on either direct or indirect disposals on the proportion of any gains attributable to the CIV holding UK land. The investors remain taxable on any disposal of an interest in a CIV that is a UK property rich entity.

The election for exemption is not available to all funds. It is only available to non-UK resident companies that are the equivalent of UK REITs and some partnerships. An extensive set of qualifying criteria needs to be met in order to be able to make the election for exemption. Where a CIV ceases to meet any of the qualifying criteria, this will trigger a deemed disposal and reacquisition of the interests of all the investors in the CIV.

CIVs will be required to make annual filings with HMRC providing details of the CIVs' investors and disposals.

Offshore receipts in respect of intangible property

New "offshore receipts in respect of intangible property" (ORIP) rules took effect from 6 April 2019. A charge to tax applies to "UK-derived amounts" if, at any time in the tax year, a person is not resident in the UK or a full treaty territory and such UK-derived amounts arise to them. A UK-derived amount is an amount made in respect of the enjoyment or exercise of intangible property rights where the enjoyment or exercise of those rights (or rights derived directly or indirectly from those rights) enables, facilitates or promotes UK sales. UK sales means any services, goods or other property either provided in the UK, or to persons in the UK. Subject to some exemptions, income tax is chargeable on the full quantum of the UK-derived amounts arising in the tax year. The person liable for the tax charge is the person receiving, or entitled to receive, the UK-derived amounts.

The new rules are designed so that a charge to UK income tax will arise to a foreign entity where UK sales supported by intangible property (or rights over that property) are held by an entity in a no- or low-tax jurisdiction. For example, where a non-UK entity receives income from the sale of goods or services in the UK, and that entity makes a payment to the

holder of intangible property in a low-tax jurisdiction, a charge will arise under this measure to the extent that the income receivable in the low-tax jurisdiction is referable to the sale of goods or services in the UK.

A tax exemption applies if income, where the tax payable by the foreign entity in relation to income that is referable to the sale of goods or services in the UK, is at least 50% of the UK income tax charge that would otherwise arise. In addition, there is a £10 million *de minimis* UK sales threshold. Targeted anti-avoidance rules will have effect for arrangements entered into on or after 29 October 2018.

Draft regulations to the ORIP rules have been released, alongside draft guidance, for consultation. The consultation period will run until 19 July 2019. The proposed amendments contained in the draft regulations include a new "specified territory" exemption and a new look-through rule for resellers of UK sales. These proposed amendments will take effect retrospectively to the commencement of the rules (6 April 2019).

Intangible fixed assets

The Intangible Fixed Assets (IFA) regime is the UK's main body of corporation tax rules for the taxation of identifiable intangible assets and goodwill. It gives companies relief for the cost of acquiring such assets by allowing a deduction from income for the amortisation and impairment debits recognised in a company's accounts. It also taxes receipts in respect of IFAs, including disposal proceeds, as income.

The UK Government underwent a consultation in early 2018 on the corporate IFA regime. The scope of the consultation was to review the IFA regime and to consider potential reforms.

The Finance Act 2019 introduced two important changes to the IFA regime; namely, the ability to defer IFA degrouping charges for "relevant disposals", and a reinstatement of amortisation relief for goodwill and other customer-related intangibles in the context of IP-intensive business acquisitions. This reform will be welcomed, although more reform will be required involving the alignment of the rules between post-2002 intangibles and pre-2002 intangibles.

Corporate interest and debtor relationships

The Corporate Interest Restriction (CIR) was introduced in the Finance Act (No. 2) 2017. The aim of the CIR rules is to restrict a group's deductions for interest expense and other financing costs to an amount which is commensurate with its activities taxed in the UK, taking into account how much the group borrows from third parties.

Schedule 11 of the Finance Act 2019 makes a number of changes to the CIR legislation that is contained in TIOPA 2010. Most of the changes made by Schedule 11 have been made to ensure that the legislation works as it was intended in response to industry representations. The majority of such changes take effect for periods of account of worldwide groups beginning on or after 1 January 2019.

Entrepreneurs' relief

A number of changes were introduced relating to entrepreneur's relief (ER), namely: (i) an increase in qualifying holding period; (ii) dilution; and (iii) the 5% shareholding test.

In order to be eligible for ER on interests in companies, a minimum shareholding of 5% and director or employee status in the company must be met throughout a minimum period immediately preceding a disposal of shares or securities. This period increased from 12 months to 24 months in respect of disposals on or after 6 April 2019.

As the tests for ER need to be satisfied for a two-year period prior to disposal, ER could

cease to be available if an individual's shareholding is diluted below 5% due to a company issuing further shares. From 6 April 2019, if the further share issue is made for commercial reasons, ER will remain available on the gain accrued on shares or securities up to the point an individual's shareholding falls below 5% due to the share issue.

The 5% shareholding test used to be based on a requirement for an individual to own at least 5% of the ordinary share capital in the company, and by virtue of that shareholding, to be able to exercise at least 5% of the voting rights in the company. The test has now been extended to include a requirement for the individual to be entitled to receive either: (i) 5% of the dividends and assets available to "equity holders" on a winding up of the business; or (ii) 5% of the sale proceeds due to holders of ordinary shares on a notional disposal of the company.

Offshore time limits

Sections 80 and 81 of the Finance Act 2019 amended the Taxes Management Act 1970 and the Inheritance Tax Act 1984 to extended time limits for assessing income tax, capital gains tax and inheritance tax in circumstances where a loss of tax arises out of, or involves, an "offshore matter" or "offshore transfer". The behaviour can be non-deliberate. For deliberate behaviour, the current maximum time limit of 20 years pursuant to the Taxes Management Act 1970 will remain regardless of whether offshore matters are involved or not.

Profit fragmentation

Schedule 4 of the Finance Act 2019 introduced new rules to target tax arrangements through which UK resident individuals (or in some cases, companies) carrying on a business, transfer a disproportionate part of their profits to offshore entities in low-tax jurisdictions and whereby the individual or a related individual gets, or could get, some kind of benefit from the value transferred.

The aim of the new provisions is to extend the existing transfer pricing rules, to address artificial profit splitting arrangements entered into by individuals, partnerships or companies that intend to move profits out of the charge to UK tax by arranging for them to be attributed to offshore persons or entities.

