Corporate Tax

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Contributing Editor:
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PREFACE

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

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. US tax reform is now a reality after years of speculation, and has created enough issues to fill a book of its own. BEPS implementation now moves into the domestic implementation phase and transfer pricing is now a mainstream aspect of tax planning. And the continuing impact of political issues like Brexit mean that it is becoming more expensive and onerous to be tax compliant.

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Albania

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Overview of corporate tax work over last year

Types of corporate tax work

Albania was awarded candidate status by the EU in June 2014 and is now in the process of implementing reforms with a view to membership, under the assistance of the EU as part of the Instrument for Pre-accession Assistance (IPA II) for the period 2014–2020.

In this context, Albania has undertaken and already partially implemented significant tax changes in the last few years, by replacing existing laws and introducing new ones aligned to EU legislation and best practice.

A new Law on VAT became effective as of 1 January 2015, which has been significantly harmonised with the corresponding EU Directive 2006/112/EC and has brought significant changes to the main VAT principles and rules in Albania. Full adoption of the EU Directive is expected to occur with Albania's membership of the EU.

A new Customs Code has been conceived and structured in line with the Union Customs Code (UCC), which was adopted as Regulation (EU) no. 952/2013 of the European Parliament and of the Council. This new Customs Code, published in 2014, gradually replaced the previous one until its complete replacement in 1 June 2017.

With the assistance of the International Finance Corporation, an elaborated transfer pricing regulation has been drafted in accordance with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration (2010), and was published in 2014 by introducing transfer pricing documentation and reporting requirements for 2014 and onwards. The transfer pricing regulation was subsequently extended in 2015 with a detailed instruction on Advance Pricing Agreements.

A new Law on Accounting and Financial Statements, partially aligned with the EU Directive 2013/34/BE, will enter into force on 1 January 2019 by abrogating the current one (please see below).

A new draft Law on Income Tax (covering corporate income tax, personal income tax and withholding tax) has been drafted by making reference to EU countries' legislation and best practice and was circulated for comment amongst groups of interest in 2015 (please see below). However, it has not yet been finalised and published. It is now expected that it will return to the Ministry of Finance's focus and will most likely enter into force on 1 January 2019.

During the last two to three years, the role of the fiscal administration has been restructured through a new strategy, focusing on simplifying tax procedures and compliance, increasing efficiency in tax collection and improving the overall business climate.

In the context of all the significant changes, the last year showed an increase in requests of our firm for:

- advisory to businesses for the implementation of the relatively new law on VAT, the new Customs Code, and the amended tax procedures;
- advisory on the structuring of international transactions to be in line with transfer pricing regulations;
- tax due diligences;
- assistance during tax audits and tax appeals;
- assistance for businesses aiming to benefit from fiscal amnesty (please see below);
- analysis of legislative gaps and preparation of proposals to the Albanian government for amendments and solutions; and
- analysis and feedback to the Albanian government on draft laws and instructions circulated for consultation with groups of interest.

Significant deals and themes

M&A

The last year has seen the following M&A transactions or announced transactions:

- in February 2018, the American Bank of Investments (ABI) announced that it had reached an Agreement for the acquisition of 100% of the shares of NBG Bank Albania Sh.a; and
- in November 2017, the purchase of the frequencies of Plus Communications Sh.a from Vodafone Albania Sha. and Telekom Albania Sha was announced.

Besides the above, several other similar transactions of a smaller scale have taken place in the last year, involving Albanian companies and subsidiaries of foreign companies.

Without entering into the details of specific transactions regarding the corporate income tax situations of Albanian companies or subsidiaries involved, we would like to present here two hot topics related to M&A: the carry forward of tax losses; and the taxation of capital gains.

Carry forward of tax losses

As a general rule, Albanian taxpayers are entitled to carry forward tax losses resulting in a certain year and utilise them against taxable profits of the three subsequent years based on the rule "earlier losses utilised first". In case that during a year, there is a change in direct and/or indirect ownership of subscribed capital or voting rights by more than 50% in number or value, the tax losses of that particular year and of previous years expire. This restriction is based on the view that tax losses are exclusively related to the taxpayer bearing them, therefore reference is made to the owner of the taxpayer.

The application of this restriction becomes particularly controversial for the following two categories of M&A transactions:

- A change of ownership in the shareholder structure of an ultimate parent publicly listed on a stock exchange market outside of Albania, resulting in an indirect change of ownership of more than 50% for the Albanian affiliate/branch. The Albanian legislation on corporate income tax is silent on whether and how the free trade of shares of the ultimate parent dispersed among the general public (which are not necessarily reported) should affect the carry forward of tax losses of the Albanian affiliate.
- A merger or takeover between Albanian affiliates with the same owner(s), whereby the newly established or absorbing entity has the same owner(s) as before the transaction.

In principle, all rights and obligations are transferred to the new entity/absorbing entity. The Albanian legislation on corporate income tax is silent on whether and how the tax losses of the merged or absorbed affiliates can be transferred to the newly established or the absorbing entity (by respecting the three-year and utilisation limitations) in circumstances where, in fact, there is no change in effective ownership.

Taxation of capital gains

The Albanian legislation on corporate income tax is silent as regards the taxation in Albania of capital gains deriving from the sale of shares in Albanian entities.

When a double tax treaty is in place between Albania and the country of residence of the shareholder (please see below), the provisions of the treaty will prevail over the Albanian legislation. As such, if the treaty provides for the exemption of such gains from tax in Albania, this provision will prevail. However, double tax treaties are not automatically applied in Albania. The General Tax Directorate (GTD) has the sole authority to approve the application of treaty provisions for all specific circumstances of taxpayers after the latter follow certain application procedures to benefit from exemptions, reduced rates and credits. In this case, it is unclear whether the obligation to follow said procedures for obtaining approval of exemption from capital gains tax in Albania lies with the non-resident shareholder, or such exemption applies automatically. In practice, in a few cases, Albanian tax authorities have charged the Albanian entities whose shares were traded with withholding tax liabilities on behalf of the non-resident shareholders.

The situation is even more unclear for capital gains of shareholders resident in countries with which there is no double tax treaty in place.

Transfer pricing

The transfer pricing regulation introduced in 2014 requires an Albanian taxpayer engaged in controlled transactions with non-resident associated parties to ensure consistency of the controlled transactions with the 'market principle'. 'Associated parties' means entities that have a direct or indirect participation in the management, control or capital of one another or by the same third party. To determine the consistency of controlled transactions with the market principle, the regulation recommends the nine-step process of comparability analysis given by the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration (2010) and the application of the five approved transfer pricing methods (other methods may be applied where none of these five can reasonably be applied).

A significant number of medium and large taxpayer members of multinational groups have taken the necessary measures to prepare the transfer pricing documentation up-front. According to the regulation, taxpayers are required to make such documentation available to the tax administration within 30 days following a request. The preparation and submission of the documentation on time (within 30 days after the request) does not prevent the tax administration from making a transfer pricing adjustment (if necessary), but avoids the application of penalties on the additional corporate income tax liabilities assessed (only interest for late payment applied). A large number of taxpayers have been requested by the tax administration in the last one to two years to submit transfer pricing documentation within such 30-day period. However, only a few of them have already been subjected to transfer pricing audits conducted by a specialised transfer pricing audit unit of the tax administration.

An amendment to the Law on Tax Procedures has specified that the transfer pricing audit is separate and independent of a general tax audit and, as such, may be undertaken in a

tax period already submitted to a general tax audit and therefore already assessed once for corporate income tax purposes. Further, it is yet to be tested in practice how any transfer pricing adjustments made by a transfer pricing audit will affect the concerned transactions for other tax purposes, e.g. VAT, customs duties, withholding taxes, etc.

Advance pricing agreement

Starting from March 2015, any taxpayer whose cross-border controlled transactions in a period of five years are expected to exceed in total the value of €30m, is entitled to apply for an advance pricing agreement (APA). In case the threshold is not expected to be met, the request may still be accepted if the case is sufficiently complex or it is highly important in commercial and economic terms for Albania. If there are double tax treaties in place with the countries of the other associated parties, applications should be bilateral or multilateral APAs. Unilateral filings for APAs will be taken into consideration by the GTD only on special occasions (e.g. when the foreign tax administration does not agree to enter into negotiations). The administrative fees payable by the taxpayer comprise ALL 50,000 (approximately €360) upon filing of the application and ALL 1.2m (approximately €8,500) for bilateral and multilateral or ALL 300,000 (approximately €2,000) for unilateral APAs.

The maximum time period covered by an APA is five years. The tax authorities may audit a taxpayer that has entered into an APA as part of their regular tax audits; however, for transactions covered by the APA, the purpose of the audit shall be limited to compliance with the provisions of the APA (which has determined in advance the transfer pricing methodology).

To the best of our knowledge, there has not yet been any APAs concluded in Albania and there is only one multinational APA in the negotiation stage.

Permanent establishment

Under the current Law on Income Tax (in force since 1998), permanent establishment (PE) is defined as a fixed location of business where an entity carries out its business activity. Specifically, the following are considered PEs: an administration office; a branch; a factory; a workshop; a mine, an oil or gas well or a quarry; any other place of extraction of natural resources; and a construction or installation site. The said law provides for no minimum time period for any of the above to be considered a PE. If there is a double tax treaty in place, the related provisions for the determination of a PE, including any time limitations, will prevail.

We have noted some controversy between interpretations of Albanian tax advisors on the consequences of creating a PE in Albania as a result of managerial, professional, consultancy and other types of services provided herein.

One interpretation is that the non-resident person has the obligation to register the PE with the Albanian tax authorities in the form of a branch (there is no option to formally register a PE as such). The registered branch would pay tax on income attributable to it in the form of corporate income tax, by deducting costs (including those recharged by the Head Office). However, the registered branch would also trigger all other applicable taxes, e.g. VAT, social and health contributions and employment income tax (for employees), local taxes, etc., as well as other compliance obligations, e.g. preparation and audit of statutory financial statements.

Another interpretation is that the non-resident person has no obligation to register the

PE in the form of a branch, as long as the Albanian beneficiary of the services retains 15% withholding tax from the gross payment made to the non-resident and remits it to the Albanian tax administration. The PE in this case would not be allowed to deduct any costs in determining the amount subject to Albanian income tax. On the other hand, the PE would not typically be subject to other taxes and compliance obligations. Under this latter interpretation, the decision of whether to register the PE in Albania in the form of a branch remains at the discretion of the non-resident person and should not necessarily be driven by tax reasons.

Withholding tax on services

We have noted an increasing controversy between taxpayers and tax advisors on one hand, and Albanian tax authorities on the other, as regards the application of withholding tax on managerial, professional, consultancy and other types of services provided with no physical presence of personnel/equipment in Albania when no double tax treaty is in place.

The general understanding of taxpayers and tax advisors is that such services should not be taxable in Albania (and therefore the Albanian beneficiary should not be charged with withholding tax liabilities) because they are provided without physical presence of the foreign personnel and equipment in Albania and therefore do not create a PE in Albania according to the definition provided by law.

The interpretation of the Albanian tax administration has not been consistent on this matter throughout the past few years. However, the final position taken by the tax administration and recently published in the form of a technical decision is that such services should be subject to withholding tax in Albania, to be retained by the Albanian beneficiary, as long as the source of payment for such services is in Albania, regardless of where they are carried out. As such, the Albanian tax authorities are indicating that in their interpretation, the 'source of service income' is equal to the 'source of payment for such income'.

Thin capitalisation rule

There are two thin capitalisation rules in Albania, one applicable since 1998 and a new one introduced recently and applicable as of 1 January 2018. The first rule determines that interest expenses pertaining to the part of loans exceeding four times the net equity are not deductible for corporate income tax purposes. Unlike in many other countries where a similar rule applies to loans by shareholders having more than a certain percentage of shares (e.g. 25%), in Albania such rule applies to all loans, except for short-term loans (payable within less than one year). This rule does not apply to banks, finance leases or insurance companies. There is particular controversy in the application of this rule on branches of foreign companies, which by default have no subscribed capital and therefore have no way of increasing net equity except for retained profits.

Based on the second rule, effective as from 1 January 2018, in the case of loans from related parties, the excess of net interest over 30% of earnings before interest, taxes, depreciation and amortisation (EBITDA) will be considered as a non-deductible expense. Such excess net interest will be carried forward and deducted in subsequent years, until a transfer of more than 50% of the company's shares or voting rights occurs. This thin capitalisation rule will not apply to banks, insurance companies, non-bank credit financial institutions and financial leasing companies. There is no instruction yet on how the carry forward and future deduction of the excess net interest will be reflected in the current limited format of the corporate income tax declaration.

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

Administrative tax appeal and court procedures

Some important amendments have been introduced during the last one to two years to the tax appeal procedures and structures.

- Voluntary pre-declaration and pre-payment of tax liabilities
  As of 30 November 2016, taxpayers are offered a 'self-declaration form', sent as an attachment to the tax audit programme notification, for the voluntary pre-declaration and pre-payment of tax liabilities for any non-declared transactions. The pre-declaration of such tax liabilities and the prepayment of them and any related interest should take place during the 30-calendar-day period between the tax audit programme notification and the tax audit commencement. The tax liabilities concerned will be subject to the respective administrative penalties as provided by the Law, to be imposed through the tax audit assessment. However, in case the taxpayer has opted to pre-declare and pre-pay the tax liabilities as described above, such penalties will be capped to 50% (in case they are higher).
- Appeal structures
  As of 1 January 2017, the Tax Appeal Directorate has been transferred under the organigram of the Ministry of Finance (it previously was under the General Tax Directorate) and has been designated to make decisions on tax administrative appeals concerning 'values subject to appeal' under ALL 20,000,000. As of the same date, a new parallel structure has been established under the Ministry of Finance and has been designated to analyse and take decisions on tax administrative appeals involving 'values subject to appeal' over ALL 20,000,000 – 'the Commission for Assessment of Tax Appeals'.
  'Values subject to appeal' include tax liabilities re-assessed, tax credits reduced, tax losses reduced as well as tax reimbursement requests rejected – that are subject to appeal.
  The tax appeal procedures will be equally applicable for both the Tax Appeal Directorate and the Commission for Assessment of Tax Appeals, including the obligation of the concerned taxpayer to pay or create a bank guarantee for the amount of tax liabilities appealed (excluding penalties). These new structures came into force on May 2017.
  A taxpayer may file an appeal against any action or omission of the tax authorities which affect its tax obligations.
- Court procedures
  Against decisions of the Tax Appeal Directorate/Commission for Assessment of Tax Appeals, taxpayers may file a lawsuit with an Albanian administrative court.
  As regards court procedures, pursuant to the law 'On administrative courts and examination of administrative disputes', the public authorities have the burden of proof in relation to the legality of administrative acts issued without the request of the private party.

New law on accounting and financial statements

A new law on accounting and financial statements, partially aligned with the EU Directive 2013/34/EU, will enter into force on 1 January 2019 by abrogating the current law on accounting and financial statements, which has been in force since in 2006. The new law introduces new concepts such as 'a public interest entity', 'financial 'holding' entity', 'group of entities', 'participating interest', 'functional and presentation currency' and

'person responsible for the preparation of financial statements'. It classifies entities into micro-entities, small and medium-sized entities (SMEs), and large entities, based on criteria such as total assets, turnover and number of employees. Similar criteria are also used to classify groups of entities into small, medium and large groups. According to the new law, the International Accounting Standards and International Financial Reporting Standards (IAS/IFRS) should be applied only by public interest entities as well as credit and insurance regulatory bodies. All other entities should apply National Accounting Standards (aligned with IFRS for SMEs), as prepared and published by the National Accounting Council, although they may opt to apply IAS/IFRS instead. 'Public interest entities' include companies listed on stock exchange markets, banks and non-bank financial institutions, insurance and reinsurance companies, investment and voluntary pension funds, and also other companies that will be considered with public interest because of the nature of their business, their size and the number of their employees. Based on the current law, IAS/IFRS are applied not only by companies registered in a stock exchange but also by their affiliates, subject to consolidation of accounts. The new law brings a significant change for these affiliates. It also introduces additional requirements on information to include in the notes to the financial statements, as well as additional reporting requirements such as the 'management report', including non-financial information.

Law providing amnesty for certain tax liabilities

A law on fiscal amnesty applicable from 6 May 2017 to 31 December 2017 provided that certain unpaid tax liabilities and customs duties, as well as certain penalties and interest, could be cancelled if certain conditions were fulfilled. The relief depended on the type of liability and the period to which it related and it was applicable to legal entities and individuals for both national and local taxes (with certain exceptions).

There were two main conditions to meet in order to benefit from the law:

- the taxpayer should withdraw from any ongoing administrative appeal or court proceedings related to the concerned tax liabilities, penalties and interest; and
- the VAT credit balance available to the taxpayer, if any, would be automatically used to offset its unpaid tax liabilities (except for social and health contribution liabilities), the related penalties and interest, in order for any remaining portion of the tax liabilities not offset, to be cancelled based on the law.

According to the information made available by the GTD, around 120,000 individual and business taxpayers fulfilling the criteria benefited from the law, either through automatic cancellation of their tax liabilities, penalties and interest by the tax administration or by following certain procedures with the tax administration.

'Tax certification' of tax declarations

Based on a recent amendment to the Law on Tax Procedures, taxpayers have the possibility to engage certain authorised audit companies (amongst which is Deloitte) to certify their 'tax declarations' as 'in compliance with the fiscal legislation'. The benefit of this certification, however, has been limited to improving the taxpayer's position in the risk assessment performed by the tax administration when selecting taxpayers for tax audit (where the 'tax certification' will be an additional indicator to consider, amongst other existing indicators). There is still no legal guarantee that certified tax declarations will be considered to be in compliance with the tax legislation by the tax auditors. In fact, in case a tax audit reassesses the tax liabilities of a taxpayer related to a period 'certified by an audit company as in compliance with the tax legislation':

- the taxpayer will be subject to the full amount of the additional tax liabilities (and related interest and penalties); whereas

- the authorised audit company will be subject to a penalty amounting to 50% of the reassessed tax liabilities, in addition to the penalties already applicable to the concerned taxpayer.

There has, as yet, been no guidance issued in relation to the methods of conducting and reporting a tax certification by authorised audit companies, nor any such process undertaken by any taxpayer/authorised audit company. In our view, in the way it is currently provided by law, the tax certification is hardly applicable since the benefit of a taxpayer in having certified tax declarations is way too low compared to the risk incurred by authorised audit companies.

Re-evaluation of immovable property and new basis of calculation of local tax on buildings

By means of a law introduced on 20 August 2016, individuals and legal entities were granted the possibility to re-evaluate their immovable properties at market value by submitting a request before 31 May 2017 and paying a tax on the revaluation of 2% of the taxable base for individuals and 3% for legal entities. This revaluation option was available in anticipation of an expected significant change in the local tax on immovable property. The Fiscal Package of 2018 brought amendments to the taxable base and tax rate for the tax on buildings, with effect from 1 April 2018. The taxable base for the tax on buildings will be the market value of the building (previously, the taxable base was the surface area, adjusted based on the location, age and purpose of the building). The tax rates will be as follows: (i) 0.05% for buildings used for habitation; (ii) 0.2% for buildings used for business purposes; and (iii) 30% of the relevant tax rate for an entire construction site for which a builder obtained a construction permit but failed to complete the construction according to the deadline in the permit. A central registry, known as the fiscal cadastre, will be set up for the authorities to administer the tax on immovable property. The registry will be managed by the General Directorate of Property Tax, an institution under the responsibility of the Ministry of Finance. This is a particularly sensitive and highly debated tax change in Albania, so we would expect some controversy during its first years of application in 2018 and 2019.

Inspired by international developments

Double tax treaties

Albania has entered into double tax treaties with 41 countries, of which 39 are effective (Austria, Belgium, Bosnia & Herzegovina, Bulgaria, China, Croatia, the Czech Republic, Egypt, Estonia, France, Germany, Greece, Hungary, Ireland, Italy, Kosovo, Kuwait, Latvia, Macedonia, Malaysia, Malta, Moldova, the Netherlands, Norway, Poland, Qatar, Romania, Russia, Serbia & Montenegro, Singapore, Slovenia, South Korea, Spain, Sweden, Switzerland, Turkey, the United Arab Emirates and the United Kingdom) and two are not yet effective (India and Luxembourg). They are principally based on the OECD Model Convention and they have certain differing provisions compared to each other based on the year in which they were respectively signed.