Broadly, these rules apply where: (i) there is a provision between a UK resident entity and an overseas entity; (ii) as a result of the provision, value is transferred from the UK resident entity to the overseas entity which derives from the profits of a UK trade; (iii) the value transferred is greater than an arm's length price; (iv) the enjoyment conditions are met in relation to a related individual; and (v) there is a tax mismatch (broadly the extra tax payable overseas is less than 80% of the reduction in UK tax). These new rules came into effect in respect of value transferred on or after 1 or 6 April 2019 for corporation tax and income tax purposes, respectively.

NICs treatment of termination payments

The Finance (No. 2) Act 2017 enacted changes to the taxation of termination payments to align the rules for income tax and employer NICs by making an employer liable to pay national insurance contributions on any part of a termination payment they make to an employee that exceeds the £30,000 threshold.

The UK Government has confirmed that delayed introduction of the National Insurance Contribution Bill means employer national insurance contributions on payments above £30,000 will not apply until 6 April 2020.

Domestic case law

The below cases are a sample of significant recent tax cases. *HMRC v Joint Administrators of Lehman Brothers International* outlines the circumstances in which statutory interest can be regarded as yearly interest. The case of *Development Securities v HMRC* is a continuation of cases in connection with corporate tax residence and provides a comprehensive analysis of the law relating to the "central management and control" test. The case of *Stephen Warshaw v HMRC* is significant as it concerns the circumstances whereby cumulative preference shares may fall within the definition of ordinary share capital. Finally, the recent case of *Hannover Leasing Wachstumswerte Europa Beteiligungsgesellschaft and another v HMRC* confirmed that the stamp duty land tax general anti-avoidance provisions apply in situations where the relevant arrangements are not tax avoidance arrangements.

HMRC v Joint Administrators of Lehman Brothers International [2019] UKSC 12

The Supreme Court's decision in this case reviews the statutory background to the yearly interest provisions and case law going back to *Bebb v Bunny* (1854) 1 K&J 216.

Agreeing with the Court of Appeal, the Supreme Court found that statutory interest paid under the Insolvency Rules 2016 rule 14.23(7) is yearly interest subject to a deduction of tax at source under ITA 2007 section 874.

The administration of Lehman Brothers had generated an unprecedented surplus after payment of all provable debts, amounting to approximately £7 billion, of which circa £5 billion was estimated to be payable by way of statutory interest (before any deduction of income tax). The periods in respect of which interest was payable under rule 14.23(7) ranged from around four years (which expired when the first interim distribution to proving creditors was made) and five-and-a-half years, when the final dividend to creditors was made. The pertinent question was whether or not statutory interest payable by administrators to creditors out of a surplus is "yearly interest".

The Supreme Court noted that the statutory interest in this case shared many of the relevant features with the contractual provision for interest in *Chevron Petroleum (UK) Ltd v BP Petroleum Development Ltd [1981] STC 689.* Similarly, in both cases (a) it could not be determined whether interest would be payable in respect of the period in which it was calculated, and (b) there was no liability to pay interest during the period in respect of which it was calculated, as it was rolled up and payable in a single lump sum. The relevant question in this case was: "*what period of durability is to be identified for interest payable in a single lump sum as compensation for the payee being out of the money in the past, for the purpose of deciding whether it is to be treated as yearly interest?*" Applying the principles in *Hay (1924) VIII TC 636*, the Supreme Court concluded that the relevant period was the period in respect of which the interest was calculated, because that was the period during which the loss of the use of money had been incurred, for which the interest was compensation.

It is significant that the Supreme Court identified the categories of yearly interest assessment as the determination of whether (a) interest which accrues over time is yearly interest, and (b) an entitlement to money described as interest but which does not accrue over time can be regarded as yearly interest. This case concerned the second category as the statutory interest did not arise on borrowed money, nor did it accrue over time. Accordingly, this decision may be relevant to consideration, for example, of whether interest paid for late completion of a property or share purchase is yearly interest, or whether interest payable on a judgment (for the period between the damages occurring and judgment being given) is yearly interest.

Development Securities plc and other companies v Revenue and Customs Commissioners [2019] UKUT 169 (TCC)

Corporate tax residence is an area of enduring enquiry and focus for HMRC in the UK. This case provides a reminder of the steps that should be taken to ensure that a foreign company does not unintentionally become UK tax resident.

In Development Securities, three Jersey companies had been incorporated for the purpose of implementing arrangements for crystallising latent capital losses in certain property assets and, thereby, obtaining capital loss relief in respect of the same. Importantly, the effectiveness of the arrangements relied on the Jersey companies being tax resident in Jersey (and not in the UK) during the relevant period. As non-UK incorporated companies, this required the "central management and control" (CMC) of each subsidiary to be located in Jersey. The CMC test generally looks to where high-level executive decisions are made (including policy and strategy). The issue in dispute was whether the subsidiaries were, in fact, Jersey tax resident or UK tax resident under the CMC test.

The case law relating to company residency was set out in *De Beers Consolidated Mines v Howe [1905] 5 TC 198*. Following consideration of *De Beers* and other relevant cases, the First-tier Tribunal held that key decisions to acquire assets at an overvalue, and then move control of Jersey companies back to the UK, were taken by the parent company in the UK. The Jersey board in effect "rubber stamped" the key decisions.

However, the Upper Tribunal has recently overturned the First-tier Tribunal's decision, finding in the taxpayer's favour that the Jersey incorporated special purpose vehicles were centrally managed and controlled in Jersey at the material times and were not therefore UK tax resident.

Development Securities might be viewed as having been decided on its particular facts as any CMC analysis is highly fact-sensitive. However, this series of cases provides a comprehensive restatement of the issues relating to the CMC test and is a reminder on the importance of the scrutiny to be expected regarding company residence.

Stephen Warshaw v HMRC [2019] UKFTT 08674 (TC)

In this case, the First-tier Tax Tribunal found that preference shares could make up part of the shareholder's holding in 'ordinary share capital' for the purposes of the application of entrepreneur's relief (ER). Ordinary share capital is defined in section 989 of the Income Tax Act 2007 (ITA) as follows: "*ordinary share capital, in relation to a company, means all the company's issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits.*"

The issue in this case was whether the preference shares held by Mr Warshaw were "ordinary share capital" as defined by section 989 ITA. If so, Mr Warshaw would have been entitled to ER on the disposal of his shares. It was accepted that the relevant shares gave a right to a dividend and that there were no other rights to share in the profits. Accordingly, the key consideration was whether the preference shares had a right to dividends at a fixed rate. The preference shares carried the right to a fixed (10%) and cumulative dividend. If there were insufficient reserves to pay dividends in a particular year, the company's articles of association provided that payment would be deferred to a subsequent year. In this event, the dividend would constitute 10% of an increased amount, being the sum of the subscription price and the aggregate unpaid dividends. The unpaid dividend was compounded until it was eventually paid.

HMRC argued that as the rate of the dividend remained fixed, the shares could not be ordinary share capital. However, the Tribunal agreed with Mr Warshaw's counsel and stated that both the percentage element and the amount to which it is applied to identify the rate of the dividend need to be taken into account. Accordingly, if, as in the present case, at the time the preference shares are issued the Articles of Association provide that only one of these, the percentage element, is fixed and the amount to which that percentage is to be applied may vary, those shares cannot be regarded as having a right to a dividend at a fixed rate and are therefore ordinary share capital, as defined by section 989 ITA.

This case is significant because most cumulative preference shares provide for compounding and accordingly may fall within the definition of ordinary share capital. This is particularly relevant in determining the percentage of ownership of ordinary share capital for grouping purposes in addition to the application of particular tax reliefs including ER, the substantial shareholding exemption and the dividend exemption.

Hannover Leasing Wachstumswerte Europa Beteiligungsgesellschaft and another v HMRC [2019] UKFTT 262

The First-tier Tribunal found that section 75A of the Finance Act 2003 applied to a series of transaction steps and the stamp duty land tax (SDLT) liability on the "notional transaction" was £5,554,000, as compared to the SDLT paid of £55,540 in respect of the disregarded transactions.

- The structure of the transaction

Greycoat Central London Office Development LP (GCLOD) was established in 2006 as a fund backed by a small group of investors and managed by a company in the Greycoat group. GCLOD was established to acquire, develop, and invest in offices in central London, and particularly in this case, 30 Crown Place (the "Property").

A Guernsey Unit Trust (GPUT) was set up and its units issued to GCLOD (99.7%) and Greycoat Unitholder Limited (0.3%). The GPUT was tax resident in Guernsey. The GPUT was structured as a "Baker trust" and, as such, its income did not form part of the trust fund, but was instead allocated to unitholders *pro rata* to their holding of units. Accordingly, the GPUT was "fiscally transparent" as regards income. The GPUT units are not chargeable interests in land and, accordingly, the sale of the units would be outside the scope of SDLT.

The trustee of the GPUT was at all material times the sole limited partner in the Greycoat Partnership (a limited partnership established under English Law). The sole general partner of the Greycoat Partnership was Greycoat Crown Place General Partner Limited (General Partner), a company incorporated in England and tax resident in the UK. Profits of the Greycoat Partnership were allocated as 99% to the GPUT and 1% to the General Partner. The Greycoat Partnership acquired the Property.

Hannover (a German real estate fund) offered to acquire the GPUT units via a number of transaction steps, i.e.: the sale of the Property by the Greycoat Partnership to the GPUT; the sale of the units in the GPUT to Hannover; and the distribution *in specie* of the Property to Hannover by the GPUT.

- Sections 75A – 75C Finance Act 2003

The transaction steps described above did not result in a substantial SDLT charge. The issue before the Tribunal was whether the anti-avoidance provisions in sections 75A–75C of the Finance Act 2003 applied in relation to the present transaction, such that SDLT would be payable on the "notional transaction".

The anti-avoidance provision in section 75A(1) applies whereby:

Section 75(A)(1)

...

(a) one person (V) disposes of a chargeable interest and another person (P) acquires either it or a chargeable interest deriving from it,

(b) a number of transactions (including the disposal and acquisition) are involved in connection with the disposal and acquisition ("the scheme transactions"), and

(c) the sum of the amounts of stamp duty land tax payable in respect of the scheme transactions is less than the amount that would be payable on a notional land transaction effecting the acquisition of V's chargeable interest by P on its disposal by V.

The Tribunal stated that the "*mechanism of s75A is to compare the SDLT payable as a result of the individual 'scheme transactions'... with the SDLT that would be payable on a 'notional land transaction'*". The Tribunal concluded that pursuant to section 75A(1), V was the Greycoat Partnership and P was Hannover. The Greycoat Partnership was V because it was the owner of the property immediately prior to the series of steps that make up the scheme transactions. Hannover was P on the basis that it was always intended to be the "final destination" of the property.

The Tribunal stated that section 75A is to be interpreted purposively but did not accept that a tax avoidance scheme or unintended tax loss which exploits a loophole in the statutory provisions has to be present for section 75A to apply. Accordingly, a tax avoidance motive is not required for section 75A to apply.

The Tribunal opined that HMRC's guidance in connection with section 75A was either "irrelevant or wrong". It was further stated that Hannover may have had a legitimate expectation that the series of transactions entered into were appropriate based on HMRC guidance pertaining to section 75A, which is an issue that can only be resolved by judicial review. The relevant HMRC guidance states that "*Section 75A is an anti-avoidance provision. HM Revenue & Customs (HMRC) therefore takes the view that it applies only where there is avoidance of tax. On that basis, HMRC will not seek to apply s.75A where it considers transactions have already been taxed appropriately*". The Tribunal noted that HMRC do not have the power to narrow the operation of legislation by guidance – this can only be achieved by amending the relevant legislation. HMRC are currently in the process of updating the section 75A guidance but the points made in this case in relation to the reliance on HMRC guidance will be important for taxpayers and advisers to take into account.

European – EU law developments

The below section on EU tax law developments reflects a summary of the key developments in 2018, but it is not a comprehensive or detailed discussion of all measures in the past year. The law and information stated below is accurate as at May 2019.

Brexit update

The UK voted to leave the EU in a referendum on EU membership. On 29 March 2017, the Prime Minister triggered Article 50 of the Treaty on European Union which in turn started a two-year period for the negotiation and conclusion of a UK-EU withdrawal agreement.

The UK's exit from the EU was due to take place on 29 March 2019 but this has since been extended. The EU Withdrawal Act 2018 is now in place. This Act intends to transpose EU law into domestic law on the day which the UK leaves the EU.