Provisions of a tax treaty prevail only when an application is filed by the Albanian taxpayer requesting a benefit under such treaty, i.e. exemption from withholding tax or obtaining an authorisation to apply a reduced rate. In practice, taxpayers are facing an increasing number of cases where the implementation of the provisions of the tax treaty remain on hold until the exchange of information procedures between the tax authorities of both contracting states are concluded.

Anti-avoidance measures

Albanian tax legislation provides to local tax authorities the right to re-characterise or disregard transactions in case of a lack of substantial economic reasons and effects. With the introduction of the detailed transfer pricing regulation in 2014, this provision of the income tax legislation was improved. In this context, there is now increased scrutiny over transactions involving 'tax havens'. Transactions between an Albanian resident person or a non-resident person having a PE in Albania and a person resident in a jurisdiction out of the 65 listed in the transfer pricing regulation, are deemed 'controlled transactions' and are subject to transfer pricing requirements, regardless of the relationship between the parties. This list of 65 jurisdictions includes the British Virgin Islands, Guernsey, Hong Kong, Jersey, Liechtenstein, the Marshall Islands, Monaco, Panama, the Philippines, San Marino, the U.S. Virgin Islands, etc.

Exchange of tax information

Albania has adhered to the Convention on Mutual Administrative Assistance in Tax Matters since 2013. Pursuant to this Convention, the Albanian tax administration has the right to receive information not only from banks and non-bank financial institutions but also from each individual who possesses the information concerned.

In March 2016, Albania approved the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information and assigned the Ministry of Finance and the General Tax Directorate as the appointed competent authority for Albania. The intended first information exchange for Albania is in September 2018.

FATCA

Twenty-three Albanian financial institutions (mostly second-level banks and subsidiaries of foreign financial institutions) are currently listed as with approved FATCA registration.[1] These financial institutions have therefore committed to reporting about financial accounts held by U.S. taxpayers or foreign entities in which U.S. taxpayers hold a substantial ownership interest.

BEPS

Although Albania is not a member or a candidate country of the OECD, representatives of the Ministry of Finance have directly participated in the BEPS meetings. However, Albania has not yet introduced any legislation in response to the OECD's project and there are no publicly expressed intentions to adopt any legislation against BEPS, either within or beyond the OECD's recommendations, nor to become a signatory of the Multilateral Instrument.

Tax climate in Albania

Based on the most recent World Bank report on Doing Business,[2] Albania stands at 65 in the ranking of 190 economies on the ease of paying taxes. One of the main positive factors in this ranking is the increased ease of paying taxes. Albania launched an upgraded online platform for filing corporate income tax, VAT and social insurance contributions as of 1 January 2015. Consolidated online return for mandatory contributions and payroll taxes was integrated within the online system. Soon, all taxpayers (individuals and/or legal entities) will be able to submit electronically through the state portal e-Albania requests to obtain tax certificates and download them free of charge. Albania has also significantly reduced the time spent in customs by adopting a digital risk-based border inspection process and by implementing an electronic facility, based on ASYCUDA modules for risk management.

The tax climate over the last few years has been reflective of the Albanian government's measures against fiscal informality, initiatives to increase efficiency in tax collection and

simplify procedures of tax reimbursement, implementation of a new e-tax filing system for the declaration and payment of taxes as well as for electronic communication between taxpayers and the tax administration.

Developments affecting attractiveness of Albania for holding companies

Albania generally does not provide for specific tax incentives or attractions for holding companies.

The following may, however, be of interest for holding companies established in Albania:

- For inbound dividends distributed to an Albanian holding company by its subsidiaries:
  - In case of domestic subsidiaries, dividend income is exempt from corporate income tax.
  - In case of foreign subsidiaries, dividend income is subject to corporate income tax but credit of foreign tax paid is available (up to 15%) if there is a double tax treaty in place with the country of the foreign subsidiary. In this regard, a certain administrative inconvenience is caused by the current format of the corporate income tax return, which does not provide for such credit option.
- For outbound dividends distributed by an Albanian holding company to its shareholders:
  - In case of resident shareholder entities subject to Albanian corporate income tax, no withholding tax liability is applicable.
  - In case of resident shareholder individuals, withholding tax of 15% is applicable.
  - For foreign shareholders, withholding tax of 15% is applicable. However, if such shareholders are resident in countries with a double tax treaty in place, the withholding tax rate may be reduced or even zero-rated depending on the respective treaty provisions.
- Please see above in relation to possible income tax on the future sale of shares of an Albanian holding company by its shareholders.

Industry sector focus

Tourism

In the last few years, tourism has been one of the focuses of the Albanian government. In the context of supporting and promoting investments in tourism, the government took several legal initiatives, with the purpose of creating and providing fiscal facilities to the hotel sector.

Starting from 1 January 2018, four- and five-star hotels with "special status" are exempt from corporate income tax for a 10-year period starting from the date business activities commence, but no later than three years from the date the hotel obtains special status.

The classification of hotels (awarding of stars) is performed by the Standardization Commission of the Tourism Activity, a structure under the responsibility of the Ministry for Tourism.

In order to qualify for special status, the hotel must meet certain criteria provided by the law and the Council of Ministers and is granted by a commission under the responsibility of the Ministry for Tourism. This special status should be obtained by 31 December 2024. Moreover, starting from 1 January 2018, all supplies of services at five-star hotels/resorts that have special status are subject to a reduced VAT rate of 6% (until 31 December 2017, only the supply of accommodations was subject to such reduced rate). Accommodation

facilities in four- and five-star hotels with special status are also exempt from the local tax on buildings as well as from the infrastructure tax (a tax imposed on new construction) as from 1 January 2018.

Apart from the above, the law on tourism provides the possibility of the Council of Ministers to grant to investors which invest in tourism priority zones the right to use state-owned real estate for a period of 99 years based on a symbolic contract of €1.

Oil and gas

Albania is rich in petroleum resources both on- and offshore. Hydrocarbons contractors who have entered into Production Sharing Agreements with the Albanian government are subject to a special corporate income tax regime. They are taxed at 50% of the taxable profit calculated after recovery of all hydrocarbons recoverable costs (capital and operational), as provided by the respective Agreements. Services from subcontractors and imports of materials at the exploration phase may benefit from a VAT exemption if approved by the National Agency of Natural Resources by relieving hydrocarbons operators from an excessive cash burden at the exploration phase.

In February 2017, the Albanian parliament approved law no. 6/2017 amending law no. 7746, dated 28 July 1993 "On Hydrocarbons". These amendments aim to improve the provisions of law no. 7746 by reflecting the concepts laid down by Directive 94/22/EC of the European Parliament and the European Council, dated 30 May 1994 "On the Conditions for Granting and Using Authorisations for the Prospection, Exploration and Production of Hydrocarbons".

Energy

On 2 February 2017, the Albanian Parliament approved law no. 7/2017, dated 2 February 2017 "On Promotion and Use of Energy from Renewable Sources". The aim of such law is to incentivise the production of energy from renewable sources by partially adopting Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources.

Strategic investors and operators of economic development zones

In May 2015, the Albanian Parliament passed law no. 55/2015 "On Strategic Investments in the Republic of Albania". This legal instrument aims for the encouragement and attraction of domestic and foreign strategic investments in the economic sector through the establishment of specific favourable administrative procedures that facilitate and accelerate services for and support to investors.

Some noteworthy tax incentives and reliefs were introduced in September 2015 for operators and developers of technology and economic development zones such as the special VAT treatment of goods entering economic zones, exemption from corporate income tax for a certain time period, deductibility of various expenses for the purposes of corporate income tax, etc.

The year ahead

Apart from the measures to combat fiscal informality and those to increase the efficiency of the tax administration, a major change expected to occur in the next one to two years is related to the new Law on Income Tax.

Based on the draft law circulated for comment amongst groups of interest back in 2015, the following major changes to corporate income tax may be expected, amongst others:

- New rules for PE determination, including a time limitation.
- New rules for exemption of dividend income from corporate income tax related to a minimum shareholding and for a minimum period of time.
- A new thin capitalisation rule limiting the net interest expenses to a percentage of taxable earnings before profit and tax.
- Special rules for the valuation of the shares received in connection with an incorporation or a transfer of a branch/branches of activity.
- Special tax avoidance rules allowing the tax administration to disregard transactions lacking economic substance put in place for the main purpose of obtaining a tax benefit.
- Recognition of revenue on long-term contracts based on the percentage of completion.
- Taxation of capital gains on the transfer of business assets and liabilities.
- Changes in the depreciation methods allowed for tax purposes and introduction of the concept book value 'for tax purposes'.
- Extension of the period for utilisation of tax losses.
- Subjecting certain payments to withholding tax despite them being paid to resident taxpayers.

* * *

Endnotes

1. https://apps.irs.gov/app/fatcaFfiList/flu.jsf.
2. http://www.doingbusiness.org/data/exploreeconomies/albania.

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Andorra

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Key developments

As the Andorran direct corporate tax system has only been recently implemented (before 1 January 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 (i) it is incorporated there, (ii) it has its corporate address there, or (iii) it 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 companies that are: (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 Act 6/2018, amending Act 95/2010 of 29 December, regulating Corporate Income Tax, approved as law on 19 April 2018 by the General Council of Andorra. Notwithstanding, in the case of elimination of the special regimes, they will be gradually reduced until the end of the financial year 2020.

The regime for holding companies (subsidiaries of which may be either resident or non-resident) is still very attractive, since the tax rate for profits distributed by subsidiaries in the form of dividends, or capital gains arising from the sale of shares of foreign subsidiaries, is 0%. Nevertheless, the new law establishes that non-resident subsidiaries 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 with Andorra.

As a consequence of this efficient corporate tax system, we have seen movement of certain businesses and companies to Andorra, especially those related to 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-related companies and other similar businesses. Likewise, we have seen movement of individuals or executives into Andorra with the aim to manage groups of operational companies located in several countries within the European Union through Andorran holding companies.

The introduction of the principle of tax neutrality ("*roll over regime*") in the Andorran tax regime was approved by Act 17/2017 of 20 October on corporate restructuring, partially amending the Corporate Income Tax Act, the Personal Income Tax Act and the Capital Gains Act in relation to real estate transactions. Act 17/2017 has created opportunities for local

companies or individuals to make decisions about corporate reorganisation, contributions in kind, mergers, spin-offs and acquisitions.

Andorra regulates the possibility of applying a tax credit to losses with future tax profits within 10 years of the origination of the loss.

At present, Andorra has not yet introduced any "controlled foreign company regime". This means that profits not distributed to an Andorra holding company or to an individual shareholder by subsidiaries is not taken into account when calculating the business profit and the taxable base.

Another important matter is Andorra's treatment of international double tax relief. The Andorran tax regime allows the unilateral application of a tax exemption withheld at the source up to the limit of the domestic tax rate (10%).

Another key feature of the Andorra corporate tax system is the Pyrenean country's definitive stance in relation to tax transparency. This is a development of the decision taken by Andorra to join the Common Reporting Standard (CRS) of the OECD for the automatic exchange of tax information on April 2014, which was made a reality through an agreement executed with the European Union on February 2016, and the corresponding transposition into domestic law, which entered into force on 1 January 2017.

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

- Corporate Income Tax Act, 29 December 2011 (*Llei de l'impost de societats, 10/95, de 29 de desembre*).
- Decree developing the Corporate Income Tax, 23 September 2015 (*Decret de 23 de setembre de 2015 del reglament de l'impost de societats*).
- Act of 20 October 2017 approving the principle of tax neutrality on corporate restructurings (*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 26 February 2016.
- Act on automatic exchange of tax information, 29 November 2016 (*Llei d'intercanvi automàtic d'informació fiscal de 29 de novembre de 2016*).
- International Double Tax Treaty with Spain, 5 January 2015 (already in force).
- International Double Tax Treaty with France, 1 July 2015 (already in force).
- International Double Tax Treaty with Portugal, 27 September 2015 (entered into force on 1 January 2018).
- International Double Tax Treaty with Luxembourg, 2 July 2014 (already in force).
- International Double Tax Treaty with Malta, 20 September 2016 (already in force).

BEPS

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

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 foreign 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

The fact that Andorra has implemented BEPS and the CRS and has committed to the International Standards is quite positive, as it has led to many countries removing Andorra from their black lists, consequently eliminating the high penalties that these countries apply to jurisdictions that have not yet decided to move towards transparency and adoption of the international tax standards.

Currently, Andorra is discussing a potential agreement of association with the European Union. The European Union has already communicated that it will respect the low tax rates of Andorra due to its particularities and the VAT harmonised system will not be applied to Andorra. This 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; the freedom of movement of capital; the 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 domestic tax system.

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Overview of corporate tax work

The year to April 2018 saw continuing strong M&A activity in Australia, including an uptick in mining deals. Both interest rates and wage growth remain historically low, although both are anticipated to trend upwards. Business confidence has been trending up for some time. Mergermarket reported that, in calendar 2017, Australia was by both deal count and value the most targeted Asia Pacific destination.

Public infrastructure remains the stand-out in terms of investment though, and attracts probably the lion's share of tax work. Infrastructure Partnerships Australia reports that '[r]oads remain the most attractive asset type, followed by renewable energy generation, water infrastructure and tunnels'. Notable transactions include Melbourne's West Gate Tunnel ($A7 billion) and Sydney's Westconnex motorway ($A16 billion). There have also been significant sales of brownfield infrastructure, such as the $A10 billion Transgrid transmission network (completed 2017).

Perhaps not surprisingly, given the amount of funds flowing into this sector, infrastructure has also attracted its fair share of tax scrutiny. Following a lengthy review, the Government announced a clampdown on local investment funds using 'stapled security' structures to convert income into rent for distribution offshore at concessional withholding tax rates.

The year also saw significant advances in the Australian Taxation Office (ATO) armoury, both through a Federal Court win in particular (the *Chevron* decision), and new or pending 'integrity' legislation. The Tax Commissioner openly now claims the upper hand in corporate and multinational enterprise (MNE) tax compliance. Mr Chris Jordan, re-appointed Tax Commissioner last year for a further seven years, reported during the year that the large company tax gap in Australia (the shortfall on what would be 100% compliance) is in the order of '$2.5 billion; equivalent to 5.8% of collections for that market, and similar [proportionally] to the gap estimated for large corporates in the UK'. Collections at this level (i.e., 94%, including 3% through ATO compliance interventions), according to the Commissioner, are 'around global best practice, and many countries aspire to this level of compliance'; and the Commissioner believes the remaining gap to be 'assailable' on current settings:

> *With a number of recent law reforms in this market ... the MAAL, DPT, the BEPS Anti-Hybrid Rules, the exchange of information, much better sharing of data between international tax authorities, and the corporate transparency measures, we are better placed to ensure that what is earned here is taxed here.*

Apart from integrity measures, the other notable aspect of new tax legislation during the year was its specific targeting of those identified by Government as able to pay more tax

– wealthy individuals through their pension funds, and large banks. Ironically, this was, against a background of Government efforts, only partly successful to reduce the general company tax rate, which at 30% is now much higher than US, UK and South East Asian rates.

Significant deals and highlights illustrating aspects of corporate tax

Life & wealth business sales

One notable development has been Australia's major banks shedding their life insurance businesses, and reviewing their continued involvement in broader funds ('wealth') management. ANZ, CBA, Macquarie and NAB have all either sold or sold down their life insurance businesses, and ANZ, CBA and NAB have also flagged sales or reviews of their wealth arms.

Funds management in Australia is in large part pension fund-driven, with employers required to contribute 9.5% of base level salaries to employee funds. There is currently in excess of $A1.6 trillion in pension fund assets under management, of which the retail funds (mainly the major banks, AMP and BT) manage roughly one third.

Separating these businesses can be difficult – marrying the complex accounting for life insurance businesses with the equally complex tax rules applicable to them can require a work of art.

Mining deals

Finally, recovering a little from our commodities boom hangover, 2017 saw mining and resources deals tentatively re-emerge, with coal assets probably the most actively traded. Significant deals included Rio Tinto's sales of its New South Wales and Queensland coal assets, ExxonMobil and BHP Billiton's near (but not quite) exit from Bass Straight oil, Mineral Resources' acquisition of iron ore company Atlas Iron and Beach Energy's $A1.6 billion acquisition of Origin's oil and gas business, Lattice Energy.

Key developments affecting tax law and practice

Changes resulting from/inspired by international developments

Chevron ruling on arm's length price

The potentially most far-reaching corporate tax development for the year was probably the landmark Federal Court decision in *Chevron*. The court ruled that to satisfy the requirement for an 'arm's length price', cross-border loan pricing must reflect implicit and unpaid-for parental support. Accordingly, a loan to an Australian subsidiary of the Chevron group was to be priced essentially as if a formal parent guarantee was in place.

The Court's ruling may have been coloured to some extent by the otherwise fortuitous tax result of the arrangement for the Australian taxpayer. Its US subsidiary had borrowed USD in financial markets under guarantee from Chevron Corporation, and on-lent the funds unsecured in AUD to the taxpayer. Given the currency and security differences, the rate gap on the two loans was substantial, and consequently the US borrower made substantial profits. These were in large part paid by dividend back to Australia tax-free due to a participation exemption – so on the one hand a tax deduction for funds leaving Australia, but on the other a tax exemption for funds returning.

Nevertheless, the legacy of the ruling may be in the Court's view that arm's length pricing involves more than just working out the price of the loan in question. That was because, as Chief Justice Alsop put it:

> *... one could well accept, without difficulty, that a stand-alone company with [the taxpayer's] balance sheet which borrowed AUD 2.5 billion unsecured for five years with no operational or financial covenants would pay a significant interest rate, and in all likelihood on the evidence, above 9% ... [So] all one would have to do would be to constrain internally the transaction to give the highest price and include or omit terms of the agreement that would never be included or omitted in an arm's length transaction and which are not driven or dictated by commercial or operational imperatives, as the foundation for assessing an hypothesised arm's length consideration.*

This did not extend to overriding the choice of currency, however, which remains both a potentially significant planning lever for taxpayers and a source for future disputes with the ATO.

Domestically, the ATO estimated the Court's ruling, as written, '… will bring in more than $A10 billion dollars of additional revenue over the next ten years in the pricing of related party finance alone'. The ATO has since backed the Court's ruling with a somewhat strident new risk weighting guide, for MNEs to assess whether they are in a controversial red zone so far as a likely ATO investigation or challenge is concerned.

The case also has potentially important connotations outside Australia, because of course the 'arm's length price' is an internationally accepted cross-border pricing standard. How much this is depends what is being priced and that, according to this Court, is not for the taxpayer alone to fashion.

The case leaves open the question, in Australia at least, of whether the cure for taxpayers might be simply a formal guarantee for which guarantee fees may be tax-deductible.

Resource Capital Fund decision

The first instance decision of the Federal Court in *Resource Capital Fund IV LP & Resource Capital Fund V LP* in February 2018 has raised eyebrows and unhelpful uncertainty among private equity investors. The case involved two common enough Cayman Islands funds that the Australian Tax Commissioner had sought to tax on a sale of shares in an Australian company. The funds had been established, quite typically, as limited partnerships which are normally treated as a company for Australian tax purposes.

Justice Pagone held that a limited partnership is not a separate legal entity in Australia and therefore the partners rather than the two funds were the taxpayers. This in turn gave access, potentially, to US-Australia DTA relief which was not available to the Cayman funds.

Whilst a victory for these investors so far as treaty relief is concerned, the decision is unsettling because it also threatens to pass on to foreign investors Australian tax compliance obligations. That could be a significant impediment to the use of these otherwise preferred investment vehicles, a practice in fact about to be endorsed by Australia's participation in the proposed new Asian Region Funds Passport regime.

The issue is admittedly complex, and can raise difficulties for other jurisdictions as well as Australia as the 1999 OECD report *The Application of the Model Tax Convention to Partnerships* attests. The *RCF* decision is also to be appealed. It is a matter that a capital-importing country like Australia needs resolved quickly.

Diverted profits tax

Following the UK, Australia introduced a Diverted Profits Tax (DPT) from 1 July 2017 for any significant global entity (group income globally of at least $A1 billion) inclined to shift profits to a lower tax jurisdiction. The effect of the new DPT is hard to quantify and yet to be seen. In this respect it is reminiscent of the general anti-avoidance rule introduced in

Australia in 1981. The first meaningful Court application of that rule was not until 1994. In the meantime it stood as an untried but nevertheless intimidating sentinel.

Likewise, the DPT is not intended to itself raise significant tax, but to 'encourage greater compliance' with other tax laws, and timely provision of information to the Tax Commissioner in transfer pricing disputes in particular. Time will tell but, if it is applied, at the discretion of the Commissioner, our DPT will collect tax at a punishing 40% rate, on a pay-now, argue-later basis.

The potential reach of this new rule is just as frightening. It can be applied to any scheme that includes a principal purpose of an Australian tax benefit or both an Australian and a foreign tax benefit, seemingly even where the Australian benefit is the lesser of the two. It is then left to the taxpayer to fit within a statutory defence, mainly that at least 80% of the tax saved in Australia is paid overseas anyway, or that the profits shifted no more than match the economic substance of functions undertaken overseas.

This is not just a back-drop. There are 1,600 significant global entities operating in Australia, and our Treasury forecast that some 130 of them 'may need to engage with the ATO' in relation to the DPT from the outset.

Anti-hybrid legislation

With the release of draft anti-hybrid legislation in November 2017, Australia again stamped itself as an early mover on Base Erosion and Profit Shifting (BEPS) measures.

The draft legislation includes both general and specific rules targeting double deduction and deduction/non-inclusion outcomes, through either misalignment of entity recognition (hybrid entities) or mismatched characterisations of instruments (hybrid instruments).

Non-portfolio dividend exemptions will be denied to Australian companies where the dividends are deductible offshore to the payer company, and the rules will also prevent use of 'deductible/frankable' prudential capital instruments by Australian banks. The *Mills* High Court decision had allowed CBA to frank (i.e., attach imputation credits to) dividends deducted as debt servicing costs by the bank's New Zealand branch.

A proposed new interposed entity rule will go so far as to require either a minimum 10% foreign tax rate on interest or a justification of the destination jurisdiction, before a tax deduction will be allowed in Australia – even when Australian interest withholding tax has been paid.

This is a brave new world that taxpayers and their advisors are only just starting to navigate, and the DPT looks more pervasive than originally anticipated. Perhaps unsurprisingly, US check-the-box rules are in the frame, allowing as they do selective disregard of US domestic and foreign legal entities. Australia's own tax consolidation rules though, largely a tax integrity measure themselves, also allow disregard of legal entities such as could trigger aspects of the new rules.

A practical difficulty with the new rules will be their presumed knowledge of foreign tax laws and their outcomes. The legislation sometimes lowers the bar by looking to the outcome *expected* of a foreign law, but not always. We should expect the co-ordination required of country tax advisors to notch up.

OECD Multilateral Instrument

Australia signed the OECD Multilateral Instrument (MLI) in June 2017 and legislation is currently before Parliament to enact it as part of Australian domestic law. Australia is expected to deposit its instrument of ratification with the Secretary General of the OECD shortly after the domestic legislation is passed.

Based on the indicative positions of Australia's treaty partners and Australia's own proposed positions, it is expected that the MLI will affect about 30 of Australia's 44 current bilateral tax treaties. Depending on positions ultimately taken by Australia and its treaty partners, the MLI will amend various articles of those treaties which could include a 'saving clause' to ensure unhindered taxation of residents, a 'principal purpose test' as a basis for denial of treaty benefits, and a requirement for mandatory arbitration of tax disputes.

Higher penalties for MNEs

1 July 2017 also saw extraordinary increases in Australian tax penalties for significant global entities.

In part, the increases were an effort to tighten MNE corporate tax functions. Penalties were doubled for false statements, failing to take reasonable care, taking a tax position that is not reasonably arguable, or failing to provide documents when required. Late lodgement penalties were increased 500-fold in some cases.

In addition, harsh new penalties were also introduced for significant global entities involved in profit shifting. The maximum penalty can be up to 120% of the tax avoided.

Regrettably, the Government's justification for the penalty increases does not instil confidence in its motivation:

> *...Australia is taking a leading role in the push for foreign businesses to pay their fair share. ... An increase in the penalties for large companies may also increase community confidence in the tax system...*

Against a background of Australian Senate enquiries into MNE taxation, this sounds more like placating the masses than carefully designed tax law. The Senate enquiries, driven by the non-Government side of that chamber, reflected and to some extent generated community concern about integrity in the tax system – a call for MNEs to pay their 'fair share' of Australian tax. The ensuing reality is that the subjective *lore* of 'fair share' from the headlines is being steadily embedded in the tax law through perspective and discretion based rules, with crucifixion-style penalties to match.

Purely domestic changes

New large bank tax

With limited justification beyond raising revenue, the May 2017 Federal Budget caused uproar with a surprise new levy to raise $A1.6 billion per each year from Australia's five largest banks – ANZ, CBA, Macquarie, NAB and Westpac. The announcement of the levy (payable quarterly at 0.015% of bank liabilities) triggered a plunge in bank share prices and, indeed, an ultimately unsuccessful attempt by the South Australian State Government to introduce an equivalent levy of its own.

The move was reminiscent of the previous Labor Government's attempt to introduce a new mining tax. The mining industry seemed to have more supporters than the banks though, and that tax spectacularly failed.

Australia's large banks are currently under intense scrutiny with a Royal Commission under way to investigate various aspects of their lending and insurance dealings with consumers and financial planning advice to customers, and as a consequence their governance.

Restrictions on pension funds

Changes to restrict access to superannuation system tax concessions took effect on 1 July 2017, to 'better target' support for retirement rather than wealth accumulation more broadly.

Pension fund earnings are taxed at a concessional 15% in Australia, and are tax-free once funding a retirement pension. The new restrictions limit amounts that can be contributed

into the concessional pension fund environment, whether on a tax deductible or non-deductible basis, and also the amount of pension fund assets eligible for tax-free earnings.

The restrictions affect mainly wealthier Australians whom the Government regards as able to afford the additional tax burden. Accommodating the new rules required a wave of systems rebuilds and, from a tax perspective, numerous transitional complexities.

Heat on work expenses

With the large corporate tax 'gap' in Australia ostensibly now under control, the ATO is switching tack somewhat to 'small business, the black economy, phoenix activity and the individuals market', where the ATO expects now bigger gaps than in the large corporate market, e.g., $A2.5 billion in work-related expense deductions alone.

Tax agents are under scrutiny. The Tax Commissioner has identified 'concerning … different results for self-preparers and those who use an agent', reputedly the 'guardians of the system'.

The ATO has also taken the novel step of conducting one-on-one interviews with representatives of Australia's top 320 private groups, the criteria for which include having more than $A350 million in turnover or more than $A500 million in net assets.

Phoenixing crack down

Prompted by a major Pay-As-You-Go tax instalment scam that ultimately caught up one of the ATO's own lieutenants, the Government announced in September 2017 a package of proposed reforms to crack down on illegal 'phoenixing' of companies, i.e. stripping of their assets to avoid paying creditors, often the ATO. Amongst various contemplated new restrictions and offences, company directors will henceforth require unique Director Identification Numbers to connect individuals with companies and show up serial phoenixing operators. The proposal is currently in the consultation phase.

Tax climate

Senate scrutiny of e-commerce

MNEs in Australia faced an often hostile local press and Australian Senate in 2017. A Senate enquiry into MNE tax minimisation moved from cross-examination of our major mining companies in 2016 to e-commerce companies in 2017. Apple, Microsoft, Google, Facebook and IBM were all called before the Senate to justify their effective tax rates here.

The substance of the Senate's complaint was invariably large Australian revenues and low Australian tax; but there were common explanations, namely that income tax is a tax on profits, not turnover, and profits are generated in countries where value is added. Unfortunately this has not been Australia. In large part, what happens here has been sales and marketing, whereas the major product development work, the key value add, has happened elsewhere.

This is more of a competition issue more than a tax avoidance issue. The Senate heard from these companies that product development investment is occurring in countries such as Ireland that have low company tax rates (12.5%). Regional headquarters are located in countries like Singapore that also have low company tax rates (17%). Australia's 30% company tax rate was low when it was first introduced in 2001, but we have been left well behind competitor countries now.

Nevertheless, two of the groups appearing before the Senate reported tax settlements with the ATO, and two of them reported restructures accommodating Australia's new multinational anti-avoidance law (MAAL) and diverted profits tax.

Deputy Tax Commissioner Mark Konza reported $A4 billion tax raised in 2017 through MNE audits, including 'almost $2.9 billion raised from just seven very large multinational companies', and ATO anticipation that 'sales returned in Australia as a result of the MAAL will amount to over $7 billion each year.'

Perhaps not surprisingly, 2018 opened with a quieter press and an emboldened Commissioner. Some high-value disputes remain to be settled, most notably the use of offshore marketing hubs by, for example, Australian mining groups.

Developments affecting the attractiveness of Australia for holding companies

Tax rate drag

The corporate tax rate for MNEs remains at 30%, which is now one of the highest of Australia's major trading partners and competitors. Although the Government supports reducing it to 25% over 10 years, neither the main opposition nor the minor parties controlling the Senate (Australia's upper house of Parliament) have yet supported that.

Part of the difficulty is our 'expensive' dividend imputation system, whereby Australian residents get a 30% credit for tax paid on profits funding a dividend, whereas non-residents get only a 15% benefit (as a withholding tax offset), if any.

Australia does maintain a 'conduit foreign income' regime such that foreign income, within parameters, can be flowed through Australia without tax. Beyond that though, the attractiveness of Australia as a holding jurisdiction does not lie in its corporate tax regime; Australia's controlled foreign company (CFC) regime has an extensive reach especially for services activities conducted offshore, and being at the vanguard of OECD BEPS initiatives, Australia is not likely to offer any lasting tax arbitrage opportunities.

Industry sector focus

Managed funds withholding

After a year-long review, the Government has moved to tighten several aspects of Australia's managed funds withholding tax rules.

Subject to transitional rules, current withholding tax exemptions for distributions to sovereign wealth funds and foreign pension funds will be limited to essentially portfolio investments. Managed fund thin capitalisation (maximum gearing) rules will also be expanded to draw in more investment entity gearing.

In addition, again subject to transitional rules, 'stapling' arrangements that allow conversion of active income into passive rent eligible for 15% withholding on distribution offshore will be neutralised – a 30% withholding will apply. The measure will impact some sectors in particular; for example, hotel trusts and infrastructure projects. In the latter case, however, exemptions from the new rule will be available for approved 'nationally significant infrastructure' projects. Just what approval will require is yet to be seen, but it is likely to involve a broader assessment of the project financing from a tax perspective, as currently takes place where Foreign Investment Review Board approval is required.

CIVs

It has been a long time coming, but Australia is inching closer to a corporate collective investment vehicle (CCIV) regime, allowing transparent tax treatment of Australian companies in circumstances matching those in which managed funds operate here. Tax transparency is currently only available in Australia for managed funds that are in legal form trusts.

This proposal, currently in draft Bill form, is part of broader measures to more readily integrate Australia's funds sector with regional investors:

> *It has been designed to be an internationally recognisable investment vehicle that can be marketed to foreign investors, including through the Asia Region Funds Passport.*

The Asia Region Funds Passport regime will be a system for (partial) mutual recognition of regional securities laws. As a subsequent step, the Government proposes to also allow a limited partnership alternative to the CCIV.

The year ahead

Probably highest on the watch list for the coming year should be the fortunes of our two major political parties, because they harbour significant tax differences and the pundits are favouring the opposition Labor party to win Government in 2019.

Labor would maintain the corporate tax rate at 30%, limit debt capitalisation at the worldwide average for the group, ramp-up transparency by publishing country-by-country reports and requiring public reporting of dealings with tax havens, and require the ATO to disclose settlements of disputes above $A50 million. In place of a tax rate reduction, Labor would introduce an immediate 20% write-off for new plant and equipment.

Another thing to watch out for will be any judicial consideration of offshore marketing hubs, and in particular how any Court ruling affects the 29-page ATO Practical Compliance Guide released last year in respect of these arrangements (PCG 2017/1).

And finally, in tabling its financial year 2018–19 Federal Budget in May 2018, the Government reiterated its intention to ensure that digital economy companies pay 'their fair share of tax', if necessary by unilateral action pending a multilateral resolution. The Government somewhat enigmatically foreshadowed a Discussion Paper on the topic. It may follow European Commission initiatives to develop treaty rules for 'virtual permanent establishments' in the countries of digital users, or conceivably an interim tax on online service turnover such as the 3% tax proposed by the European Commission.

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Key areas of practice include:

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- superannuation and life insurance taxation;
- capital gains tax and other reorganisation issues associated with mergers & acquisitions and corporate restructures;
- the taxation of public and private trusts and alternative structures such as stapled vehicles, partnerships and unincorporated joint ventures;
- employee share and option plans;
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Tony has had significant involvement in tax reform and has written or coordinated many submissions for the banking industry. He regularly authors articles and seminar papers, as well as speaking at industry events and conferences. Tony also spent 15 years as a lecturer in the Master of Laws programme at the University of Sydney.

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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 to be 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 related to corporate reorganisations, including capital reductions and dividend distributions, and corporate migrations. Third, there has been an increase in litigation regarding the applicability of the corporate income tax on non-profit organisations.

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. Nevertheless, judgments always need to be made on a case-by-case basis, as 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 Belgium's highest court (the Court of Cassation) have in practice the value of precedents.

We illustrate Belgian tax jurisprudence with three sets of decisions from the last year.

- Tax procedure
  A significant portion of Belgian (tax) jurisprudence over the last few year(s) relates to Belgian tax procedure.
  For example, the court of first instance of Antwerp ruled on the basis of European case law that a taxpayer can claim back Belgian taxes that the European Court of Justice had judged to be a violation of European law even though the regular period to appeal had already expired. Otherwise, the Belgian legislation would be in breach of European law.[1]

Another interesting judgment was that of the Belgian Court of Cassation with regard to the ability of a judge to fill a legislative gap.[2] In the case at hand, the facts can be summarised as follows. Several years ago, the delay for a taxpayer to file an administrative appeal against a tax reassessment started running as of the date of sending of the reassessment notice. The Belgian Constitutional Court declared this rule to be unconstitutional, and clarified that the Belgian Constitution would not be violated if the delay to file an administrative appeal would only start running as of the third business day following the date of sending of the reassessment notice. Pursuant to this jurisprudence, this three-day waiting period was introduced in Belgian tax law. Old situations were, however, not governed by this new law. The Belgian Court of Cassation now decided that a judge can fill this legislative gap, by way of calculating the delay to file administrative appeal taken into account the three-business-day waiting period.

- Fairness tax
  Belgium has a so-called "fairness tax". Under the fairness tax, large companies are liable to a 5.15% charge on the amount of dividends distributed out of current profits that have been offset by carry-over losses.
  By judgment of 1 March 2018, the Belgian Constitutional Court declared the fairness tax to be unconstitutional:[3]
  - First, the fairness tax violates EU law (in particular article 4 of the Parent-Subsidiary Directive) to the extent that it constitutes a tax on distributed dividends. Before deciding on this point, the Belgian Constitutional Court referred a preliminary question to the Court of Justice of the European Union (CJEU), which ruled on 17 May 2017 that the fairness tax indeed violated article 4 of the Parent-Subsidiary Directive.
  - Second, the fairness tax infringes Belgian Constitutional Law (in particular the principles of legality, equality and non-discrimination).

  As a consequence, the fairness tax was struck down as of tax year 2019. The tax consequences of the annulled tax are maintained for prior tax years (in the light of budgetary and administrative difficulties). This means that, for this period, the fairness tax remains due. However, to the extent that the fairness tax violates the parent-subsidiary directive, it is annulled as from its introduction. For companies which had not yet filed a tax claim, the Constitutional Court's judgment begins a new period of six months to challenge the fairness tax.
- 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". For example, the court of appeal of Ghent refused by its judgment of 9 January 2018 the deductibility of interest paid on a loan contracted to proceed to the distribution of a superdividend. This position is highly debatable.

(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 have 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) under "European – CJEU cases and EU law developments" below).

In addition to the changing legal framework in the context of international developments, 2017–2018 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 balance the Belgian competitive tax regime against the pressures of BEPS and to provide a favourable entrepreneurial environment.

The main changes to Belgian corporate tax law pursuant to the Belgian corporate income tax reform are as follows:[4]

- **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 now reduced its corporate tax rate from 33.99% to 29.58% (for 2018 and 2019) and to 25% (as of 2020). Provided that certain conditions are fulfilled, SMEs can benefit from lower rates.[5]
- **Changes to the dividends received deduction ("DRD")**
  The corporate income tax reform modified the dividends received deduction at three levels:
  - First, as of 2018, the DRD increases from 95% to 100%.[6] As a consequence thereof, there will no longer be a 1.7% Belgian tax leakage on upstream dividends.[7]
  - Second, as of 2018, the current limited deduction of the carried-forward tax losses in the framework of a tax-neutral reorganisation will also apply to carried-forward DRD.[8]
  - Third, the current change of control rule is extended to DRD as of 2018. Consequently, carried-forward DRD will be forfeited (just as tax losses and carried-forward NID) upon a change of control which does not meet the business purpose test.[9]
- **Tax consolidation regime**
  As of 2019, Belgian tax law will contain an optional tax consolidation regime between Belgian companies and the Belgian permanent establishments within a group.[10]
  Under this regime, companies within a group are allowed, subject to certain conditions, to transfer for tax purposes all of their taxable profit to their parent, subsidiary or "sister" company with which they have a direct relationship in terms of capital of 90% at least. To compensate the transferee for receiving the taxable result, the transferor must pay compensation equal to the saved taxes (non-deductible cost for the transferor, exempt income for the transferee).[11]
  This tax consolidation regime only applies to profits and losses of the concerned taxable year (and therefore does not apply to losses carried-forward or other tax assets).
  Currently, one of the conditions required for the optional consolidation regime is that the participation must be held uninterruptedly during the taxable period and the four preceding taxable periods. Consequently, new entities would not be able to benefit from the consolidation regime. In our opinion, the Belgian legislator did not intend for this result. It could therefore be that this condition is redefined/redrafted/interpreted for new entities (but this is not a certainty).

- **Limit on the notional interest deduction ("NID")**
  The Belgian legislator further limited the advantage of the NID by changing it from a deduction calculated on the total equity of a company, to a deduction calculated on the "incremental (i.e., the increase in) equity" (capital increases plus retained earnings) of a company over a period of five years.[12]
  As a consequence of the new rule and the current low rate of the NID (0.746%, 1.246% 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 (for example, 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%.[13]
  This will result in an effective taxation of 8.9% for 2018 and 2019 (i.e. 30% taxed at the CIT rate of 29.58%) and 7.5% as of 2020 (i.e. 30% taxed at the CIT rate of 25%).
- **Capital reimbursements**
  Until 31 December 2017, a capital reimbursement could for tax purposes entirely be imputed on the paid-up capital of a company, even if the company had reserves. As of 1 January 2018, capital reimbursements should be imputed proportionally to 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.[14]
- **Matching principle**
  As of 2018 (assessment year 2019), a fiscal matching principle is introduced, as a consequence of which pre-paid costs that have been attributed to the income of the following year will no longer be deductible upon payment in the current financial year – now only in the year in which they are paid.[15]
- **Deductibility of provisions for risks and charges**
  As of 2018 (assessment year 2019), provisions for risks and charges will only be tax exempt if they result from a contractual, legal or regulatory obligation that exists at the closing date of the reporting period (other than those resulting from the Belgian accounting law).[16]
- **Changes in tax procedure**
  As of 2018, a rectification with an effectively applied tax increase (≥10%) (as well as an *ex officio* tax assessment) will in principle lead to effective taxation. No carried-forward tax assets or tax deductions of the year (except for DRD of the year) and losses of the year can be used to offset the additional income.[17]
  Another change concerns late payment interests. 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 is 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 (leading for 2018 to an interest of 4% if due by the taxpayer, and 2% if due by the tax authorities). For the interest due by the tax authorities to start running, a notice of default is required, whereas before this, interest started running automatically.[18]

European – CJEU cases and EU law developments

(a) Cases

- **Fairness tax**
  See section (a) under "Domestic – cases and legislation" above.
- **Deduction of interest payments**
  During tax years 1996–2003, Belgian tax law contained a rule according to which the deduction of interest payments was disallowed to the extent that the taxpayer received in that same year dividends which benefitted from the DRD and which came from shares held for a short period of time (less than a year) (old article 198, §1,10° ITC).
  By a judgment of 26 October 2017, the CJEU ruled that this interest payment deduction rule was incompatible with the Parent-Subsidiary Directive.[19] In particular, the CJEU ruled that the deduction limitation applied to all interests, including those which do not relate to the financing of the concerned shareholdings. Therefore, the limitation went beyond the possibility for the Member States, as provided in article 4(2) of the Directive, to limit the deductibility of interest related to the financing of shareholdings.
- **State aid**
  Over the past few years, the European Commission intensified its investigations regarding the existence of state aid.
  In this respect, the European Commission considered the Belgian so-called excess profit rulings to constitute illegal state aid in January 2016, and ordered the recovery of this unlawful state aid granted.[20] Under the excess profit rulings, the corporate tax base was reduced for excess profits that resulted from being part of a multinational group.[21] Belgium filed an appeal against the decision on 22 March 2016. Pending a decision of the General Court, the Belgian legislator introduced a law which determines the modalities of the recovery of this state aid from the beneficiaries.[22] The importance of the execution by a Member State of its obligation to recover illegal state aid (article 278 TFEU) is illustrated by the decision of the EC to refer Ireland to the European Court of Justice for failing to recover the illegal state aid amounting to €13bn that was granted to Apple.[23]

(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".[24] One of the main examples thereof is probably the EU Anti-Tax Avoidance Package.