The UK and the EU have agreed the terms of the UK's withdrawal (the "Withdrawal Agreement"). The Withdrawal Agreement provides for an interim "transition period"

following the day on which the UK leaves the EU until 31 December 2020, during which all benefits and obligations of EU membership will still apply to the UK, although the UK will not take part in the decision-making process anymore.

The Withdrawal Agreement has to date been rejected by UK MPs. The Withdrawal Agreement, or any renegotiated deal, must be approved by Parliament before it can be ratified.

Digital taxation – OECD and EU updates

The OECD published its interim report on the Tax Challenges arising from Digitalisation on 16 March 2018.

The report noted that the BEPS 2015 Action 1 Report identified a number of broader tax challenges raised by digitalisation (notably, in relation to nexus, data and characterisation). However, there are challenges to be addressed that go beyond BEPS and relate to the question of how taxing rights on income generated from cross-border activities in the digital age should be allocated.

On 13 February 2019, the OECD published its consultation document, which was followed by a Public Consultation meeting in Paris on 13 and 14 March 2019. A number of further meetings have been organised over the remainder of 2019, and the OECD aims to issue its final recommendations for a global solution (ideally a consensus-based long-term solution) in 2020.

The EU Commission published two proposals for the taxation of the digital economy in March 2018. The first was based on a long-term solution that proposed to tax a "*digital permanent establishment*", whilst the second was a short-term proposal which would apply to revenues created from certain digital activities. In March 2019, the Economic and Financial Affairs Council of the EU failed to reach a consensus on a way forward. It seems likely that there will be no EU-agreed approach until at least 2020. In the meantime, a number of EU Member States have introduced or are considering introducing national, unilateral measures, including Austria, France, Spain, Italy and the UK.

Economic substance

In 2017, new economic substance requirements were introduced by the Code of Conduct Group (CoCG). Broadly, the requirements are aimed at ensuring that companies have the necessary substance, by which:

(a) they are directed and managed from the relevant jurisdiction;

(b) they carry out their "core income generating activities" in the relevant jurisdiction; and

(c) they have adequate people, premises and expenditure in the relevant jurisdiction.

From 1 January 2019, the British Virgin Islands, the Cayman Islands, Guernsey, Isle of Man and Jersey have all introduced economic substance requirements for companies resident in their jurisdictions.

Directive on Administrative Cooperation (DAC 6)

The Directive on Administrative Cooperation (DAC 6) is a further measure aimed at tackling perceived tax avoidance. DAC 6 imposes mandatory reporting of cross-border arrangements affecting at least one EU Member State that fall within one of a number of "hallmarks". The reporting obligations fall on "intermediaries". DAC 6 is very broad in scope and, as such, there is a concern that DAC 6 applies to standard transactions with no particular tax motive.

The first notifications will be due in August 2020, but DAC 6 provides that notifications should be made in respect of arrangements dating back to 25 June 2018. Notwithstanding Brexit, the UK has committed to implementing DAC 6.

Intermediaries are defined as anyone who "designs, markets, organises or makes available for implementation or manages the implementation" of a reportable arrangement. Those caught include (but are not limited to) financial advisers, lawyers, financial institutions and accountants. The relevant disclosures need to be made within 30 days from the date of implementation of the arrangement.

The hallmarks are widely drawn and leave a lot of room for debate as to whether many "ordinary" transactions and structures will be reportable. They are broad categories setting out particular characteristics identified as potentially indicative of aggressive tax planning. However, arguably the hallmarks make it an almost catch-all approach to tax planning and cross-border transactions.

Financial Transaction Tax (FTT)

The EU FTT was initially proposed by the European Commission in the wake of the financial crisis. In February 2013, the European Commission issued a proposal for a common set of rules for a Council Directive that would create an EU FTT for the 10 Member States that had agreed to participate in the Enhanced Cooperation Procedure. The tax would be imposed at fixed rates on certain transactions involving financial instruments such as shares, bonds and derivative contracts.

France and Germany also put forward a simplified FTT proposal for the European Union in a joint economic roadmap. The proposed tax would be similar to the system currently used in France, which levies a tax on stock transactions in listed companies with a market capitalisation of more than €1 billion. No consensus has been reached in relation to the proposed Franco-German FTT proposal.

BEPS update

In 2018, the UK has continued its implementation of the Base Erosion and Profit Shifting (BEPS) measures. An update on the implementation status of certain key BEPS measures is outlined below:

Action 1: Addressing the Tax Challenges of the Digital Economy – The UK Government announced that it will introduce a digital services tax from 1 April 2020.

Action 2: Hybrids – The UK has introduced hybrid mismatch rules and these rules closely follow the OECD's recommendations. The UK has made further amendments to these rules as a result of the EU-wide implementation of the Anti-Tax Avoidance Directive (ATAD), specifically in relation to Article 9(5) ATAD II (treatment of disregarded permanent establishments) and Article 9(4) ATAD II (exemption of certain regulatory capital).

Action 3: CFC Rules – Finance Act 2019 contains the latest UK CFC legislation amendments required by the introduction of the ATAD.

Action 4: Interest Deductions – The restriction on tax deductibility of corporate interest expense consistent with OECD recommendations was introduced on 1 April 2017, well in advance of other EU and OECD countries. The complexity of these rules is such that further and regular amendments are required to make them fit for purpose.

Action 13: Transfer pricing documentation and country-by-country reporting – The UK is party to the automatic exchange of country-by-country reports, and as of June 2017, has activated 39 exchange relationships. There has also been a harmonisation of multi-jurisdictional group business documentation.

Action 15: Multilateral Instrument – the MLI has now been implemented in the UK, the effect of which is to enable countries to implement the recommendations contained in the

relevant BEPS actions into double tax treaties. Other countries are now also ratifying the instrument and thereby enacting amendments into bilateral tax treaties. A key focus of discussion has been on the application of the "principle purpose test".

Developments affecting attractiveness of the UK for holding companies

Tax climate in the UK

The UK has continued to experience a period of uncertainty as a result of Brexit and the lack of any clear direction for the UK's departure from the EU. A significant (and unclear) change will be the effect of Brexit on the trading ability of businesses in relation to the loss of EU directives and the consequent impact for EU-wide tax planning. New tax measures continue to be imposed, particularly in relation to the implementation of the BEPS project and measures aimed at promoting cross-border tax transparency. The UK Government announced the introduction of a Digital Services Tax, but there are many questions as to its practical application.

The new provisions in relation to profit fragmentation and offshore receipts in respect of intangible property highlight the wide powers that the UK tax authorities will have to combat tax avoidance. DAC 6 and the CoCG economic substance requirements will also have a significant impact on compliance obligations for many organisations.

Industry sector focus

Overseas property investors

The UK continues to be one of the most mature and diverse real estate markets in the world, but the numerous changes to the UK real estate tax provisions will potentially impact the economic return for overseas investors, and therefore such investors may need to adapt their financial models to take into account the relevant new tax charges.

Finance

There are a number of legislative and regulatory issues to consider in order to preserve the UK financial sector's trading power in connection with the UK's exit from the EU. Maintaining passporting arrangements between the UK and the single market will be incredibly important in any future trade negotiations, as the outcome will be relevant to the ability of UK-based institutions to export financial services into the EU.

Access to EU Directives has been part of the standard toolkit for EU cross-border tax planning, and any consequent loss of access following Brexit will have a negative impact. For example, the UK could no longer benefit from the EU's Parent-Subsidiary Directive (which, *inter alia*, allows group companies to pay dividends between subsidiaries without being subject to withholding taxes) following Brexit. Accordingly, organisations will need to consider how this may impact repatriation of their profits and the extent to which tax treaties can ameliorate the issue.

The banking sector has been targeted to raise revenue in the UK ever since the financial crisis, and the bank levy is an example of this. The UK Government confirmed that it would re-scope the bank levy from 2021, but the UK may be less attractive for large banks given the application of the bank levy and the uncertainty over Brexit.

Oil and gas

In the Autumn 2017 Budget, the UK Government announced that it will introduce a transferable tax history ("TTH") mechanism for UK Continental Shelf oil and gas producers.

This is to allow companies selling North Sea oil and gas fields to transfer some of their tax payment history to the buyers of those fields. The buyers will then be able to set the costs of decommissioning the fields at the end of their lives against the TTH. The Finance Act 2019 included provisions to enable a seller's tax history to be transferred on the sale of an interest in a UK oil licence, thereby enabling the buyer to set the decommissioning costs of the field against the TTH. The petroleum revenue tax rules were also amended to allow a deduction for decommissioning costs.

The year ahead

The outcome of Brexit negotiations are uncertain and this ambiguity will continue to impact UK industry. The challenging political climate means that companies are not only having to consider various potential Brexit deals, but may also have to be prepared to implement opposition party proposals in the event of a change in Government.

Brexit aside, the UK tax authorities continue to use extensive powers to counteract perceived tax avoidance, on a UK-wide and global level. Companies need to be prepared for increased scrutiny on arrangements and structures which previously would have been considered as *bona fide* commercial tax planning. The introduction of the digital services tax in the UK is the most recent measure to deal with the tax challenges arising from digital businesses. Draft legislation of the DST has recently been published in the Finance Bill 2019–2020 but the impact of the DST in the UK remains to be seen, as well as how it will interact with similar measures on an EU-wide and global level.

* * *

Endnotes

1. https://www.ons.gov.uk/businessindustryandtrade/changestobusiness/mergersandacquisitions/bulletins/mergersandacquisitionsinvolvingukcompanies/octobertodecember2018#main-points.
2. https://www.ey.com/uk/en/newsroom/news-releases/19-01-08-london-ipos-listings-slow-in-2018-amid-brexit-uncertainty.
3. https://assets.kpmg/content/dam/kpmg/uk/pdf/2019/01/look-back-face-forward-real-estate-review-predictions.pdf.
4. https://www.savills.co.uk/research_articles/229130/277331-0.
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6. *Ibid.*

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Introduction

Since December 22, 2017, corporate tax practitioners in the United States have been predominantly focused on the impact of legislation commonly known as the Tax Cuts and Jobs Act (the "Act"), which was signed into law on that date. In the ensuing months, the U.S. Treasury Department ("Treasury") and the Internal Revenue Service (the "IRS") have had the monumental task of issuing Treasury Regulations addressing the numerous provisions of the Act. In the meantime, prior to the release of regulatory guidance, corporations and practitioners alike have been grappling with how to implement the modifications to the Internal Revenue Code of 1986, as amended (the "Code").

The Act was promulgated over 18 months ago, so our focus will be on the key regulatory guidance that has been released in the past year rather than on the provisions of the Act itself.

Deemed dividend inclusions under Section 956

Under Section 956,[1] a U.S. 10% shareholder of a controlled foreign corporation ("CFC") that has made investments in certain U.S. property is deemed to have dividend income based on the U.S. 10% shareholder's *pro rata* share of the CFC's investment in U.S. property. Section 956 provides that investments in U.S. property include obligations of the U.S. 10% shareholder. Under applicable regulations,[2] an obligation includes a pledge by the U.S. 10% shareholder of more than 65% of the voting stock of the CFC as well as a guarantee of the debt of such U.S. 10% shareholder by the CFC.

One of the key features of the Act is Section 245A, which introduced a modified territorial tax system by including a participation exemption pursuant to which corporate U.S. 10% shareholders of certain foreign corporations, including CFCs, are entitled to a 100% dividends-received deduction for dividends distributed to the U.S. shareholder. Unexpectedly, however, the Act did not modify Section 956, meaning that corporate U.S. 10% shareholders of a CFC continued to be taxed on deemed dividend income, even though an actual dividend would have been eligible for a 100% deduction.

The IRS issued proposed regulations in November 2018[3] (the "Proposed 956 Regulations"), which were finalised in May 2019[4] (the "Final 956 Regulations"). These regulations are intended to reconcile Section 956 and the participation exemption. The Final 956 Regulations are effective as of July 22, 2019. Although taxpayers were entitled to rely on the Proposed 956 Regulations until finalised, in practice many taxpayers did not do so. The Final 956 Regulations provide that for corporate U.S. 10% shareholders of a CFC, the amount of income inclusion determined under Section 956 is reduced to the extent the shareholder would have been eligible for a dividends-received deduction under Section 245A

if the shareholder had actually received a dividend in the same amount. The Final Regulations also include changes to the ordering rules of previously taxed income under Section 959. The net effect of the Final Section 956 Regulations is that, in general, a corporate U.S. 10% shareholder should no longer face deemed dividend income consequences by pledging voting stock of its CFC or having its CFC guarantee the shareholder's obligations. The same is not true, however, for non-corporate U.S. 10% shareholders (e.g., partnerships) – because Section 245A does not apply to these shareholders, they must still contend with Section 956.