The EU Anti-Tax Avoidance Directives ("ATAD")[25] contain various measures regarding thin cap, CFCs, general anti-abuse rules and exit taxation, which will all have to be implemented (if not implemented already) into Belgian law in the upcoming years. In addition, other measures that have already been adopted at the EU level are effective as of 1 January 2017 (such as with regard to the mandatory automatic exchange of cross-border rulings and cross-border pricing arrangements).

- **ATAD: Interest deduction limitation**
  Belgian law currently contains limited thin capitalisation rules (i.e. a 5:1 debt-to-equity ratio).
  As of 2020, the Belgian regime will be amended to be in line with the interest limitation rule provided in the ATAD (and the proposals in the BEPS Action 4 interest deduction limitation). According to the new regime, the deduction of the "exceeding borrowing cost" (net interest expense) will be limited to 30% of the taxpayer's fiscal EBITDA

(earnings before interest, tax, depreciation and amortisation). 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 existing 5:1 thin-cap rule will be abolished, except with respect to interest paid to tax havens.

Loans concluded before 17 June 2016 are subject to grandfathering;[26] for these loans the current 5:1 debt-to-equity thin-cap rule remains applicable.

The ITC provides for several exceptions to the applicability of the rule, such as for certain financial enterprises and stand-alone entities.

- **ATAD: Anti-abuse**

  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.

  The ATAD also provides for a general anti-abuse rule. This rule will have to be implemented by EU Member States by 1 January 2019. As Belgium already has a general anti-abuse rule, it will most likely not introduce the ATAD general anti-abuse rule. A proposal to modify the current anti-abuse rule was not upheld in the Law of 25 December 2017.

- **ATAD: Controlled foreign corporations**

  Belgian tax law contained until recently no real CFC rules. In 2015, Belgium implemented for the first time a CFC-like rule known as the "Cayman Tax". In short, the Cayman Tax implies a look-through taxation for income received by Belgian individuals and non-profit entities from qualifying legal constructions (e.g. trusts and low-taxed entities). Apart from this rule, Belgian law contains a rule that allows disregard of a transfer of ownership of assets by a Belgian company 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 for the sole purpose of tax avoidance.

  In 2016, the Council of the European Union adopted a CFC rule as part of the ATAD (articles 7 and 8). Following this CFC rule, the Member State of a taxpayer will treat an entity (or a permanent establishment 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 Court of Justice of the European Union, the Directive provides for a substance exclusion.

  In implementation of the ATAD, the Law of 25 December 2017 introduced a CFC rule to Belgium as of 2019.[27] The Belgian regime is based on a so-called "transactional approach" and goes in certain respects beyond the minimal protection provided in the ATAD.

- **ATAD: Exit taxation**

  The ATAD also provides for an exit taxation regime. This regime was implemented into Belgian law by the Law of 1 December 2016 and the Law of 25 December 2017.

  - Law of 1 December 2016

    By the Law of 1 December 2016, Belgium modified its exit tax regime to be in line with the jurisprudence of the Court of Justice of the European Union (National Grid Indus and DMC) and the relevant dispositions of the EU Anti-Tax Avoidance Directive. More specifically, Belgium introduced a deferred payment regime in

case of an outbound transfer of assets (migration or restructuring) from Belgium towards a Member State of the European Economic Area (except for Liechtenstein) which entails a taxation of latent capital gains. The new regime is applicable as of 8 December 2016. Under the new regime, a taxpayer can choose between one of two options. Either the latent capital gains are taxable immediately, or the tax can be paid in instalments over a period of five years. In case of a deferred payment, no interest can be imposed. The tax authorities can, however, subject the benefit of the deferral to the payment of a guarantee if they can prove that there is a real risk of non-recovery.[28] The law provides that, in case of a deferral, the outstanding balance becomes immediately recoverable in certain events. This will, for example, be the case when all (or even a part) of the assets are disposed of or transferred outside of the EU, Iceland or Norway. Another example is when the taxpayer does not comply with the yearly payments; contrary to what the EU Anti-Tax Avoidance Directive provides, the taxpayer hereby does not have the possibility to rectify the situation within a reasonable delay.

The Law of 1 December 2016 did not create new events under which an exit tax will be due. There will, therefore, still be no exit tax due on the transfer of assets from a Belgian company to a permanent establishment in the European Economic Area.

- Law of 25 December 2017

  The Law of 25 December 2017 completed the existing exit taxation rules. First, the exit tax is now extended to transfers of assets from head offices to permanent establishments.[29] Second, a step-up is now provided in case of an inbound transfer of foreign assets (provided that the gain has been subject to tax in the exit state, and that Belgium concluded a treaty or bilateral or multilateral instrument with the exit state that provides for an exchange of information).[30] These new rules will enter into force for transfers that take place as of 1 January 2019.

- **ATAD: Hybrid mismatches**

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

  In short, these rules will 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.

  The Law of 25 December 2017 introduced rules and definitions to tackle hybrid mismatching arrangements, tax residency mismatches and imported mismatches as from assessment year 2020 (for accounting years starting as of 1 January 2019).[31]

- **Directive (EU) 2015/2376: International exchange of cross-border rulings, advance pricing arrangements**

  Since 2003, Belgium has an efficient and effective ruling system that is very similar to other more traditional ruling jurisdictions: as a rule, taxpayers may obtain from the Belgian tax authorities advance rulings on the application of tax laws to any contemplated transaction (including transfer prices), provided such transaction has not yet generated a fiscal effect. The Belgian ruling practice serves to create confidence for investors considering investing in Belgium. Indeed, a ruling ensures a legally binding accurate forecast of all the tax implications for an investment project.[32]

  As a result of BEPS as implemented in the European Union, advance cross-border tax

rulings and advance pricing arrangements need to be automatically communicated to the Commission and the tax authorities of all the other Member States as from 1 January 2017.[33] Mid-2017, the Belgian law on the exchange of tax rulings and country-by-country reports was finally formally adopted, installing the legal basis for the exchange of the tax rulings.[34]

- **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".

BEPS

General introduction

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

As explained above, the European Union is travelling 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 benefit 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 have provided an 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 Instrument. This Multilateral Instrument was signed by Belgium (together with 67 other jurisdictions) on 7 June 2017. The Multilateral Instrument will impact the existing bilateral tax treaties listed by both participating jurisdictions upon ratification by the signatories and after expiration of the waiting periods. In the meantime, Belgium takes the BEPS proposed rules into account in its negotiations for new treaties.[35]

Transfer pricing documentation requirements and country-by-country reporting

By the law of 1 July 2016, Belgium introduced a transfer pricing documentation requirement into Belgian tax law. The purpose of this requirement is to increase the transparency of the global operations of multinational enterprises.

More specifically, 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.[36]

PE

The law of 25 December 2017 clarifies the concept of personal PE, and hereby gives a new (and negative) definition of an independent agent. The change makes the concept of PE more aligned with the OECD Model Treaty, and will be applicable as of 2020.[37]

Tax climate in Belgium

Belgium has always had a competitive tax-policy objective (e.g. by way of its notional interest deduction, 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 have 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.

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

DRD, NID, and capital reimbursements

See section (b) under "Domestic – cases and legislation" above.

Capital gains exemption on shares

The Law of 25 December 2017 changed the tax treatment of capital gains on shares realised by a corporate entity on several levels:

- First, the Law of 25 December 2017 linked the conditions for the capital gains exemption on shares to the conditions applicable to the DRD, being (i) a subject-to-tax condition at the level of the subsidiary, (ii) a minimum holding period of one year, and (iii) a minimal participation of 10% or €2.5m.
- Second, the 0.412% minimum tax on exempt capital gains was abolished.[38]
- Third, the separate rate for short-term capital gains disappears.
- Finally, a special anti-abuse provision was inserted for capital gains on shares providing from a tax-neutral exchange.

General anti-abuse provision

As a result 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 to Belgian law in 1 December 2016. This general anti-abuse provision will deny the withholding tax exemption where 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 or when dividends originate from (a whole of) legal acts that are artificial and that have the main purpose or one of the main purposes to obtain the dividends received deduction, or the advantage of the Parent-Subsidiary Directive.[39]

The year ahead

Corporate income tax reform

The Belgian legislator is currently working on an additional law which will impact the ITC as well as the law of 25 December 2017.[40] The timing of this law and the contents thereof is still uncertain, as no official texts are available yet. According to the information available to us, the law will contain amongst others the following changes:

- a new anti-abuse provision regarding the NID will be added (limiting double-dip possibilities for companies);
- the fairness tax will be abolished; and

- the new rules regarding CFCs, deductibility of interest, and tax consolidation will be modified on some technical points.[41]

Corporate law reform

The Belgian legislator is working on a major corporate law reform (to be expected in the course of 2018). The purpose of this reform is to provide more efficient tools to enterprises to and to make Belgium more attractive for investors and entrepreneurs.

Proposed changes include a reduction in the variety of Belgian corporate vehicles, as well as various measures that will increase the flexibility of the corporate instruments. For example, some corporate vehicles, such as the BV/SRL, will be able to have only one shareholder and will not be required to have a (minimum) corporate capital.

Another proposed change would be that the corporate law applicable to a company will no longer be determined on the basis of the effective management of conduct of business of the company, but on the basis of the "place of incorporation" of a company.[42]

* * *

Endnotes

1. Court of First Instance of Antwerp, department Antwerp, 24 April 2017, A.R. nr. 2013/4098/A.
2. Belgian Court of Cassation of 16 November 2017, nr. F15.0034.N.
3. Belgian Constitutional Court 1 March 2018, nr. 24/2018.
4. Law of 25 December 2017 on the reform of the corporate income tax regime, Belgian O.J. 29 December 2017.
5. Article 54 of the Law of 25 December 2017 on the reform of the corporate income tax regime.
6. Article 45 of the Law of 25 December 2017 on the reform of the corporate income tax regime (changing article 204 of the Belgian CIT).
7. Consequently, it was no longer necessary to maintain the special Tate & Lyle withholding tax rate. This withholding tax rate is therefore now replaced by a withholding tax exemption.
8. Article 52, 2°–5° of the Law of 25 December 2017 on the reform of the corporate income tax regime.
9. Article 53, 3° of the Law of 25 December 2017 on the reform of the corporate income tax regime (modifying article 207, paragraph 3 ITC, which becomes paragraph 8).
10. Article 35, 36, 39, °9 and 48 of the Law of 25 December 2017 on the reform of the corporate income tax regime (modifying article 194 *septies* and 198 °15/1 and 205/5 of the Belgian ITC).
11. 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.
12. Articles 49–51 and 86 of the Law of 25 December 2017 on the reform of the corporate income tax regime (modifying articles 205*bis* – 205*novies* and 536 of the Belgian ITC).
13. Article 53, 1° and 3°–6° of the Law of 25 December 2017 on the reform of the corporate income tax regime (modifying article 207 of the Belgian ITC).
14. Article 4 1° and 2°, article 16 and article 68 of the Law of 25 December 2017 on the reform of the corporate income tax regime (modifying article 18, first paragraph 2° and 2°*bis*, article 18 second – seventh paragraph, article 184, fifth paragraph, article 264 first paragraph, 3°, c and article 264, second and third paragraph of the ITC).

15. Article 37 of the Law of 25 December 2017 (modifying article 195/1 ITC).
16. Articles 28 and 29 of the Law of 25 December 2017 (modifying article 194 ITC).
17. Article 53, 4° of the Law of 25 December 2017 (modifying article 207, paragraph 7 ITC).
18. Articles 77–80 and 90 of the Law of 25 December 2017 (modifying articles 414, 416, 418 and 419 ITC).
19. CJEU 26 October 2017, *Argenta Spaarbank vs. Belgian State*, C-39/16, www.curia.eu.
20. 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.
21. 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).
22. Program Law of 25 December 2016, O.J. 29 December 2016 (ed. 2).
23. EC Press Release 4 October 2017, *"State aid: Commission refers Ireland to Court for failure to recover illegal tax benefits from Apple worth up to €13 billion"*.
24. See endnote 13.
25. See endnote 14.
26. To the extent that these loans are not materially altered afterwards.
27. Articles 20 and 44, 2° of the Law of 25 December 2017 (modifying articles 185/2 and 202, §1, 4° ITC).
28. See endnote 7.
29. Articles 19 and 76 of the Law of 25 December 2017 (modifying articles 185/1 and 413/1 ITC).
30. Articles 17, 2°–5° and 61, 2° of the Law of 25 December 2017 (modifying article 184*ter*, §2 and 22ç, §5 ITC).
31. Articles 3, 18, 39 and 73 of the Law of 25 December 2017 (modifying article 2, §1, 16°–18° ITC, article 198, §1, 10/1–10/4 ITC; article 185, §1 paragraphs 2–4 ITC; article 185, §2/1 ITC; article 292, paragraph 3 ITC).
32. As a rule, a ruling is legally binding for five years (but renewable).
33. Council Directive (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, O.J. L 332, 18.12.2015, pp. 1–10.
34. Law of 31 July 2017, *Belgian Official Gazette* 11 August 2017.
35. Please note that treaty abuse is also playing a central role at a European level. On 28 January 2016, the European Commission issued a recommendation on the implementation of measures against tax treaty abuse. The recommendation advises Member States how to reinforce their tax treaties against aggressive tax planners, and covers, *inter alia*, the introduction of a general anti-abuse rule in tax treaties.
36. Article 338, §6/3 ITC; Law of 11 August 2017 on the Multilateral Agreement between competent authorities concerning the exchange of country-by-country reports*, Belgian Official Gazette* 24 November 2017.
37. Article 61, 1° of the Law of 25 December 2017 (modifying article 229, §2 ITC).
38. Article 55, 5° of the Law of 25 December 2017 (abolishing article 217, first paragraph, 3° ITC).
39. See endnote 18.
40. Preliminary draft law containing various dispositions regarding income taxes.

41. J. Van Dijk, *"Exit fairness tax en verhoging vrijstelling dividenden"*, *Fiscoloog* 2018, nr. 1549, 1.
42. 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.

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Bolivia

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Transfer pricing rules and their implementation

Although, as mentioned in previous editions, the Plurinational State of Bolivia (hereinafter "Bolivia") published transfer pricing rules[1] in the year 2014, as of the time of writing the Tax Administration has not yet carried out assessments challenging or questioning transfer pricing reports filed by taxpayers (mainly multinational entities) as required by law.[2] Please note that transfer pricing rules only apply to cross-border transactions, as there are no rules applicable to domestic transactions between related parties. Also, as Bolivia is not part of the Organization for Economic Co-operation and Development ("OECD"), the Transfer Pricing Guidelines and Base Erosion and Profit Shifting ("BEPS") Actions do not represent binding law in Bolivia. The tax authorities would rather not apply said guidelines if they could be interpreted in favour of taxpayers; in that regard, as local transfer pricing rules do not specifically create the obligation to produce a Master File or the obligation to comply with Country-by-Country Reporting, only local documentation, support and reporting is required. For that matter, the Bolivian Local File must be completed and presented (when a specific threshold is met), including the following information: a) a content correlative index; b) an executive summary; c) a functional analysis of: the related parties' background; the types of relationships; economic activities; commercial strategies; transaction and contractual agreement details; and financial and profitability information; d) a functional analysis of: the operation's quantification; a determination and description of the assessment method used; a selection and establishment of the comparable, establishing the value difference range; a descriptive analysis of the results of the implementation of the method; and necessary adjustments if applicable; and e) a conclusion containing an explanation of the adjustment made or why no adjustment was necessary.

Also, a specific tax return needs to be completed and filed and fines could be imposed by the tax authorities in case the information presented is incomplete and/or the tax return or the transfer pricing report is not filed in due time, which is 120 days after the closing of the fiscal year. As mentioned before, most transfer pricing reports filed by taxpayers are prepared with the assistance of multinational audit and legal firms as there is not enough expertise in the country on how exactly the reports should be presented. Even locally drafted transfer pricing reports have been, at a final stage, reviewed by experts from neighbouring jurisdictions in order to contemplate certain aspects that, based on their familiarity, were deemed to be relevant. The tax authorities are still undergoing practical training from sources abroad in order to be prepared to carry out assessments in the future.

Although, as mentioned before, Bolivia is not part of the OECD, in compliance with transfer pricing regulations, the Tax Administration issued a list of countries considered to have low or no taxation based on the criteria set by the OECD. The list initially

comprised 76 countries, including, amongst others, Hong Kong, the British and U.S. Virgin Islands, Panama, Trinidad & Tobago and Yemen. The list has an important effect on local companies that carry out business and/or commercial transactions with entities domiciled in those countries or regions. In that regard, operations carried out with entities domiciled in the listed jurisdictions need to be analysed as if they were carried out between related parties, and thus need to be reported in the annual Transfer Pricing Report, which must be filed and detailed in Electronic Form 601. Additionally, certain regulations specify that, in case the local tax authorities enter into an *Information Exchange Agreement* with the tax administrations of the listed jurisdictions, said countries or regions may be excluded from the list. On 9 March 2018, the list was updated by means of Board Resolution No. 101800000006 R-0011, excluding, for example, the Dutch Antilles, Guatemala, Madeira, Micronesia and Western Samoa, and including Bonaire, Christmas Island, Cocos (Keeling) Islands, the Falklands, Guam, Palau, Puerto Rico, Saba, Saint Eustatius, Sri Lanka, Tokelau, Tuvalu, and the United Arab Emirates.

Application of the statute of limitations and further changes to local legislation

The interpretation of how the statute of limitations in tax matters should be applied by taxpayers and by the administrative and judicial tax courts still remains ambiguous, as there has been a division between the two basic understandings of which law should be used in which case (taxable event). As mentioned in previous editions, article 59.I. of the Bolivian Tax Code (Law No. 2492) has been amended on several occasions and, therefore, the term within which to control, investigate, verify and assess taxes has been changed at different points. In that regard, in 2012, Law No. 291, dated 22 September 2012, was issued in order to amend the previous article 59.I. of the Bolivian Tax Code (Law No. 2492) as follows: "*[the] Tax Administration's actions to control, investigate, verify and assess taxes ends: In four (4) years in the fiscal year 2012, five (5) years in the fiscal year 2013, six (6) years in the fiscal year 2014, seven (7) years in the fiscal year 2015, eight (8) years in the fiscal year 2016, nine (9) years in the fiscal year 2017 and ten (10) years in the fiscal year 2018. The statute of limitation for each year as determined in the previous paragraph will apply to those tax obligations and contraventions that had occurred in said year.*"

Later that year, on 11 December 2012, Law No. 317 was issued and inexplicably eliminated the last part of the previous article. With that exclusion, doubt was generated as to whether the statute of limitations regime would increase in time beginning in the year 2012 and going forward regarding those tax obligations and contraventions that had occurred in the year 2013, 2014 and so on. Finally, pursuant to Law No. 812, dated 30 June 2016, a new amendment was introduced, specifying that the Tax Administration's statute of limitations for actions to control, investigate, verify and assess taxes is eight years. The many changes to the laws regulating the statute of limitations within a period of less than five years has created major confusion and turmoil amongst taxpayers, not because the regulations are difficult to interpret, but because tax authorities wish to and are attempting to apply the laws retroactively for collection purposes only.

Although the Supreme Tribunal issued two rulings (No. 39, dated 13 May 2016, and No. 47, dated 16 June 2017) detailing that laws specifying new statute of limitations terms could not be applied retroactively – as that would be understood as a fracture of the principles of rule of law, legality, hierarchy and the non-retroactivity of the law – both rulings were later overruled by the Constitutional Tribunal on the basis of form and not of substance. Despite the above, on 20 November 2017, the Supreme Tribunal issued ruling No. 153 (abiding

constitutional ruling No. SCP No. 0048/2017-S2), specifying that the Tax Administration may not apply laws retroactively, diminishing taxpayers' rights regarding the correct application of the statute of limitation rules. Once again, the ruling cites both article 123 of the Bolivian Constitution and article 150 of the Tax Code.[3]

Disappointingly, both the Tax Administration and the administrative tax courts have failed to recognise the validity of the ruling by citing ludicrous arguments, going as far as stipulating that administrative courts may not follow judicial rulings as they have no effect on administrative procedures. The previous is incomprehensible, as the administrative courts have been citing rulings issued by the Supreme Tribunal and the Constitutional Tribunal in their own rulings since the administrative courts were created in the year 2003.

In light of the above, as of today and based on constitutional and legal principles, the statute of limitations should be interpreted as follows:

- Eight years for obligations that were due in the year 2016.
- A term of seven, six, five and four years is applicable to years before 2016, respectively, as follows: a) seven years for obligations that were due in the year 2015; b) six years for obligations that were due in the year 2014; c) five years for obligations that were due in the year 2013; and d) four years for obligations that were due in the year 2012.

Despite the above, the Tax Administration is actually notifying taxpayers for assessments of the fiscal year 2010, basically counting back eight years from the year 2018, thus applying Law No. 812 retroactively. As this controversial issue is no nearer to being solved, taxpayers still have to wait to see if the Constitutional Tribunal takes a stand and eventually issues a ruling on this specific topic and, pursuant to said ruling, decides to abide by the Supreme Tribunal's rulings, as the decisions issued by the Constitutional Tribunal are no doubt binding and applicable *erga omnes*.

Application of tax treaties

Bolivia has entered into the following tax treaties to avoid double taxation: a) Andean Pact Countries – Directive 578; b) Republic of Argentina (October 30, 1976); c) Federal Republic of Germany (30 September 1992); d) Kingdom of Sweden (14 January 1994); e) United Kingdom of Great Britain and Northern Ireland (3 November 1994); f) Republic of France (15 December 1994); and g) Kingdom of Spain (30 May 1997). The current multilateral treaty follows the Andean Community model, while the other bilateral treaties are based on the same Andean Community model and/or the OECD model, with some particularities.

In Bolivia, pursuant to paragraph 14 of article 158 of the current Constitution, tax treaties need to be ratified by the Plurinational Legislative Assembly (Legislative Power) in order to have effect in Bolivia. The current tax treaties in Bolivia were entered into before the aforementioned constitutional provision and had to be reviewed and/or denounced in order to be left without effect in case they were contrary to constitutional provisions set forth in the Constitution issued in 2009. As this did not happen, they are currently valid and in effect. The aforementioned tax treaties may not be overridden by domestic law rules as they become part of the internal legislation of the Bolivia once they are ratified by the Legislative Assembly. Article 5 of Law No. 2492 (the current Tax Code, as amended and restated) specifies the following as sources of tax law, in hierarchical order: the Constitution (in first place); international treaties approved and/or ratified by the Legislative Power; laws; Supreme Decrees; Supreme Resolutions; and so on.

On 29 December 2017, the Tax Administration issued Board Resolution No. 10170000030 R-0011 in order to establish the obligations, procedures and requisites that must be complied

with by individuals and/or entities that wish to apply the articles contained in tax treaties. In that regard, permanent establishments or branches of entities domiciled in jurisdictions other than Bolivia, that have entered into a tax treaty to avoid double taxation, need to prove their residence or domicile in Bolivia before the corresponding tax office. Additionally, withholding agents liberated from withholding and paying Bolivian sourced income to beneficiaries abroad under a specific treaty need to certify their domicile or residence, or will lose the benefit of not having to withhold and pay the tax.

In a nutshell, the board resolution has created further formal obligations for taxpayers that wish to benefit from tax treaty prerogatives, threatening the application of treaties based on formal and non-material commitments to be complied with by taxpayers. This constitutes one further obstacle to the proper use and implementation of tax treaties in Bolivia, as it now generates additional formal obligations, combined with the fact that, for some time, the administrative and judicial tax courts have not been inclined to issue rulings in favour of taxpayers benefiting from treaty aids.

Further regulations on tax consultations

Taxpayers may obtain administrative rulings on specific matters by presenting inquiries before the Tax Administration in the form of a legal consultation that officially expresses their legal standing. The opinions issued by the specific technical office are considered as compulsory for the inquiring parties and the Administration, and could be used as legal grounds with regard to future tax assessments. In relation to this, the Tax Administration issued Board Resolution No. 101700000019 R-0011 in order to establish the requisites and applicable procedure for tax consultations. The resolution attempts to define when a specific matter is deemed to be *controversial* and/or *confusing* in order to allow a taxpayer to file a consultation that will be issued with a binding character. Based on the resolution, "controversial" implies the existence of two regulations of equal standing that regulate a specific tax matter with different or opposing criteria, while "confusing" implies a lack of order or clarity in a specific regulation, or an absence of regulations that cannot be interpreted pursuant to the interpretation methods set forth in the tax code.

In practice, however, despite this new regulation, the tax authorities have failed to issue binding answers to tax consultations even if the consultation complies with the requisites set forth in the tax code and in the specific, recently issued resolution. This has been the case because tax officers do not wish to provide taxpayers with a legally binding answer that could be used against them in future interpretations by the tax entity. Regardless of whether a specific matter could easily be construed as being confusing and/or controversial, the tax authorities prefer to issue non-binding or informal answers in order to avoid responsibilities in the future in case, for example, the tax authority changes its mind on its interpretation of a specific regulation. If binding answers were to be issued, tax officers could face internal administrative procedures initiated by newly elected officers alleging that any binding answer was issued to the detriment of the Bolivian State and, thus, the former should be responsible for their acts.

Tax climate in Bolivia

As mentioned in the previous edition, in the most recent World Bank Report (2016) on Doing Business,[4] Bolivia stands at 189 in the ranking of 189 economies on the ease of paying taxes. According to the Global Competiveness Report (2016–2017) of the World Economic Forum (which assesses the competitiveness landscape of 138 economies),

Bolivia places at number 121.[5] Also, the Total Tax Rate report of the World Bank lists Bolivia on the fourth level, with one of the highest tax burdens globally. This, plus the fact that the current members of the administrative and/or judicial courts were in the past – in the majority – officers at the tax administrations, their judgment is not always impartial, as they were, just a few years ago, assessing taxpayers and wishing to comply with their collection goals.

Taxpayers often decide to agree with assessments carried out by the tax administration and obtain payment plans, as they know that they might not obtain a favourable ruling in time, despite the fact that they could have strong arguments to reduce or eliminate their alleged tax debt. Another reason for agreeing to pay a specific tax debt, even though there are legal and technical grounds to challenge it, is the fact that the interests accrued and value maintenance increases the tax debt exponentially.

The year ahead

As mentioned in the last edition, the Bolivian Congress has appointed a special commission in order to investigate 95 offshore companies with Bolivian links that were listed in the leaked "Panama Papers" documents. The investigation that is being carried out will focus on companies with Bolivian ties. The investigation aims to determine if the entities that were incorporated in said jurisdiction were done so for tax avoidance purposes, and if any monies sent from Bolivia failed to be subject to Bolivian taxes.

Although the commission has been working for more than a year or so, the Tax Administration has not, as of the time of writing, initiated a tax assessment seeking to determine if tax avoidance schemes were actually utilised by taxpayers in Bolivia in order to pay less or no taxes at all by means of links with Panama-based entities. The commission has, however, approved a law project creating a *Direction to Fight the Use of Tax Havens* to be part of the Financial Investigation Unit, to detect commercial and/or financial operations in order to apply fines. Based on the previous, although the initial purpose of creating the commission was to identify and pursue possible tax avoidance schemes, as there is no specific legal statute defining tax contraventions and/or crimes regarding the use of tax havens (aside from those related to transfer pricing regulations), it is highly likely that the investigation will focus on money laundering structures rather than tax avoidance schemes.

* * *

Endnotes

1. The law basically sets forth that in order to readjust or revalue transaction values between related parties, any of the following methods could be employed: a) Comparable Uncontrolled Price Method; b) Resale Price Method; c) Cost Plus Method; d) Profit Split Method; e) Transactional Net Margin Method; and f) Publicly Quoted Prices in Transparent Markets Method.
2. a) Taxpayers carrying out operations with related parties that amount to a sum equal to or greater (accumulated in one year) than BOB 15,000,000 (fifteen million bolivianos), are compelled to file an electronic tax return (601) declaring operations held with related parties and a file a Transfer Pricing Study; b) taxpayers carrying out operations with related parties that amount to a sum equal to or greater (accumulated in one year) than BOB 7,500,000 (seven million five hundred thousand bolivianos), but lower than BOB 15,000,000 (fifteen million bolivianos) are compelled to file an electronic tax

return (601); and c) taxpayers carrying out operations with related parties that amount to a sum lower (accumulated in one year) than BOB 7,500,000 (seven million five hundred thousand bolivianos), are compelled to keep safe the necessary documentation in order to demonstrate that said operations were carried out pursuant to market value and/or that they were subject to the necessary adjustments (one boliviano is currently equivalent to approximately USD 6.96 or EUR 1.19).

3. Pursuant to article 123 of the Bolivian Constitution: "*The law may only regulate for the future and shall not have a retroactive effect, except in labour law, when it favours employees; in criminal law, when it benefits the accused; in corruption cases, in order to investigate, process and sanction crimes committed by public servants against the State and in other cases as set forth by the Constitution.*" Likewise, article 150 of the Tax Code (Law No. 2492) specifies that: "*Tax regulations shall not have a retroactive character unless those that eliminate tax crimes and or contraventions, set forth more favourable sanctions, those that shorten statute of limitations terms or that, in any manner, benefit taxpayers or responsible third parties.*"
4. http://www.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB16-Full-Report.pdf.
5. http://www3.weforum.org/docs/GCR2016-2017/05FullReport/TheGlobalCompetitiveness Report2016-2017_FINAL.pdf.

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China

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Overview of corporate tax work over last year

General introduction

China is a civil law system country wherein tax laws and regulations should be followed by both tax authorities at different levels and taxpayers for tax administration and tax compliance purposes, and any precedent judgments rendered by courts in relation to tax disputes have no binding effects on any subsequent cases in a strict legal sense.

China's tax legislation system consists of the following levels:

- laws, as formulated by the National People's Congress, which govern the fundamental tax rules;
- administrative regulations and rules, as formulated by the State Council in accordance with law;
- local regulations and rules, formulated by the People's Congresses and their Standing Committees at provincial level;
- autonomous regulations and single regulations, formulated by the People's Congresses of the autonomous localities;
- departmental rules, formulated by the Ministry of Finance ("**MOF**"), the State Administration of Taxation ("**SAT**"), the General Administration of Customs, etc.;
- rules of local governments, formulated by the people's governments at different levels; and
- bilateral double taxation agreements or arrangements ("**DTAs**").

As published by the SAT on 31 October 2017, China has signed 103 DTAs with other countries, 99 of which are in force and four of which have been signed but are not yet in force. China has also concluded DTAs with Hong Kong Special Administrative Region ("**SAR**"), Macao SAR and Taiwan (the DTA with Taiwan is not yet in force).

Under the current tax regime of China, corporate taxes can be divided into the following categories:

(i) taxes levied on goods and services, which mainly include value-added tax ("**VAT**"), land value-added tax ("**LVAT**"), consumption tax and customs duty;
(ii) income taxes, which is mainly the enterprise income tax ("**EIT**");
(iii) property taxes, which mainly include house property tax, land use tax, land occupation tax, deed tax, etc.; and
(iv) other taxes, which mainly include stamp duty, urban maintenance and construction tax, educational surcharges, and tobacco tax.

For foreign investors with investment in China, the typical major types of applicable corporate taxes include EIT, VAT and local surcharges, LVAT, deed tax and stamp duty.

EIT

General

Under the People's Republic of China ("**PRC**") Enterprise Income Tax Law and its implementation rules, enterprises are divided into resident enterprises and non-resident enterprises, and their definitions and tax liability are specified as follows:

- A resident enterprise refers to an enterprise established in the PRC or established in accordance with the law of a foreign country (region) but with its effective management located in the PRC. A resident enterprise is subject to EIT on its worldwide income and the standard EIT rate is 25%.
- A non-resident enterprise refers to an enterprise established in accordance with the law of a foreign country (region) with its effective management not being located in the PRC, and which has an establishment or place in the PRC, or has no establishment or place in the PRC, but has income sourced from the PRC.
- A non-resident enterprise which has an establishment or place in the PRC is subject to EIT at 25% on income derived by such establishment or place from sources within the PRC, as well as income derived from outside of the PRC, but which is effectively connected with such establishment or place. If the non-resident enterprise resides in a country/region that has an income tax treaty with China, it is subject to EIT in the PRC if it constitutes a permanent establishment ("**PE**") in the PRC due to carrying out business activities in the PRC exceeding a certain time period (e.g. more than 183 days or six months within any 12-month period).
- Meanwhile, a non-resident enterprise that has no establishment or place in the PRC, or has an establishment or place in the PRC, but the income derived from the PRC is not effectively connected with such establishment or place, will be subject to EIT on the income sourced from the PRC at 10%, unless a preferential rate applies under a double tax treaty. In order to be entitled to the treaty benefits, a non-resident enterprise needs to be recognised as tax resident in the tax treaty jurisdiction. Furthermore, for the purpose of enjoying the treaty benefits on dividends, interest and royalties, non-resident enterprises shall be the Beneficial Owners of the received income according to the PRC anti-avoidance rules.

PRC transfer pricing practice

Under the PRC transfer pricing rules, related party transactions should be conducted in line with the arm's length principle; otherwise, the PRC tax authorities are empowered to make transfer pricing adjustments up to 10 years retroactively.

The PRC transfer pricing rules generally follow the Organisation for Economic Co-operation and Development ("**OECD**") Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and have also actively incorporated the principles and rules of the Base Erosion and Profit Shifting Action Plan ("**BEPS Action Plan**") into China's domestic tax regulations. In certain areas, China has adopted a more innovative approach to cope with the unique challenges that are faced by developing countries, which include:

- Location-specific advantages.
- Lack of adequate local comparable companies.
- Lack of experience and knowledge on both how multinational companies operate and the norms of particular industries.

Traditionally, the transactional net margin method (TNMM) is the most commonly applied transfer pricing methodology by the China tax authorities in transfer pricing audit cases. However, in recent years, tax authorities have tried using other transfer pricing

methods, especially in nationwide audit cases, including value chain analysis (in assessing the functions and risks undertaken by Chinese tested enterprises) and other profit-based methods, such as the profit split method. Meanwhile, over the past few years, China's tax authorities have been focusing their attention on the cross-border service fee and royalties arrangement.

Furthermore, according to the current transfer pricing reporting regulation, companies are required to prepare three-tier transfer pricing documentation (including a master file, local file and special issue file) as well as country-by-country reporting if certain thresholds are passed.

VAT and local surcharges

From 1 May 2016, the business tax regime has been replaced by a VAT regime in all industries in the PRC and, since then, sales of goods, provision of services, and transfer of intangibles or immovable properties have been subject to VAT in the PRC. For a general VAT taxpayer, output VAT is calculated at the applicable VAT rate and VAT payable is the balance of output VAT less input VAT. For small-scale VAT taxpayers, VAT payable is calculated at a rate of 3% of the taxable turnover, without input VAT being creditable.

Depending on the specific business activities or transactions, different VAT rates may apply; for instance:

- for sale of goods, a 16% rate generally applies;
- for sale of transportation, postage, basic telecommunication and construction services, a 10% rate generally applies;
- for sale of other services, a 6% rate generally applies; and
- for transfer or lease of immovable properties, a 10% rate generally applies.

Some transactions may be exempt from VAT if the relevant conditions are met.

Meanwhile, VAT taxpayers are also subject to urban maintenance and construction tax, education surcharge and local education surcharge (collectively, "local surcharges"), which is usually at 12%–14% of the VAT payment, if any.

LVAT

According to China's current LVAT regulations, disposal of real properties is subject to LVAT. LVAT is charged in four progressive brackets, ranging from 30% to 60%, depending on the ratio of gain realised (e.g. value added) to the amount of deductible items.

Deed tax

Deed tax is levied on a transferee for acquiring land and/or real property, the tax rate of which is 3%–5%.

Stamp duties

Entities and individuals executing or receiving stipulated taxable vouchers or agreements within the PRC are subject to stamp duties. For example, for loans provided by financial institutions to borrowers, the two parties to the loan agreement are subject to stamp duties at 0.005% of the loan, respectively; also, upon capital increase, a company is subject to stamp duties on the increased capital at 0.025%.

Key developments affecting corporate tax law and practice

In-depth VAT reform

Further to the replacement of business tax by VAT in all industries and sectors across the

country in May 2016, China has continued to publish a series of detailed VAT measures to deepen the VAT reform, including:

(a) The *Provisional Regulations of Value-added Tax* were revised on 19 November 2017 to incorporate the achievements of the VAT reform.

(b) The *Circular on the Adjustment to Value-Added Tax Rates* (Cai Shui [2018] No. 32) was jointly issued by the MOF and the SAT on 4 April 2018, effective from 1 May 2018. Under Circular 32, among other measures, the VAT rates have been adjusted as follows:
   - reduction of the 17% VAT rate to 16%, applicable to sales of goods, importation of goods, sales of repairing and maintenance services and lease of tangible movable properties; and
   - reduction of the 11% VAT rate to 10%, applicable to sales of transportation, postal, telecommunications and construction services, leases/sales of immovable properties as well as sales/importation of publications, agriculture-related products, etc.

(c) The *Circular on Harmonizing the Criterion for VAT Small-scale Taxpayers* (Cai Shui [2018] No. 33) was jointly issued by the MOF and the SAT on 4 April 2018, effective from 1 May 2018, under which the annual taxable sales ceiling for small-scale VAT taxpayers (who are subject to a 3% rate without input tax being creditable against output VAT) has been adjusted to RMB 5m uniformly for all industries (from RMB 0.5m, RMB 0.8m or RMB 5m as applied to different industries).

Tax deferral for overseas investors' re-investment in China

To promote the growth of foreign investment, further actively utilise foreign capital and improve the quality of foreign investment, China, in late 2017, granted a temporary waiver of EIT (usually at 10%, unless a preferential tax rate applies under a double tax treaty or arrangement) for non-tax-resident enterprises (i.e. overseas investors) that make direct investments in an encouraged industry with profits distributed by a tax-resident enterprise in the PRC ("**tax deferral**"), if certain conditions are met.

Two Circulars were issued to regulate and implement the tax deferral policy, one being the *Circular on Policy Issues Concerning Provisionally Not Levying Withholding Income Tax on Direct Investments by Foreign Investors Made Using Distributed Profits* (Cai Shui [2017] No. 88, "**Circular 88**"), jointly issued by the MOF, the SAT, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOC) on 21 December 2017; the other is the *Announcement on Issues Relevant to the Implementation of the Policy of Provisionally Not Levying Withholding Income Tax on Direct Investments Made by Foreign Investors Using Distributed Profits* (SAT Announcement [2018] No. 3, "**Announcement 3**") issued by the SAT on 2 January 2018.

Requirements to enjoy the tax deferral

According to Circular 88 and Announcement 3, an overseas investor must satisfy *all* of the following requirements to enjoy the tax deferral:

- Investment form. An overseas investor must make a direct equity investment in the PRC with distributed profits in the form of a capital increase, establishment of new foreign investment enterprises, acquisition of shares, etc.
- Nature of profits. The profits derived by an overseas investor must be dividends or any other profit distributions from equity investment. Such profit distribution must arise from retained earnings that are already realised and actually distributed by a tax-resident enterprise in China, including earnings accumulated in previous years.
- Payment method. The distributed profits, either in cash or non-cash form, must be directly paid by the profit-distributing enterprise to the invested enterprise or the transferor of the shares.

- Investment scope. The invested enterprises must, within the overseas investor's investment term, conduct business activities falling within the scope of encouraged industries for foreign investment, as specified in (i) the *Catalogue on Industry Guidelines for Foreign Investment* (revised in 2017), and (ii) the *Catalogue of Priority Industries for Foreign Investment in Central and Western China* (revised in 2017).

Retrospective application of the tax deferral

The tax deferral retrospectively applies to dividends or profit distributions derived by overseas investors from their equity investments in China on and after 1 January 2017.

Hence, for profits distributed on and after 1 January 2017, where an overseas investor was entitled to but had not claimed the tax deferral, it may apply to claim the said entitlement retrospectively within a three-year period after actual payment of the relevant taxes, and thus obtain a tax refund.