Transition tax

The implementation of the modified territorial system resulting from the introduction of the dividends received deduction under Section 245A required certain transition rules to rationalise the old and new taxing regimes, including a so-called "transition tax" on the previously untaxed earnings of certain foreign corporations. This result is accomplished under new Section 965 by increasing the Subpart F income of these foreign corporations for their last taxable year beginning before January 1, 2018 by the greater of the "accumulated post-1986 deferred foreign income" determined as of November 2, 2017 or December 31, 2017. The corporation's asset mix determines the applicable rate of tax – earnings held in the form of cash and cash equivalents are subject to tax at a higher 15.5% rate, as compared to an 8% rate on other earnings. In addition, under Section 965(h), a taxpayer can elect to make payments of the transition tax over eight annual instalments.

The IRS issued Proposed Regulations on August 9, 2018[5] and Final Regulations effective February 5, 2019[6] (the "Proposed Transition Tax Regulations" and the "Final Transition Tax Regulations", respectively) addressing the calculation of the transition tax. The Final Regulations generally adopted the Proposed Regulations, with certain modifications. Anti-avoidance rules disregard transactions undertaken on or after November 2, 2017 with a principal purpose of changing the Section 965 inclusion amount of a U.S. 10% shareholder, the aggregate foreign cash position or the amount of foreign income taxes deemed paid by the U.S. 10% shareholder as a result of a Section 965 inclusion. Certain transactions, referred to as cash reduction transactions, E&P reduction transactions and *pro rata* share transactions, are rebuttably presumed to be undertaken with a principal purpose of having such effect.

Further, under the Final Regulations, any change in method of accounting for a corporation for a taxable year ending in 2017 or 2018 is generally disregarded for purposes of calculating Section 965 amounts if the method change would change the Section 965 inclusion amount of a U.S. 10% shareholder or the aggregate foreign cash position, or would change the amount of foreign income taxes deemed paid by the U.S. 10% shareholder, other than by reason of an increase in the Section 965(a) inclusion amount. This is true regardless of whether the accounting method change is made with the principal purpose of having such effect, and regardless of whether the method change was properly made. Check-the-box elections made on or after November 2, 2017 are disregarded under similar circumstances.

Global Intangible Low-Taxed Income ("GILTI")

Under Section 951A, a U.S. 10% shareholder of a CFC is required to include in income its *pro rata* share of the GILTI of such CFC. At a high level, GILTI is the business income of a CFC less a 10% return on the CFC's tangible non-U.S. assets. For U.S. 10% shareholders that are corporations, a 50% deduction is available, which is reduced to 37.5% in tax years beginning after December 31, 2025, resulting in a tax rate of 10.5% or 13.125%. In addition,

corporate U.S. 10% shareholders (but not other U.S. 10% shareholders) may claim an indirect foreign tax credit for 80% of any foreign tax paid by the CFC that is allocable to GILTI. On June 14, 2019, the IRS released final[7] and proposed[8] regulations ("Final GILTI Regulations" and "Proposed GILTI Regulations", respectively) which provide guidance related to the determination of a U.S. 10% shareholder's *pro rata* share of GILTI. The details of the GILTI Regulations are beyond the scope of this chapter, but a few items are worth highlighting.

Section 951A(c)(2)(A)(i)(III) provides that gross income excluded from the foreign base company income and insurance income of a CFC by reason of Section 954(b)(4) (i.e., gross income that is excluded from subpart F income because it is subject to an effective foreign income tax rate of greater than 90% of the U.S. corporate income tax rate (currently 18.9%)) is also excluded from the GILTI calculations. Prior proposed regulations (the "Prior Proposed GILTI Regulations") had limited the GILTI high-tax exclusion to income that otherwise would have been subpart F income.[9] This exclusion was adopted by the Final GILTI Regulations and applies to taxable years of foreign corporations beginning after December 31, 2017.

In response to numerous comments, the Proposed Regulations broaden the high-tax exclusion from GILTI to provide that an election may be made to exclude any gross income subject to foreign income tax at an effective rate that is greater than 90% of the current maximum corporate rate, even if the income would not otherwise have been subpart F income. If the election is made with respect to a CFC, it applies to all income from that CFC and is binding on all U.S. shareholders of the CFC. In addition, if a U.S. 10% shareholder owns more than 50% of a CFC, the election applies to all CFCs that are more than 50% owned by such shareholder. Notwithstanding the "all or nothing" approach to the high-tax exclusion, the Proposed GILTI Regulations do not appear to require consistency between the high-tax election for GILTI and a similar election for subpart F income. The broader high-tax exclusion described in the Proposed GILTI Regulations is not effective until adopted as Final Regulations.

The Final GILTI Regulations provide that U.S. partnerships are not treated as owning stock of a foreign corporation for purposes of determining the GILTI inclusion – instead, the partners of the partnership are treated as owning the stock of the CFC on a *pro rata* basis, meaning that solely for purposes of calculating GILTI, the 10% U.S. shareholder status is determined at the partner level. The Proposed GILTI Regulations extend this to Subpart F/Section 951 and Section 956 inclusions on a prospective basis, although taxpayers may elect to rely on the provision in the Proposed GILTI Regulations for taxable years of foreign corporations beginning after December 31, 2017.

The Prior Proposed GILTI Regulations contained a very broad anti-abuse rule that would disregard transactions that are part of a plan a principal purpose of which is to avoid U.S. federal income tax for purposes of determining a U.S. shareholder's *pro rata* share of subpart F income under Section 951 and determining the *pro rata* share of tested items of a CFC for purposes of determining GILTI. In response to comments regarding the breadth of this rule, the Final GILTI Regulations provide that the anti-abuse rule applies only to reallocate the amount of allocable earnings and profits that would be distributed in a hypothetical distribution with respect to any share of stock outstanding as of the date of the hypothetical distribution, as if such transactions had not occurred.

Foreign-Derived Intangible Income ("FDII")

The counterpart to GILTI is provided by Section 250 – an incentive for domestic corporations (other than RICs, REITs and S corporations) to invest in U.S. operations by providing a deduction with respect to income from products sold for foreign use or services provided

by a domestic corporation to any person or with respect to property not located in the United States, less a 10% return on tangible assets.[10] The deduction is 37.5% for tax years beginning before January 31, 2026 and 21.875% for tax years beginning after December 31, 2025, resulting in an effective tax rate of 13.125% and 16.406%, respectively.

Treasury and the IRS released proposed regulations regarding FDII on March 4, 2019[11] (the "Proposed FDII Regulations"). The Proposed FDII Regulations provide that domestic corporate partners of a partnership receive the benefit of the FDII deduction, which is computed and allowed solely at the corporate partner level. The Proposed FDII Regulations also provide a number of rules relevant to calculating FDII, including whether a sale of property or a provision of services is eligible for the deduction. "Sale" includes leases, licences and other dispositions of property, including a transfer that results in gain under Section 367. Generally, a sale of property other than intangible property is for foreign use if the customer is foreign and the property is not subject to domestic use for three years after sale, or is subject to further manufacture, assembly or processing outside the United States before domestic use. A sale of intangible property is for foreign use only if it is exploited outside the United States, based on the location of the end user.

The Proposed FDII Regulations divide services into four categories: (i) proximate services where the provider and the recipient are in physical proximity when the service is performed; (ii) services with respect to tangible property; (iii) transportation services; and (iv) other services. For purposes of determining whether a provision of services to a person or with respect to property not located within the United States, the relevant location is: (i) the location of the performance of proximate services; (ii) the location of the property services; (iii) the origin and destination of transportation services; and (iv) the location of the recipient of other services, respectively.

The Proposed FDII Regulations include extensive documentation requirements depending on the nature of the property sold or service rendered, as well as reliability requirements (i.e., that the seller or provider does not know or have reason to know that the documentation is unreliable), and the documentation is obtained no earlier than one year before the date of sale or service and no later than the due date (with extension) of the seller or provider's income tax return for the taxable year in which income is included from the sale of property or provision of service. The Proposed FDII Regulations are proposed to apply to taxable years ending on or after March 4, 2019. However, for taxable years beginning on or before March 4, 2019, taxpayers may use any reasonable documentation maintained in the ordinary course of business for purposes of determining foreign use, provided the reliability requirements described above are satisfied.

Base Erosion and Anti-Abuse Tax ("BEAT")

The BEAT is an additional tax that is designed to limit the ability of large U.S. corporations to reduce their corporate tax liability by making deductible payments to related non-U.S. entities (so-called base erosion payments), such as royalties, interest, and compensation for services. The BEAT is imposed only on corporations (other than regulated investment companies, real estate investment trusts and S corporations) that average $500 million in gross receipts over the prior three-year period and have a base erosion percentage of 3% or more (2% if the corporation's affiliated group includes a domestic bank or registered securities dealer).[12] The base erosion percentage is equal to the total base erosion tax benefits (generally reflecting the reduction in taxable income attributable to base erosion payments) for the taxable year divided by total deductions (with certain exceptions for deductions that

do not arise as a result of a payment by the taxpayer, such as the deduction for net operating losses ("NOLs"), the dividends-received deduction under Section 245A and the deductions for GILTI and FDII) plus base erosion tax benefits not already included in total deductions. The BEAT is essentially a minimum tax equal to the excess of 10% of the taxpayer's modified taxable income (for taxable years beginning in 2019, which increases to 12.5% beginning 2026) over its regular tax liability (with certain adjustments). Modified taxable income is determined like regular taxable income, but without reduction for base erosion tax benefits or a certain portion of the NOLs.

Treasury and the IRS released proposed regulations regarding the BEAT on December 13, 2018[13] ("Proposed BEAT Regulations"). The Proposed BEAT Regulations provide guidance on many aspects of the BEAT, including which taxpayers are subject to BEAT, and how to calculate the base erosion percentage and modified taxable income. The Proposed BEAT Regulations also addressed the application of BEAT to banks and registered securities dealers, as well as to partnerships, insurance companies and consolidated groups. The Proposed BEAT Regulations were originally proposed to apply retroactively to taxable years beginning after December 31, 2017, but the preamble stated that provisions of the Proposed BEAT Regulations finalised after June 22, 2019 would apply to taxable years ending on or after the date the Proposed BEAT Regulations were filed in the Federal Register (December 17, 2018). Taxpayers are permitted to rely on the Proposed BEAT Regulations for taxable years beginning after December 31, 2017 provided that all related taxpayers consistently apply them.

Section 59A(d)(5) provides that base erosion payments do not include amounts paid for services that are eligible to be priced under the "services cost method" under Section 482 (generally, back office and administrative activities[14]). Prior to issuance of the Proposed BEAT Regulations, one area of interest to multinational companies was whether this exception applied to services eligible for the "cost of services plus method" under Section 482. The Proposed BEAT Regulations provide that service payments under a cost plus method are eligible for the exception as to the portion of the payments that represent the cost, so that only the mark-up constitutes a base erosion payment.

Deductions for business interest expense: Section 163(j)

Section 163(j) limits a taxpayer's ability to deduct business interest to the sum of the taxpayer's business interest income, 30% of its adjusted taxable income (EBITDA for taxable years beginning before January 1, 2022 and EBIT afterwards) and the floor plan financing interest for the year. Section 163(j) does not apply to a taxpayer (other than a tax shelter prohibited from using the cash method of accounting under Section 448(a)(3)) with average annual gross receipts for the prior three-year period of $25 million or less. Any business interest expense that is disallowed under Section 163(j) may be carried forward indefinitely. Unlike prior law, Section 163(j) is no longer limited to corporations, highly leveraged companies or related party debt. The Proposed Regulations[15] (the "Proposed 163(j) Regulations") defined interest very broadly to include not only amounts treated as interest for tax purposes, but also amounts that are related to debt instruments or could be paid in *lieu* of interest, such as commitment fees, debt issuance costs, substitute interest payments and guaranteed payments paid by a partnership. In addition, the Proposed 163(j) Regulations contain an anti-avoidance rule that extends Section 163(j) to any deductible expense or loss "predominantly incurred" in consideration of the time value of money. The Proposed 163(j) Regulations also include complex rules governing how partnerships allocate Section 163(j) items to their partners. Finally, the Proposed 163(j) Regulations confirm that one Section

163(j) limitation applies to an affiliated group of corporations filing a consolidated return, and provide a default rule with respect to CFCs that Section 163(j) applies to determine the deductibility of their interest expense in the same manner as for domestic C corporations (on a CFC-by-CFC basis). An alternative method is provided by election to calculate the Section 163(j) limitation of 80% related CFCs on a group basis.