Recovery of the tax deferred

The deferred tax will be clawed back where the overseas investor withdraws or disposes its investment in China that enjoyed the tax deferral (unless, by virtue of an internal restructuring, special tax treatment is granted upon the restructuring) or the overseas investor enjoys the tax deferral without meeting all the requirements. Under such circumstances, the overseas investor may be imposed with late payment interest on top of the unpaid tax, and the profit distributing enterprise may be subject to an administrative penalty for its failure to fulfil its withholding obligation.

Significant improvements to the withholding regime

China continues to optimise its business environment and ease the administrative burden of non-tax-resident taxpayers and their withholding agents. For such purpose, on 17 October 2017, the SAT released the *Announcement on the Matters regarding Withholding Enterprise Income Tax at Source for Non-Tax-Resident Enterprises* (SAT Announcement [2017] No. 37, "**Announcement 37**").

Announcement 37 makes prominent changes to the existing withholding regime in the following aspects:

Revision of the timing of the withholding obligation

For dividends derived by a non-tax-resident enterprise from China, Announcement 37 stipulates that the withholding obligation arises on the date of actual payment of the dividends. It abolishes the previous rules whereby the withholding obligation arises on the date when the board resolves to distribute dividends to its foreign shareholder, irrespective of whether the dividends are actually paid or not.

For instalment payments received by a non-tax-resident enterprise from transferring assets in China, Announcement 37 provides that the instalment payments can be considered first as the recovery of investment so that the EIT is withheld only after the investment cost has been fully recovered.

Removal of the tax filing deadline for non-tax-resident enterprises

Previously, a non-tax-resident enterprise had to file its taxes within seven days from the date the tax/withholding obligation occurred if the withholding agent failed to withhold tax on its behalf, otherwise late payment interest would be imposed.

Announcement 37 repeals such deadline and stipulates that, where a withholding agent fails to withhold tax or is unable to fulfil the withholding obligation, the non-tax-resident enterprise must declare and pay the tax on its own; where a non-Chinese-resident enterprise

fails to do so, the tax authority may order it to make the tax payment within a specified time limit, and the non-tax-resident enterprise will be deemed to have paid the tax in time if it declares and pays the tax within such time limit, which relieves non-tax-resident enterprises' compliance burden.

Simplification of the currency conversion in calculating tax liability

For outbound payments denominated in a foreign currency, Announcement 37 clarifies the applicable exchange rate for conversion into Renminbi under the following three scenarios: 1) where the tax is withheld by a withholding agent, the exchange rate on the date when withholding obligation arises will apply; 2) where a non-tax-resident enterprise submits a tax filing, the exchange rate on the date one day before the issuance of the tax payment notice will apply; and 3) where the tax authority sets out a time limit for the non-Chinese-resident enterprise to make the tax payment, the exchange rate on the date one day before the decision of the time limit will apply.

The calculation of tax liability arising from asset transfers (including equity transfers) also follows the above rules. This is a simplification compared to the previous method, which required the share transfer price and cost to be firstly converted to the foreign currency used in the first capital injection to calculate taxable income, and then the taxable income would be converted to Renminbi.

Abolition of the contract registration requirement

Among other measures, Announcement 37 also removes the previous requirement for the withholding agent to perform contract registration with the tax authorities within 30 days from the date when the contract is concluded.

Further guidance on tax treaty application

On 9 February 2018, the SAT issued the *Announcement on Several Issues Relating to Implementation of Tax Treaties* (Announcement [2018] No. 11, "**Announcement 11**"), effective as of 1 April 2018, to provide further guidance on certain tax treaty articles, including permanent establishment, shipping and air transport, artistes and sportsmen, as well as treaty entitlement of partnerships. The prominent points are as follows:

Threshold for service PEs

Announcement 11 clarifies that the "six-month" threshold applicable to the constitution of a PE due to provision of services in China under some Chinese tax treaties will be implemented and interpreted by referring to "183 days".

Treaty entitlement of partnerships

In principle, a partnership established in China is a disregarded entity for Chinese income tax purposes, thus the partners are subject to treaty entitlement assessment; partnerships established in foreign jurisdictions are regarded as non-tax-resident enterprises in China and be entitled to treaty benefits on the condition that they are tax resident in the treaty-contracting state and liable for tax in that state, unless otherwise prescribed by the applicable tax treaty.

New guidance for the "Beneficial Owner" assessment

On 3 February 2018, the SAT issued the *Announcement on Issues Relating to "Beneficial Owner" in Tax Treaties* (Announcement [2018] No. 9, "**Announcement 9**"), effective from 1 April 2018, as new guidance on the recognition of a Beneficial Owner ("**BO**") in tax treaties, replacing the previous rules in this regard.

Income recipients need to be recognised as BOs so that they are eligible for the preferential tax rates under the dividends/interest/royalty articles in tax treaties. Announcement 9 has made major amendments to the assessment of BO status, by taking into account practical experience of Chinese tax authorities in recent years, which also reflect the recent developments of international taxation. For example:

Expansion of the scope of "safe harbour rules" for dividends

Under the "safe harbour rules", a dividends recipient can be directly recognised as the BO without undergoing a comprehensive assessment. Announcement 9 has broadened the scope of safe harbour rules to include governments of contracting states, listed companies and individuals that are residents of the contracting states as well as companies that are 100% held by the aforesaid, directly or indirectly, provided that each intermediary shareholder is either a resident of China or a resident of the other contracting state (in an indirect shareholding scenario). This amendment aims to improve certainty on treaty entitlement and reduce the tax administration burden.

Introduction of the same jurisdiction rule and the same treaty benefits rule

Under these two rules, a dividends recipient who is not qualified as a BO can be deemed as the BO provided that the shareholder who has directly or indirectly held 100% of the shares of the recipient for 12 consecutive months before obtaining dividends qualifies as the BO, and (i) the qualified shareholder is tax-resident in the same jurisdiction as the recipient, or (ii) the qualified shareholder and all intermediary shareholders are entitled to tax treaty benefits identical to or more favourable than those the recipient would be entitled to. This reflects the outcome of BEPS Action 6 and grants taxpayers treaty benefits where treaty abuse is not involved.

Revision of unfavourable factors for BO assessment

Under Announcement 9, and to a large extent in line with the previous rules, unfavourable factors, i.e. the payment obligation of the income recipient, the business activities conducted by it, tax that it pays in the contracting state and the existence of back-to-back loan/licensing agreements, will be assessed on a comprehensive basis for the purpose of assessing the BO status of the income recipient, unless otherwise stipulated (e.g. where safe harbour rules apply).

Tax climate in China

In recent years, China has been continuously working on the improvement of its tax environment for both Chinese domestic companies and foreign investors, especially from the following main aspects:

- The tax burden of market players has been reduced as a result of VAT reform, VAT rates having been cut, tax incentives for small and micro enterprises and tax incentives for high-tech enterprises having been introduced, etc. The tax cut trend is expected to continue in the following years.
- From a tax collection and administration perspective, China has made great efforts in improving the efficiency of the tax authorities, simplifying tax procedures, as well as enhancing information-sharing among different authorities. It is noteworthy that, in mid-2018, China launched a nationwide reform to combine the state tax bureaus and the local tax bureaus at different levels. After the reform, taxpayers will be able to report their various tax issues to one centralised tax authority, which will be more convenient for taxpayers when handling routine tax compliance matters, as previously taxpayers generally had to conduct tax declarations with two different tax authorities (the state tax bureau and the local tax bureau) for different types of taxes.

In addition, with China's proactive participation in the BEPS project and the incorporation of the BEPS achievements into its domestic rules, the Chinese tax authorities have been increasingly focused on and experienced in combating profit shifting and tax avoidance schemes. This is evidenced by an increased number of transfer pricing audit cases and general anti-tax avoidance cases.

Developments affecting attractiveness of China for holding companies

Allowing more foreign taxes to be credited in China

As a measure to reduce the tax burden and facilitate the profit repatriation of Chinese companies with foreign investments, on 28 December 2017, the MOF and the SAT jointly issued the *Notice on Issues Relating to Refining Foreign Income Tax Credit Policies for Enterprises* (Cai Shui [2017] No. 84, "**Circular 84**").

Introduction of the consolidation method

Circular 84 allows Chinese enterprises to calculate their creditable foreign taxes and foreign tax credit limit based upon either (i) income derived from a single foreign jurisdiction, or (ii) consolidated income from various jurisdictions. By comparison, the consolidation method allows Chinese enterprises to balance the tax burden in different foreign jurisdictions and provides more foreign tax credit to be utilised by Chinese enterprises.

Allowing more tiers of foreign subsidiaries to be eligible for foreign tax credit

Circular 84 grants the entitlement of foreign tax credit to five tiers of foreign subsidiaries, increased from three tiers.

Industry sector focus

Clarification of VAT rules for fund management products

On 30 June 2017, the MOF and the SAT jointly issued the *Circular on Matters Relating to VAT on Fund Management Products* (Cai Shui [2017] No. 56, "**Circular 56**") to regulate the imposition of VAT on fund management products.

Circular 56 provides that, starting from 1 January 2018, managers of fund management products are subject to VAT at a 3% rate as the taxpayers for any taxable activities during their operation of the fund management products. Circular 56 has also defined the scope to be considered as a fund manager as well as the scope of fund management products.

Preferential tax policy for Advanced Technology Service Enterprises ("**ATSEs**") nationwide

To support technology development, China has granted a preferential EIT rate of 15% for ATSEs in pilot cities starting from 2006. As one of the government's continuing efforts to encourage technology innovation, the preferential policy is expanded nationwide; specifically:

(a) With retroactive effect from 1 January 2017, qualified ATSEs engaging in information technology outsourcing services (ITO), technical business process outsourcing services (BPO) and technical knowledge process outsourcing services (KPO) are entitled to a 15% reduced EIT rate, pursuant to the *Circular on Promoting the Implementation of Enterprise Income Tax Policies for Advanced Technology Service Enterprises Nationwide* (Cai Shui [2017] No. 79).

(b) With retroactive effect from 1 January 2018, qualified ATSEs engaging in service trading, such as IT services, R&D services, cross-border licensing and transfer of intellectual properties, Chinese medicine healthcare services, etc., are entitled to a 15% reduced EIT rate, pursuant to the *Circular on Full launch of Pilot Enterprise Income*

Tax Policies for Advanced Technology Service Enterprises Engaging in Service Trading (Cai Shui [2018] No. 44).

The year ahead

With respect to taxation legislation, the amendments to the Individual Income Tax Law and Tax Collection and Administration Law are expected to be moved forward.

Under the global contest for capital, for the purpose of driving economic growth, industry upgrade and technology development, China may issue more tax policies to further reduce the tax costs of domestic market players and enhance the competitiveness of the Chinese market in order to attract more foreign capital. Also, for the purpose of encouraging technology development, detailed rules may be released to grant a refund of excessive input VAT to certain industries with advanced technologies within a certain period.

Along with the in-depth promotion of the Belt and Road initiative, China is expected to further improve the tax regime in relation to outbound investments.

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Cyprus

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Introduction

The past few years have seen some significant amendments and refinements of existing legislative provisions in the field of taxation, as well as the introduction of new provisions aimed at providing incentives for investment in Cyprus and ensuring fairness, effectiveness and efficiency. In addition, Cyprus has also demonstrated its full commitment to comply with EU and international initiatives, including the Organization for the Economic Cooperation and Development (OECD) initiative on tackling harmful tax practices and unjustified tax avoidance, by introducing appropriate mechanisms and closing any remaining loopholes in its domestic legislation. All these themes have continued through 2017 and into 2018, as described below.

Types of corporate tax work

Tax practitioners in Cyprus, including those in our firm, have been kept busy over the past year advising on and implementing the various incentives introduced since 2015, including the notional interest deduction on new equity investment, income tax exemptions for individuals relocating to Cyprus, new residence rules and exemptions for individuals who are resident but not domiciled in Cyprus. The tax authorities have issued detailed guidance on implementation of several of these issues.

In addition, the intellectual property box regime, amended to follow the modified nexus approach, has continued to receive considerable interest. While the changes restrict the range of qualifying IP assets from mid-2016, there are grandfathering provisions to cover the transition.

We have also seen increased interest in the establishment of alternative investment funds in Cyprus following the modernisation of the legal framework relating to funds, which can be very effectively combined with the tax and non-tax benefits that Cyprus offers. Cyprus law is based on English law, which is familiar to international investors. The mutual funds industry in Cyprus is developing well; and law and accounting firms are establishing specialist departments and independent firms specialising in funds are also springing up.

The tax landscape on a global and domestic level is changing at an unprecedented rate, with an enormous volume of new practices and standards imposed by European and international initiatives for tax practitioners to keep abreast of, analyse and assess. Cyprus has made significant progress in amending its primary and secondary legislation to align its tax practices with the OECD's project on base erosion and profit shifting (BEPs) demonstrating its full commitment to comply with the new global demands. It is equally important for Cyprus to offer fair, effective and competitive solutions to entrepreneurs wishing to invest in Europe through the island, and to meet their expectations to the fullest extent possible.

Significant deals and themes

Notwithstanding the many confident predictions of the demise of tax planning and tax mitigation, Cyprus holding companies continue to be utilised by investors wishing to combine the already attractive features of Cyprus's tax laws with the newly introduced provisions. Cyprus does not impose withholding taxes on dividends or interest paid to non-residents. Royalties paid to non-residents are subject to withholding taxes (at 10%, or 5% in the case of cinema films) only if they arise from use of an intellectual property asset within Cyprus. There is no tax on capital gains, apart from gains tax on the sale of immovable property situated in Cyprus or on the sale of shares in a company directly or indirectly owning such immovable property, to the extent that the gain is derived from the immovable property. The sale of shares is generally exempt from income tax in Cyprus, except in some limited circumstances.

These long-established features of the Cyprus tax system, in combination with the new incentives, have prompted investors and multinational corporations alike from all over the world to include Cyprus holding companies in their structures and in some instances set up a significant economic presence in Cyprus or relocate to the island.

A recurring significant element of our work relates to the application of the Notional Interest Deduction (NID) regime, which was introduced in 2015. International businesses continue to establish Cyprus tax resident companies and we provide detailed in-depth advice on operational and management substance and anti-avoidance issues in order to ensure that the proposed structures comply with applicable requirements.

In addition to activity arising from new developments and initiatives, there is a constant flow of work on restructurings aimed at improving governance, operational effectiveness or tax-efficiency. Many substantial international businesses make use of Cyprus holding and finance structures and the Cyprus aspects are often central to the entire restructuring. These restructuring projects may not only involve companies, but also trusts, foundations, partnerships and other structures registered or resident in any of a wide range of jurisdictions. Our analysis focuses on domestic legislation, anti-avoidance provisions, procuring tax rulings, existing DTTs and informing clients on international initiatives which may affect the proposed transactions.

Key developments affecting corporate tax law and practice

Double tax treaties (DTTs)

During 2017 and the first half of 2018, Cyprus's already extensive network of DTTs has continued to expand. The provisions of the new DTTS with Bahrain, Georgia, India and Latvia, which had entered into force during 2016, took effect from the beginning of 2017. During 2017, new DTTs with Barbados (signed in 2017) Ethiopia, Iran (both signed in 2015) and Jersey (signed in 2016) entered into force. All four DTTs took effect as regards Cyprus taxes from the beginning of 2018. Also during 2017, a new agreement was signed with Luxembourg, as were protocols to the existing agreements with Mauritius and San Marino.

The conclusion of new DTTs has continued into 2018, with new agreements with Andorra and Saudi Arabia, and a revised agreement with the United Kingdom having been signed during the first five months of the year.

One of the most significant developments regarding DTTs was the continued deferral of the implementation of amendments to the DTT with Russia, one of Cyprus's most important

DTTs, which were due to take effect on 1 January 2017, providing for source-based taxation of capital gains on shares in "property-rich" Russian companies.

Under the 1998 double taxation agreement between Cyprus and Russia, gains on disposals of shares are taxable only in the country of residence of the person disposing of the shares. Since Cyprus does not impose any capital gains tax on disposals of shares in companies unless they own immovable property in Cyprus, this makes Cyprus a very advantageous location for holding shares in Russian companies.

The Protocol to the 1998 double taxation agreement, which was signed in 2010, provided that gains on the disposal of shares in companies which derive their value principally from immovable property in Russia (so-called "property-rich" companies) would be subject to tax in Russia after a transitional period, which was due to expire at the end of 2016. Shares in other companies were not affected.

However, the application of this provision of the Protocol has now been deferred until similar provisions are introduced into Russia's double taxation agreements with other European countries, and disposals of shares in property-rich companies will continue to be taxable only in the country of residence of the person disposing of the shares, in the same way as other shares.

Notional interest deduction

In order to align the tax treatment of debt and equity finance, the Income Tax (Amendment) Law introduced a deemed interest deduction on new equity capital (paid-up share capital and share premium) contributed after 1 January 2015 into companies and permanent establishments of foreign companies in order to finance business assets.

NID is deducted from the taxable profit of the Cyprus tax resident entity and is limited to 80% of its total taxable profit. Unclaimed NID cannot be carried forward to be offset against future years' profits.

For the purposes of NID, new equity may be contributed in cash or in the form of other assets, in which case the value of assets should be supported by an independent valuation report. An independent valuation is not necessary under certain circumstances such as if the assets are listed on an open market on which similar assets are sold on a regular basis or if the registrar deems it unnecessary since the assets have been recently acquired from a third party and no event has occurred from the date of their acquisition which would significantly affect their value. No NID is available in respect of capitalisation of reserves, revaluation of assets or for companies benefiting from the reorganisation exemptions included in the tax laws. NID may be refused if the Tax Department considers that the transaction concerned has no economic or business purpose.

The NID is calculated by applying a so-called reference rate to the new capital. For capital introduced during a year, a time-apportionment is carried out. The reference rate is the 10-year government bond yield of the country in which the assets funded by the new equity are utilised, plus 3 percentage points, or the 10-year Cyprus government bond yield plus 3 percentage points, whichever is the higher. The bond yield rates to be used are as at 31 December of the year preceding the year of assessment. The Tax Department has announced the following rates for 2018:

Country	Bond yield at end-2017	Reference rate for 2018
Austria	0.563	4.881
Canada	2.079	5.079

Country	Bond yield at end-2017	Reference rate for 2018
China	4.268	7.268
Croatia	2.453	5.453
Cyprus	1.881	4.881
Czech Republic	1.650	4.881
Estonia	0.715	4.881
France	0.780	4.881
Germany	0.423	4.881
Greece	4.073	7.073
Hungary	2.031	5.031
India	7.571	10.571
Italy	2.005	5.005
Luxembourg	0.637	4.881
Netherlands	0.501	4.881
Norway	1.579	4.881
Poland	3.385	6.385
Republic of Ireland	0.811	4.881
Romania	4.314	7.314
Russia (ruble)	7.590	10.590
Russia (USD)	3.822	6.822
Serbia	5.968	8.968
Slovakia	0.815	4.881
Slovenia	0.843	4.881
South Africa	8.780	11.780
Spain	1.558	4.881
Sweden	0.540	4.881
United Kingdom	1.188	4.881
United States of America	2.406	5.406

Tax incentives

The government has also been proactive in offering incentives aimed at encouraging wealthy individuals to relocate to Cyprus or encouraging companies to relocate their operations to the island.

The "non-domiciled" regime

Up to and including 15 July 2015, both Cyprus-resident individuals and Cyprus-resident companies were liable to pay Special Defence Contribution, commonly referred to as SDC tax, on dividends, passive interest and rents received, at rates of 17%, 30% and 3% (applied to 75% of the rent), respectively. Dividends and passive interest (but not rents or active interest) are exempt from personal or corporate income tax.

With effect from 16 July 2015, the Special Defence Contribution (SDC) (Amendment) Law exempts individuals who are not domiciled in Cyprus for the year of assessment concerned from liability to SDC tax. Coupled with the income tax exemptions applying to such income, this provides individuals who are resident but not domiciled in Cyprus

with complete exemption from any form of Cyprus tax on dividends and passive interest, regardless of source. Companies are not affected by the change.

For the purposes of determining liability to SDC tax, the principles set out in the Wills and Succession Law regarding domicile, which follow the principles of English common law, apply. In summary, an individual acquires a domicile of origin at birth. It is generally the same as the domicile of the father at the time of birth, and in exceptional cases that of the mother. A domicile of origin may be replaced by a domicile of choice if in actual fact an individual permanently establishes himself or herself in another country with the intention of living there permanently and dying there. An individual will be deemed to be domiciled in Cyprus if he or she has been a tax resident for 17 or more of the 20 tax years immediately preceding the year of assessment.

The amendments are very attractive to individuals with investment income who consider relocating to Cyprus and conducting their business from the island.

Incentives for new taxpayers

For many years, there has been an exemption available to new taxpayers relocating to Cyprus, with 20% of the total emoluments or €8,550 (whichever is the lower) exempt from taxation for five years following the commencement of employment in Cyprus provided that the individual concerned was not a tax resident of Cyprus during the previous tax year. This exemption may be claimed until 2020, but will then be withdrawn.

An alternative exemption was introduced in 2015, aimed at high-paid employees. For employees with total annual earnings of €100,000 or more, 50% of emoluments earned from employment in Cyprus is exempt from income tax. The exemption is available for the first 10 years from the commencement of employment in Cyprus, provided that the individual was not tax resident in Cyprus during the tax year preceding the year in which the employment began, or for three or more of the tax years preceding the year in which the employment began.

New routes to residence

Law 119(I) of 2017 amended the provisions of the Income Tax Law regarding residence of individuals with effect from the beginning of the 2017 tax year. Previously, the only way for an individual to qualify as tax resident in Cyprus was to be physically present for at least 183 days in the tax year. However, the new law introduces an additional route to residence. With effect from 1 January 2017, individuals who meet all the following conditions in respect of a given tax year will be deemed to be tax resident in Cyprus:

- they are physically present in Cyprus for one or more periods amounting to at least 60 days;
- they do not remain in another country for one or more periods exceeding 183 days in total;
- they are not tax resident in another country;
- they undertake business in Cyprus, have employment in Cyprus or hold a post in a Cyprus-resident company which continues to the end of the tax year; and
- they maintain a permanent residence at their disposal for their use in Cyprus.

Individuals who satisfy the criteria may obtain a tax residence certificate by completing the prescribed form (T.126 (2017)) and submitting it to the Tax Department together with evidence of arrival and departure in Cyprus, property title deeds or a lease contract, and evidence of employment.

Alignment with international initiatives

As an EU member, Cyprus is committed to implementing EU initiatives such as ATAD2, automatic exchange of information and international initiatives adopted by the EU. In addition, although it is not a member of the OECD, Cyprus is fully committed to implementing OECD best practice, including the BEPS initiative.

Signature of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI)

Cyprus was one of the initial signatories of the MLI, which opened for signature on 7 June 2017. The MLI will apply alongside DTAs, modifying their application in order to implement the relevant BEPS measures, without requiring any further bilateral negotiations between the countries concerned. It will automatically amend all existing DTAs of which both parties are signatory countries to the MLI, introducing measures to prevent base erosion and profit shifting, including anti-abuse and anti-avoidance clauses.

At the time they signed the MLI, the signatories submitted a list of double tax agreements they intend to be covered, together with a preliminary list of their reservations and notifications in respect of the various provisions of the MLI. Cyprus intends to include all its existing double tax agreements, and it is likely that the changes will start to take effect in 2019, though some DTAs could be affected before then.

The most recently signed DTTs, with Andorra, Luxembourg and the United Kingdom, also include a preamble making clear that they are not designed to create opportunities for double non-taxation or reduced taxation through evasion or avoidance, and a principal purpose test-based general anti-avoidance rule.

Implementation of the EU Anti-Tax Avoidance Directives

Like other EU Member States, Cyprus is required to enact legislation to implement the EU's Anti-Tax Avoidance Directives, and in November 2017 the Tax Department published draft legislation for consultation. The proposed legislation covers all the issues required under the directives, principally the deductibility of interest expense, controlled foreign company (CFC) rules, a general anti-avoidance rule (GAAR), the introduction of an exit taxation regime and rules to eliminate cross-border double non-taxation resulting from hybrid mismatches.

Interest limitation rule

The practice of groups artificially shifting their debt to jurisdictions with more generous deductibility rules is being discouraged by limiting the amount of interest that the taxpayer is entitled to deduct in a tax year. The consultation document proposes a limit on deductible exceeding borrowing costs, defined in the same way as in ATAD, of 30% of profit adjusted for tax purposes before interest, tax, depreciation and amortisation (commonly referred to as taxable EBITDA) or €3m, whichever is higher. This rule will be applied at the company level unless the company is a member of a group as defined for Cyprus tax purposes (broadly 75% common ownership for the whole of the tax year), in which case the rule will be applied at the Cyprus group level. The interest limitation rule will not apply to wholly independent companies (those which, on a worldwide basis, are not part of a group, have no associates and no permanent establishments) or to financial institutions. There is an exemption for financing of certain public infrastructure projects and their associated income, and financial arrangements entered into before 17 June 2016 and not amended since then are outside the scope of the rule. There is an "equity escape rule" replicating article 4.5(a) of ATAD,

allowing full deduction of borrowing costs if the local taxpayer's ratio of equity to total assets is not more than 2 percentage points lower than the equivalent ratio for the group as a whole. Interest costs disallowed by reason of the rules may be carried forward for up to five years. The proposed effective date is 1 January 2019, in line with the directives.

CFC rules

The draft law defines a CFC in the same way as ATAD as an overseas permanent establishment or company directly or indirectly controlled by a Cyprus tax resident company, the corporate profit tax burden of which is less than half of what it would be under the Cyprus tax system. It adopts the approach set out in article 7.2(a) of ATAD, under which specified categories of income including interest, royalties and dividends receivable by the CFC are to be included as current income in the tax base of the Cyprus parent and taxed in accordance with Cyprus rules, unless the CFC is resident in an EU or EEA country and engages in substantive economic activities. The proposed effective date is 1 January 2019, in line with the directives.

Exit taxation

The provisions regarding exit taxation adopt the text of article 5 of ATAD, providing for the taxpayer to be liable for tax at an amount equal to the difference between the market value and the value for tax purposes of assets transferred outside the scope of Cyprus taxation while remaining under the same ownership (for example, if a company transfers a taxable asset from its Cyprus head office to an exempt foreign permanent establishment). The taxpayer will have the right to pay the exit tax by instalments over five years in the same way as prescribed in paragraph 2 of article 5 of ATAD, and subject to the same conditions, with very minor modifications regarding provision of security. The proposed effective date is 1 January 2020, in line with the directives.

General Anti-Abuse Rule

The proposed legislation adds a new article 33(6) to the Income Tax Law, which reproduces the provisions of article 6 of ATAD, allowing the Tax Department to disregard artificial arrangements (arrangements not put into place for valid commercial reasons which reflect economic reality) whose main purposes include obtaining a tax advantage that defeats the object or purpose of the tax laws. The proposed effective date is 1 January 2019, in line with the directives.

Hybrid mismatches

To the extent that a hybrid mismatch results in a double deduction, any Cyprus-resident recipient will be denied the deduction and any Cyprus-resident payer will be denied the deduction, if a deduction is given to an overseas-resident recipient. To the extent that a hybrid mismatch results in a deduction without inclusion, if the Cyprus-resident party is the payer the deduction will be denied, and if the Cyprus-resident party is the recipient and a deduction is given to the overseas-resident payer, the receipt will be included in the Cyprus-resident party's taxable income.

The effective dates for the rules are identical to those set out in the directives, with the provisions regarding mismatches of hybrid instruments and tax residence due to take effect from 1 January 2020 and those relating to reverse hybrid mismatches becoming effective on 1 January 2022.

The proposed provisions are in addition to similar provisions introduced in 2015 to apply the amended EU Parent/Subsidiary Directive.

Developments affecting Cyprus's attractiveness as a jurisdiction for holding companies

The strategy adopted by successive governments to develop Cyprus as an international financial centre has been to offer a competitive environment in terms of tax rates and incentives, while maintaining an impeccable reputation in terms of not allowing any abuse of the system for money laundering, tax evasion and other criminal activities. While the new international initiatives, which are driven by the larger economies, create increased reporting and compliance burdens, the Cyprus tax authorities are committed to minimising the impact on taxpayers by modernising their internal systems to make the process as trouble-free as possible.

Cyprus's geographic position, its membership of the EU and the Eurozone, its common law legal system and familiar business infrastructure, combined with the benign tax environment, mean that it should always be on the shortlist when choosing a holding company jurisdiction.

A Cyprus company which meets the necessary substance requirements can offer significant benefits, and the quality of life and low operating costs compared to other destinations, make Cyprus an attractive proposition.

Industry sector focus

Cyprus's economy is largely built on tourism, financial and professional services, shipping and agriculture. Cyprus is one of the world's leading shipping centres. The Cyprus registry ranks tenth among international fleets and the island is among the world's top five ship management centres. One of its attractions is a very competitive EU-approved tonnage-based system of shipping taxation, which can give substantial savings for Cyprus-resident shipping and ship management companies.

The year ahead

The Cyprus government recognises that one of the most desirable features of a holding company jurisdiction is stability and predictability, so major changes of direction are unlikely. We see the emphasis being on implementing international initiatives as efficiently as possible, and modernising the operations of the Tax Department to improve its interaction with taxpayers and eliminate delays.

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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 retails 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 year or so.

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 recently 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, which 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

The Czech Republic did not make any major tax law amendments over the last year which is, to a large extent, a result of not having a functioning government since the parliamentary election in October 2017. If a government is formed shortly (the timing of which is not yet clear), major amendments might come into force on 1 January 2019.

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 – CJEU cases and EU law developments

Being an EU country, the Czech Republic naturally implements tax directives approved by the EU. There has been no major development in this area recently, but certain BEPS measures are expected to be implemented in 2019. One of the key changes that will affect most clients and transactions is the interest deductibility limitation (the cap being 30% of earnings before interest, tax, depreciation and amortisation (EBITDA) of the debtor). Details about the new rules, especially the *de minimis* level and consolidation, are not yet clear.

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.

Tax climate in the Czech Republic

As noted above, the Czech tax authorities are becoming increasingly sophisticated and aggressive. Some clients feel that this approach that the authorities have taken 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 the 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

Assuming that the Czech Republic will have a functioning government later this year, we may expect substantial tax amendments to be approved with effect from 1 January 2019 or 1 July 2019.

It has already been announced that the personal income tax rates will be increased from the current flat rate of 15% to progressive rates of 19%–24%. The amendments will also certainly include certain BEPS-related measures (see above). Relevant details will be available later this year.

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Overview of corporate tax work over last year

2017 has been one of the most successful years for the French mergers and acquisitions (M&A) market, which has specifically benefited from European economic growth.

The French market has been very active after the election of Emmanuel Macron as President in May 2017. M&A transactions in France have reached a record level in comparison with the previous decade. The volume of announced M&A deals reached €205bn, which is an increase of 50% since 2016 (source: Thomson Reuters).

International takeovers have played a major role in this trend, notably with Unibail-Rodamco announcing its €20.97bn acquisition of Westfield (Australia) in December 2017 and Essilor announcing the acquisition of Luxottica (Italy) in January 2017.

With respect to taxation, the Westfield transaction should be emphasised, since it is one of the first international transactions to have been implemented under the new French tax regime of cross-border mergers and restructurings (see below).

More generally, despite the uncertain international environment (US tax reform, Brexit), the French M&A market remained strong and very active.

Key developments affecting corporate tax law and practice

Implications of BEPS multilateral convention for tax treaty-related measures

On 7 June 2017, France signed the multilateral convention to implement tax treaty measures to prevent BEPS (the "multilateral instrument" or MLI), among 68 other jurisdictions.

France provided the OECD with a list of bilateral treaties to be modified by the multilateral instrument as well as the list of options and reservations made with respect to the various provisions of the convention.

Eighty-eight French tax treaties are now covered in this list (out of a total of 125 treaties), including those concluded with major business partners (e.g. Germany, the Netherlands, the United Kingdom, the United States) or with commonly used investment jurisdictions such as Luxembourg. Among the list of options and reservations made by France, France intends to implement the principal purpose test clause, the dependent agent permanent establishment rule and the mandatory binding arbitration mechanism.

On 19 April 2018, the French Senate approved the bill for ratification and implementation of the MLI which is now under review by the French National Assembly.

More generally, current bilateral treaties concluded by France will most probably be subject to amendments in the very near future (as has recently been the case for Luxembourg, see below).

Implications of the Common Reporting Standard

The Common Reporting Standard (CRS) is the standard for automatic exchange of financial account information (AEOI) developed by the OECD. Based on the Foreign Account Tax Compliance Act (FATCA), CRS is a legal basis for exchange of tax data among participating jurisdictions.

On 14 June 2017, French tax authorities issued comprehensive guidelines regarding the CRS regulation application for French reporting financial institutions. Additionally, France has transmitted for the first time the CRS returns for the reporting year 2016 in September 2017.

Tax climate in France

The tax climate for 2017 in France reveals a trend towards attracting foreign investments and competitiveness.

This tendency is mainly based on the current political developments reflecting the election promises of Emmanuel Macron. The reforms have been rather important concerning corporate taxation, in comparison with the preceding years, but are also highly significant for taxation on individuals. The repeal of French wealth tax as well as the reform of dividends and capital gains taxation of individuals at the end of 2017 notably had a material impact on the structuring of M&A transactions in France. However, it is expected that further reforms on corporate taxation will be implemented over the next few years.

In parallel, prevention of tax fraud, evasion and avoidance is still a strong concern (i.e. the Paradise Papers scandal has notably contributed to the reinforcement of awareness of these matters). Tax and legal measures against fraud are continuing to be implemented on a domestic, European and international basis (e.g. BEPS legislation, signing of the MLI, implementation of the ATAD and the CRS).

Developments affecting the attractiveness of France for holding companies

Gradual reduction of corporate income tax rates

The 2018 Finance Law, which was adopted at the end of 2017, provides for a gradual reduction of the corporate income tax rate from 33.33% to 25% by 2022.

For 2018, a 28% rate will apply to the first €500,000 of profits for all companies (with the remaining profits subject to the 33.33% standard rate). In 2019, the standard rate will drop to 31% (but the 28% rate still will be applicable on profits below €500,000). The 31% rate will be reduced to 28% in 2020 (applicable on the entire amount of taxable profits), 26.5% in 2021 and finally 25% in 2022.

The rate of withholding taxes (subject to the provisions of relevant tax treaties) assessed on dividends, real estate capital gains received by foreign corporations as well as the rate of the levy assessed on capital gains related to the disposal of substantial shareholdings realised by foreign corporations (subject to relevant tax treaties), will be equal to the new rates of corporate income tax.

Abolition of the 3% contribution on profit distribution

Until 31 December 2016, dividends paid by certain French companies were subject to a 3% contribution. Distributions made between companies that were members of the same French tax consolidated group were, however, exempt from this tax.

On 30 September 2016, the French Constitutional Court ruled, in decision n° 2016-571 QPC (Layher SAS), that the above 3% contribution exemption available to members of French tax consolidated groups was unconstitutional.

This contribution was therefore abolished by the 2018 Finance Law, effective as from 1 January 2018.

New exceptional surtax on corporate tax income

To compensate for the cancellation of the 3% contribution on profit distributions, the French Parliament introduced an exceptional one-time surtax on corporate income tax due by very large companies (Amending Financing Law for 2017).

Accordingly, companies with turnover above €1bn but below €3bn will be subject to a 15% surtax on the amount of their corporate income tax liability. A higher rate of 30% will apply to very large companies whose turnover equals or exceeds €3bn.

Change to tax regime of cross-border mergers and restructurings

On 8 March 2017, the European Court of Justice (ECJ) ruled that a French tax provision which required a prior ruling of the French tax authorities in order for a taxpayer to benefit from the French corporate income tax deferral regime in situations of cross-border merger transactions (and assimilated transactions) was contrary to the freedom of establishment principle as well as to the EU Merger Directive (ECJ 8 March 2017, C-14/16, Euro Park Service).

As a consequence, the second Amending Finance Law for 2017 repealed the requirement for taxpayers to seek a prior ruling.

French companies that are absorbed by non-resident companies (or that contribute certain assets to non-resident companies) can now directly benefit from a corporate income tax deferral regime provided that (i) the concerned transactions fall into the scope of the EU Merger Directive, and (ii) where such transactions comprise the transfer of a business to a non-resident company, that such business remains held via a French permanent establishment of the absorbing company. However, they now must file, with the French tax authorities, a declaration including basic information regarding the modalities of and reasons for the concerned transaction.

Companies involved in a cross-border merger will be able to request that the French tax authorities confirm, through a ruling, that a contemplated transaction satisfies the conditions required to benefit from the deferral regime for corporate income tax purposes.

Furthermore, the requirement to hold, for a three-year period, the shares received in exchange of a full line of business or by reason of a spin-off, which applied under the former regime, was repealed – thereby possibly allowing greater flexibility in international restructuring operations.

Also, the new measures broaden the ability to attribute, as a further contribution to the shareholders of the contributing entity, new shares issued by the beneficiary entity of a contribution in kind, thereby making carve-outs and other restructuring operations less complex.

However, it is important to note that the new measures also added an anti-abuse clause similar to that of the EU Merger Directive.

Change to the Carrez Amendment

The Carrez Amendment is a mechanism disallowing deduction of interest on debts issued to finance the acquisition of certain shares by a French company where that French company is not in a position to show that:

(i) decisions relating to these acquired shares are effectively made by the acquiring company itself, or by a company established in France that "directly or indirectly" controls the acquiring company, or by a company established in France that is "directly" controlled by the same company as the one controlling the French acquiring company; and
(ii) where "control or influence" is actually exercised over the acquired company, this control or influence is effectively exercised by the acquiring company, or by a company established in France that "directly or indirectly" controls the acquiring company, or by a company established in France that is "directly" controlled by the same company as that controlling the French acquiring company.

In order to comply with European Union law, the 2018 Finance Law provided that for the purpose of the "Carrez Amendment", a company having its registered office in an EU Member State or in a country which is part of the European Economic Area, and which has a tax treaty in effect with France that includes an administrative assistance clause, will be "assimilated" to a French company.

This rule therefore broadens the possibilities for acquiring companies to demonstrate that the condition of decision-making authority and control is met.

Foreign tax credits

To address issues raised in certain court decisions, the French tax authorities have added a new provision to the law which has the effect of prohibiting the deduction of credits for foreign taxes levied in accordance with tax treaties entered into by France. The rationale for this new provision is that while in most cases, treaties provide that certain foreign taxes can be claimed as a tax credit in France, when the right to tax is shared by both the country of source and France, most treaties do not explicitly prohibit deduction of these foreign taxes from the corporate income tax basis. This new provision will apply to financial years closed as from 31 December 2017.

Additionally, in two decisions of 26 June 2017 (Sté *Crédit Agricole* n° 386269; Sté BPCE n° 406437), the Administrative Supreme Court (*Conseil d'Etat*) ruled that withholding taxes paid with respect to foreign-source income received by French companies may be offset against corporate income tax due in France, irrespective of whether the French corporate income tax was calculated at the standard rate or at a reduced rate. In doing so, the Court reversed previous decisions (notably decision n° 337253 of 29 October 2012) in which it had ruled that foreign tax credits relating to income taxed at the standard CIT rate may not be offset against corporate income tax calculated at a reduced rate.

Industry sector focus

M&A – Private equity

Increased focus on interest deduction

In France, deduction of interest paid or accrued on intercompany loans is subject to a great number of limitation provisions, including, *inter alia*:

(i) a maximum interest rate limitation under which the deductibility of interest paid or accrued on a loan granted by a related party is limited to (a) a maximum rate corresponding to the average effective floating rate on bank loans with a minimum two-year maturity, or (b) if greater, a rate that the borrower could have obtained from an independent financial institution under similar circumstances (the Market Rate); and
(ii) an anti-hybrid rule under which interest deduction on a loan granted by a related party is possible only to the extent that the borrower demonstrates, upon request of the

French tax authorities, that its related party lender is subject to an income tax equal to at least 25% of the French corporate income tax burden, determined under the standard French corporate income tax rules, on the said interest (the Effective Taxation Test). For lenders that are residents of France or established outside of France, this minimal taxation test is assessed by reference to the corporate income tax burden that they would have owed if they had been domiciled in France.

Regarding the maximum interest rate limitation, lower courts have recently been quite aggressive. In a decision rendered in January 2018, the Lower Court of Paris notably ruled that the fact that the interest rate on an intercompany loan could only be viewed as being a Market Rate to the extent that such rate was backed by a binding offer from a third-party bank (TA Paris, 18 January 2018, n° 1707553/1·2, SAS Studialis). This decision contrasts with traditional market practice and previous decisions of French courts of appeal. It creates uncertainty on the possibility to fully deduct interest on related party loans.