Case updates

South Dakota vs. Wayfair, Inc.[16]

On June 21, 2018, the U.S. Supreme Court ruled that a state can impose sales tax collection obligations on a seller without any physical presence in the taxing state, so long as the seller has sufficient connections with the state, so-called economic nexus. In so ruling, the Supreme Court overturned *Quill Corp. v. North Dakota*,[17] a 1992 Supreme Court decision holding that the Commerce Clause prohibited states from taxing sellers that did not have any physical presence in the taxing state. The Supreme Court's decision in *Wayfair* permits states to impose sales tax collection and remittance obligations on remote sellers and online retailers that have substantial nexus with the state, i.e., when the seller "avails itself of the substantial privilege of carrying on business" in the state. Under the South Dakota law at issue in *Wayfair*, a seller that delivers more than $100,000 of goods or services into the state or engages in 200 or more separate transactions for the delivery of goods and services into the state on an annual basis was required to collect and remit South Dakota sales tax. While the Supreme Court ruled that this requirement was sufficient to establish substantial nexus with South Dakota, it left open the possibility that the South Dakota law could be challenged as being unconstitutional on other grounds.

Since *Wayfair* was issued, over 30 states[18] have introduced or begun enforcing legislation or regulations requiring sellers to collect sales tax even if they do not have physical presence in the state, including California. One issue not addressed by the Supreme Court in *Wayfair* is whether economic nexus applies for purposes of determining state income tax nexus in addition to sales tax nexus.

Altera Corp. v. Commissioner[19]

On June 7, 2019, the U.S. Court of Appeals for the Ninth Circuit, in a 2-to-1 opinion, ruled that Treasury Regulations involving transfer pricing promulgated in 2003 (the Regulations)[20] complied with the Administrative Procedure Act ("APA") and were entitled to deference under Chevron. The Regulations required related entities to share the costs of employee stock-based compensation in order for their cost-sharing arrangements to be classified as qualified cost-sharing arrangements under Section 482 and the relevant Treasury Regulations. The Ninth Circuit's decision in *Altera* reversed an earlier decision of the United States Tax Court, which had held that the Regulations were invalid in part because the Treasury Department did not satisfy a reasoned decision-making standard in promulgating them as required by the APA. The Ninth Circuit, including the late Judge Stephen Reinhardt, originally ruled in favour of the Commissioner on July 24, 2018, but that opinion was withdrawn on August 7, 2018 on procedural grounds to allow time for a reconstituted panel to confer on the case, with Judge Susan P. Graber replacing Judge Reinhardt.

Regulatory: tax-free spin-off guidance under Section 355

Section 355 sets forth a number of requirements for tax-free spin-offs of corporate subsidiaries, including an "active trade or business" requirement. On September 25, 2018,

the IRS released a statement announcing a study of the "active trade or business" test for entrepreneurial ventures whose activities consist of lengthy phases of research and development. In the statement, the IRS indicated that it would entertain requests for private letter rulings from such ventures regarding qualification for the active trade or business test. This announcement generated interest among pre-revenue technology companies that have not previously been able to rely on Section 355, including companies in fields with extended development stages, such as biotechnology and pharmaceuticals.

Following the issuance of the statement, the IRS suspended two revenue rulings, Rev. Ruls. 57-464 and 57-492.[21] In these rulings, the IRS had ruled that business activities that produced negligible net income, or that produced income for less than five years, did not satisfy the active trade or business requirement. Further, on May 6, 2019, the IRS released a public request for information to "assist in identifying what types of entrepreneurial ventures should qualify as [active trades or businesses] absent a five-year track record of income collection" in order to facilitate the study of the ATB Test. The outcome of the IRS's study on the "active trade or business" test could have favourable impact for emerging growth companies in highly regulated industries or operating in stealth mode, as such companies often do not generate revenue for several years while in development stages but may also have a desire to divide businesses for legitimate business purposes.

Tax treaties

The U.S. Senate recently ratified four tax treaty protocols amending tax treaties between the United States and Japan, Luxembourg, Spain and Switzerland, which date back to as early as 1990. Prior to these ratifications, the Senate had not approved any treaties or protocols since 2010.

* * *

Endnotes

1. All Section references are to the Code.
2. Treas. Reg. Section 1.956-2(c).
3. 83 Fed. Reg. 55324 (Nov. 5, 2018).
4. 84 Fed. Reg. 23716 (May 23, 2019).
5. 83 Fed. Reg. 39514 (Aug. 9, 2018).
6. 84 Fed. Reg. 1838 (Feb. 5, 2019).
7. 84 Fed. Reg. 29288 (June 14, 2019).
8. 84 Fed. Reg. 29115 (June 14, 2019).
9. 83 Fed. Reg. 51072 (Oct. 10, 2018).
10. Section 250.
11. 84 Fed. Reg. 8188 (Mar. 6, 2019).
12. Section 59A.
13. 83 Fed. Reg. 65956.
14. Rev. Proc. 2007-13, 2007-1 C.B. 295.
15. 83 Fed. Reg. 67490 (Dec. 28, 2018).

16. No. 17-494, slip op. (June 21, 2018).
17. 504 U.S. 298 (1992).
18. *See, e.g.*, Sales Tax Institute, *Economic Nexus State Guide*, https://www.salestaxinstitute.com/resources/economic-nexus-state-guide (as of July 3, 2019).
19. No. 16-70496, slip op. (Ninth Cir. June 7, 2019).
20. Treas. Reg. §§ 1.482-7A(d)(2), 1.482-7A(a)(3) (to the extent incorporating Treas. Reg. § 1.482-7A(d)(2)).
21. Rev. Rul. 2019-9, 2019-14 IRB 925.

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