Regarding the anti-hybrid rule, the law provides that where the lender is a French *fonds commun de placement a risques* (FPCI) or an equivalent EU fund, the limitation only applies where such FPCI: (a) is controlled by a single unitholder (or group of unitholders); and (b) such controlling unitholder does not pass the Effective Taxation Test. Recent tax audits show that, according to the French tax authorities, with respect to intercompany loans granted by FPCIs or EU funds that are controlled by a single unitholder (or group of unitholders), the Effective Taxation Test may only be passed to the extent that the FPCI (or the EU fund) effectively distributes income (and such income is effectively subject to tax) in the same year as the year when the interest is accrued at the level of the borrower. In a nutshell, in this type of situation, the Effective Taxation Test can almost never be passed. It therefore adds another layer of uncertainty on the possibility to deduct interest on intercompany loans granted by funds that are controlled by a single unitholder (or group of unitholders).

Changes to the taxation of individuals having an impact on M&A transactions

The French wealth tax (ISF) used to play an important role in the way certain M&A transactions were structured. It was assessed on all the assets owned by the taxpayer when net wealth exceeded a certain threshold (€1.3m). The basis for the wealth tax included worldwide assets for taxpayers domiciled in France and French real estate for non-resident taxpayers.

The Finance bill for 2018 has now repealed the ISF. It has been replaced, with effect as of 1 January 2018, by a new real estate wealth tax ("*Impôt sur la Fortune Immobilière*" – IFI), that will be assessed only on the real estate owned by the taxpayer to the extent that the value of the taxpayer's real estate net assets exceeds €1.3m.

All other assets (especially financial assets or securities in non-real estate companies) are no longer subject to the wealth tax. The aim of the reform is to encourage taxpayers to finance the economy (companies or business activities). Likewise, certain real estate assets or rights (those deemed used for professional purposes, under very strict conditions and criteria) may be exempt from this new IFI. The progressive rates of the IFI are similar to those that currently apply for the ISF.

This should have an impact on the way M&A/private equity transactions will be structured, since shareholders who are individuals will no longer pay any wealth tax with respect to sale proceeds or with respect to the securities they hold (except for shares in property companies).

Furthermore, M&A transactions have also been favoured by a comprehensive reform of the taxation regime of dividends and capital gains on shares derived by individuals. While until 31 December 2017, capital gains were subject to individual income tax at progressive rates (with a 40% deduction for dividends and, generally, a 50% to 65% deduction for capital gains), they will now be subject to a "flat tax" at a rate of 30% (comprising a 12.8% individual taxation rate and 17.2% social contributions, the latter only being due from French residents). This should have an impact on the way private equity transactions will be structured, notably since non-resident individuals will enjoy a more favourable tax treatment with respect to the holding or the sale of shares held in French companies.

Real estate

Amendment to the France-Luxembourg double tax treaty

On 20 March 2018, France and Luxembourg signed a fully amended version of the France-Luxembourg double tax treaty, which should enter into force on 1 January 2019 or 2020.

This new treaty will have a very significant impact on the way real estate transactions will be structured in France. Indeed, most international real estate investments made in France were traditionally channelled via French real estate funds (OPCIs) held by Luxembourg holding companies. For that, French OPCIs were expected to enjoy treaty benefits under the France-Luxembourg double tax treaty (specifically with respect to French withholding tax on dividends paid out to Luxembourg).

Under the new treaty, OPCI dividends will no longer benefit from reduced withholding tax rates (except in very specific situations) and will generally suffer a 30% dividend withholding tax burden in France. This rate may be reduced to 15% provided certain conditions are met but, nevertheless, this new treaty will undoubtedly have an impact on the structuring of French real estate transactions.

Financial services – financial transactions tax

The scope of the tax on financial transactions was previously to be extended to intra-day transactions; however, given certain practical difficulties in implementing this extension, these intra-day transactions will not be subject to the financial transactions tax.

The year ahead

Further domestic changes on corporate taxation

It is expected that reforms provided by the next finance laws will be mainly focused on corporate taxation.

In view of the evolution of European Union rules and of the new BEPS legislation, the French tax authorities notably launched a public consultation from 24 April 2018 to 11 May 2018 to gather the views of the various concerned actors on the current corporate taxation regimes. The questions raised during this consultation concerned taxation on patent revenue (which currently benefit from a favourable CIT rate of 15%), the regime of group taxation (considered as rather favourable) and the conditions pertaining to interest deductibility, notably in connection with implementation of the Anti-Tax Avoidance Directives.

Therefore, these three regimes may well be amended in the 2019 Finance Law.

Implementation of the Anti-Tax Avoidance Directives

At this stage, France has not yet implemented the Anti-Tax Avoidance Directives (so-called "ATAD 1" and "ATAD 2"). However, since France has already adopted a great number of measures limiting interest deductibility, the impact of ATAD on French legislation remains uncertain.

As far as we know, France considers that its current domestic rules limiting interest deduction are equivalent to the provisions of ATAD 1. France has consequently asked, on 30 June 2017, for a delay on the implementation of the directive (by way of derogation, Member States which have domestic targeted rules for preventing base erosion and profit shifting risks at 8 August 2016, which are equally effective as the interest limitation rule set out in the directive, may apply these targeted rules until the end of the first full fiscal year following the date of publication of the agreement between the OECD members, but at the latest by 1 January 2024).

However, whether the European Commission will accept this deferral is questioned in France. Consequently, it is anticipated that ATAD 1 should be transposed into French tax law as of 1 January 2019. The directive mainly addresses interest limitation and hybrid mismatches. Most of its provisions are more or less covered by existing French interest limitations. However, it is important to note that article 4 provides for a new limitation on deduction of exceeding borrowing costs of both intercompany and third-party loans (i.e. net financial income) to 30% of the taxpayer's earnings before interest tax, depreciation and amortisation (EBITDA), subject to a possibility for Member States to adopt a group safe harbour rule. Member States may also allow a full deduction of exceeding borrowing costs up to €3m. French tax law does not yet contain an equivalent rule and therefore we do not yet know how it will be transposed into French legislation and, in doing so, whether the French Parliament will try to soften the existing interest limitation rules.

ATAD 2 extends the scope of ATAD to hybrid mismatches. Member States have until 1 January 2020 to transpose the directive into national law (1 January 2022 for the implementation of reverse hybrid mismatches). France has already adopted measures regarding hybrid mismatches which are more binding than those provided by the directive. However, to be in conformity with the provisions of this directive, new measures will need to be implemented into domestic law. The schedule and modalities for implementation are, however, still unknown.

Approval of the common corporate consolidated tax base (CCCTB) and common corporate tax base (CCTB) principles

On 15 March 2018, the European Parliament approved both the principle of common corporate consolidated tax base and the common corporate tax base.

The aim of the CCTB directive is to establish a single set of rules for calculating the corporate tax base in the EU's internal market. This would reduce administrative costs and increase legal certainty for businesses by making the calculation of their taxable profits uniform in all EU countries. The new rules would also help Member States fight against aggressive tax planning. The draft CCCTB directive sets out technical rules for the consolidation of profits and the apportionment of the consolidated base to the eligible Member States.

Such principles may now be approved by the Member States for common rules to be determined and afterwards be implemented into domestic legislation. Therefore, the future and binding effects of these principles remain uncertain at this stage.

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Germany

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Overview of corporate tax work over last year

Types of corporate tax work

With continuously low interest rates and a relatively stable economy in Germany compared to other EU countries, the German M&A market has been booming in 2017/2018. Consequently, corporate tax work has been primarily focused on M&A transactions together with subsequent restructurings.

Moreover, the German tax authorities have steadily increased application of the instruments of criminal enforcement law to tackle structures and put pressure on management. This was strengthened by discussions on tax policies of multi-nationals. Hence, the demand for tax compliance issues and advice on tax-related criminal proceedings remains high, in particular against the background of a Finance Ministry decree from 2016[1] concerning the distinction between (non-criminal) amendment of tax returns and valid (voluntary) self-disclosure, which stipulates relief by way of implementing an Internal Tax Control System.

The most publicised administrative and criminal investigations remain those around so-called cum/ex-trades concerning multiple withholding tax refunds which had only been deducted and paid once.

Significant deals and highlights illustrating aspects of corporate tax

Major deals in 2016/2017 were not predominantly tax-driven, but nearly all deals required intensive corporate tax work, *inter alia*:

- **Linde/Praxair**: The planned merger of Linde AG and Praxair, Inc., with a volume of approximately €80bn, has so far been the largest merger in the German market in the 2017/2018 period. As one would expect, ensuing antitrust issues required that several franchises be sold off prior to obtaining merger clearance, securing a further deal-flow from this planned spin-off. From a tax perspective, the most crucial point to watch is the prevention of exit taxes on assets of Linde as part of the merger.
- **Knauf KG**: Knauf KG, a family-owned German manufacturer of building materials, has taken over US-based USG Corp. The value of the acquisition is reported to be around €7bn. With financing coming both from banks as well as the business owners, the financing structure is quite challenging both from a legal and a tax perspective. The acquisition will increase the work-force of Knauf group by around a third, to around 36,000 employees.
- **Siemens**: Siemens is merging its Mobility group, which manufactures trains, *inter alia*, the well-known ICE fast trains, with its competitor, French Alstom Group. The merger will create the largest train manufacturer in Europe and will have some antitrust implications. As part of the agreed merger, the new joint group's headquarters will

move to France, resulting in structuring requirements to ensure that no exit taxes arise under German law.

- **Bain/Cinven**: Finance investors Bain Capital and Cinven have taken over Stada AG, a German pharmaceutical company. The takeover has seen the acquisition vehicle conclude a profit-and-loss-pooling agreement with Stada AG, thus incorporating the target group into the tax group of the acquisition company. Such structures allow for a higher interest deduction at the level of the acquiring company. Given the public listed status of Stada with minority shareholders, the conclusion of a profit-and-loss-pooling agreement requires a guaranteed dividend payment to outside shareholders as well as the consent of the general assembly of the stock corporation.
- **Bayer AG**: The takeover of Monsanto through Bayer finally closed in 2018. This heralds the largest ever takeover of a US corporation by a German stock corporation.

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

Effective 1 January 2018, the **German Investment Tax Act reform** was enacted. Predominantly, this reform changes the tax treatment of investment funds under German law. While such funds used to be treated as tax transparent in the past, tax is now generally being levied at fund level. The exact taxation of the fund is contingent on its structure and underlying investment.

In order to compensate for this, fund-investors are partially exempt in regard to their earnings from funds in Germany. Whether and to what extent foreign fund-investors will receive such exemption is a matter of their domestic law. In Germany, foreign investors will not be subject to withholding tax on their distributions from funds, irrespective of whether the fund was tax transparent.

Following a decision of the German Federal Constitutional Court, dated 29 March 2017,[2] according to which the restriction of loss deductions upon change of ownership pursuant to Sec. 8c Par. 1 S. 1 of the German Corporation Tax Act (KStG) is unconstitutional for changes of minority holdings, the Hamburg Tax Court has forwarded another case to the German Constitutional Court with respect to loss deductions upon majority change in ownership pursuant to **Sec. 8c Par. 1 S. 2 of the German Corporation Tax Act**. According to that provision, upon such change in ownership, all losses carried forward by a corporation will cease to exist, unless certain special safeguards are met. Under current laws, exemptions from this rule are only permissible, where certain taxable hidden reserves at the level of the company having the losses exist or pursuant to a newly introduced rule in **Sec. 8d German Corporation Tax Act**. Under the latter provision, taxpayers may elect losses carried forward to be exempt from the ordinary forfeiture rules, if the loss company has carried out the same business for at least three years before the share transfer, unless:

- the business is put on hold;
- the business is pursued with a different purpose;
- the corporation starts an additional business;
- the corporation participates in a joint venture;
- the corporation takes the position of a parent company for a tax group; and
- assets are transferred to the corporation below their fair market value.

It is generally expected that, despite the aforementioned narrow exemptions, the general rules on loss forfeiture upon change in ownership will also be challenged by the Constitutional Court, requiring retroactive adjustments to the current German law, as was the case with the

minority change in ownership. For minority stakes, Germany has until the end of the year to enact such changes relating to minority changes of ownership. For this, no draft has yet surfaced, so the actual resolution of that matter remains to be seen.

A new provision on royalty deductions was incorporated into German income tax law on 27 June 2017. Under **Sec. 4j German Income Tax Act**, a **royalty barrier rule** has been implemented. Under that provision, royalties paid to affiliated parties for the right to use IP rights are not fully tax deductible, if the respective income at the hands of the recipient is subject to a preferential tax regime. In such case, the deductible part of the expenses is calculated by reference to the preferential tax rate compared to a rate of 25%. Thus, if effective tax rates on royalty income are 25% or higher, no limitation of deductibility applies, whereas a lower tax rate will lead to a *pro rata* limitation on the deductibility (e.g. a 12.5% preferential tax rate on royalty would result in 50% of the royalty payments not being deductible). The system is aimed at IP box regimes and other preferential treatments with respect to IP rights. That said, its wording may be read more broadly to cover any preferential tax regimes resulting in a taxation of less than 25% and thus having impact on the deductibility of royalties.

The Ministry of Finance has issued guidance on the application of its anti-treaty-shopping rules in **Sec. 50d Para 3 German Income Tax Act**. Pursuant to the new guidance, the European Court of Justice (ECJ) judgment in ***Deister Holding*** will be implemented by allowing treaty benefits to be accessed more generously. A mere passive holding company may, therefore, claim treaty benefits where it exercises its shareholder rights. Also, the level and degree of personnel required for such holding activity has been significantly reduced, no longer requiring permanent presence of both management and employees in the place of residence of such holding company.

European – CJEU cases and EU law developments

Following the *AFEP* decision of the ECJ (C-365/16), the taxation of dividend distributions using a 95% exemption without granting special relief for dividends distributed from lower tier entities is in violation of the EU Parent Subsidiary Directive. In essence, such tax rules result in taxes on distributions through cascades of shareholder ownership being levied at each level. In the past, governments took the position that this was permissible, as they believed the directive only addressed taxation at the level of the distributing entity. The ECJ has now clarified that distributions received from subsidiaries cannot be taxed again at the level of the entity distributing them onward. As the system is broadly operated throughout the EU, including in Germany, it remains an open question whether an amendment of the directive will occur or if national tax laws will be adapted to comply with this requirement.

With the ECJ judgment in *Deister Holding* (C-504/16), the court has, once again, clarified that requirements for residency, in order to obtain benefits under the EU Parent Subsidiary Directive, have to be seen in the light of the activity of the respective entity. Therefore, mere holding companies need not have a substantial presence, as their activity does not necessitate such presence. The German Tax Authorities have, in the meantime, issued corresponding guidance, allowing for exemption claims to be granted more easily.

In the case of *EV/FA Lippstadt* (C-685-16), the ECJ will have to decide on the permissibility of add-back provisions under German trade tax laws. According to these rules, profit distributions received, which are usually tax-exempt under German law, are to be added back to the taxable income for trade tax purposes if certain further criteria are not met. These criteria are different for domestic cases and for cross-border cases. In his opinion, the attorney general has stated that the current German provisions violate the free movement

of capital, as there is no justification for treating domestic cases differently to cross-border cases. The decision is still pending.

In the currently pending case of *Hornbach* (C-382/16), the ECJ will have to decide on the basic provision of German controlled foreign company (CFC) rules in **Sec. 1 Para 1 of the German Foreign Tax Act**. The case deals 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. In particular, the question of whether an escape should be permissible is at the centre of the decision. The attorney general at the ECJ has stated that the provision, as it currently is, should be in line with EU law, although it leads to a different treatment of national transactions as compared to cross-border transactions. The question of whether the ECJ will follow this line remains open.

With the enactment of the EU "**ATAD 2**"[3] directive, further hybrid mismatches will be addressed. Thus, reverse hybrid structures will no longer benefit from the mismatch for tax treatment. Member States have until the end of 2019 to enact these provisions. Also, tax structuring models will need to be notified to the authorities by those marketing such models.

As Germany was a forerunner in the implementation of ATAD 1 measures, most having already been incorporated in German law prior to their introduction into the ATAD 1 directive, no substantial further amendments are expected.

On 13 March 2018, the EU adopted a directive requiring Member States to introduce a notification obligation for certain tax structures. The idea behind the directive is to give governments a heads-up, enabling them to intervene where tax structures lead to perceived undue tax advantages. In practice, there is substantial opposition to such measure, as it is going to be rather difficult to introduce such notification obligation in a manner that does not violate constitutional requirements. A previous attempt to introduce such obligation was dropped in 2006 due to similar concerns. With EU law now requiring the introduction of the obligation, some steps will have to be taken.

BEPS

On 7 June 2017, 68 countries, *inter alia*, Germany, signed the "**Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS**" (hereafter MLI) in Paris. As the first multilateral treaty of its kind, it will result in manifold and profound changes in international taxation. The agreement requires the signatory countries to implement a series of anti-avoidance rules in their network of tax treaties without renegotiating them in turn. This is a sensible procedure, as comprehensive changes to the OECD Model Tax Convention and the bilateral tax treaties concluded by countries are required in view of the anti-avoidance measures. Considering the number of internationally concluded agreements, this would lead to a delay in the adoption of the measures agreed in the OECD/G20 BEPS Action Plan.

In case an existing treaty is covered by the Convention, the Convention will come into effect three months after both parties to the treaty have deposited their instrument of ratification, acceptance or approval. The Convention will not function as an amending protocol to a treaty. Instead of directly amending the text of a covered tax agreement, the Convention will be applied alongside existing tax treaties and modifies their application. The Convention contains tax treaty measures reflecting minimum standards agreed to by countries as part of the OECD/G20/BEPS work, as well as tax treaty measures reflecting optional anti-avoidance provisions.

The countries that have signed the Convention have to consider the provisions reflecting minimum standards. Those are the provisions on the prevention of treaty abuse (*cf.* Arts 6 and 7 MLI) and the provisions on improving dispute resolution (*cf.* Arts 16 and 17 MLI). However, the Convention does provide flexibility within the minimum standards (e.g. in deciding whether to adopt provisions on "limitation on benefits" or the "principal purpose test"). Besides the minimum standards, the Convention also allows the governments to apply other anti-abuse measures within their tax treaty networks. However, the Convention contains specific anti-avoidance rules on transparent entities (*cf.* Art. 3 MLI), dual resident entities (*cf.* Art. 4 MLI), methods for elimination of double taxation (*cf.* Art. 5 MLI), dividend transfer transactions (*cf.* Art. 8 MLI), capital gains from the alienation of shares or interests of entities deriving their value principally from immovable property (*cf.* Art. 9 MLI), permanent establishment situation in third states (*cf.* Art. 10 MLI) and artificial avoidance of permanent establishment status (*cf.* Arts 12 to 15 MLI).

The Convention provides for a system of various options to opt out, which individual signing countries can exercise.[4]

In general, it can be stated that the Convention will particularly expand the definition of permanent establishment. In the future, even minor business activities abroad (e.g. a key account manager) may result in the registration of a permanent establishment.

Furthermore, the so-called "principal purpose test" will lead companies to demonstrate that their structures are economically justified and not merely set up due to tax advantages.

Another new feature is that, in the event of a double residence of a company (legal domicile in one country, management in another country), an agreement procedure will determine which double tax treaty needs to be applied.

Tax climate in Germany

Compared to other asset classes, the German real estate market still offers safe and profitable opportunities for domestic and international investors. As prices for ground in first-tier cities like Munich or Frankfurt 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. Besides the relatively high rates, the German tax authorities are currently discussing further restrictions on RETT-exempted share deals (e.g. lowering the 95% threshold for exempting sales of shares or extending the so-called retention period from five to 10 years). Additionally, the RETT exemption rule applying to group internal reorganisation is under fire from the Federal Tax Court*, inter alia*, with respect to EU state aid rules, which will probably take a very narrow view on the exemption requirements, leading to inapplicability with retroactive effect.

The most publicised tax cases currently revolve around the activity of the tax authorities which concerns multiple refunds of German withholding tax on dividends until 2011 (so-called cum/ex-trades), provoking the setting up of an enquiry commission in the lower house of the German parliament (*Bundestag*). The investigations and interrogation of well-known witnesses have led to 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.

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

The ECJ is currently contemplating a series of cases dealing with an exemption to German real estate transfer tax. Under these rules, RETT would not be levied on certain intra-group reorganisations. For this, the Federal Tax Court has asked the ECJ for guidance as to whether or not the exemption provisions constitute State Aid. The oral hearing before the ECJ hinted at it not being a State Aid concern, but a verdict is still outstanding.

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 unobtained tax refunds, substantial losses can be expected from this litigation.

The year ahead

With a new German government having taken up office in March 2018, it can be expected that some of the core items in the underlying coalition agreement will be enacted in the first year. These items mostly focus on personal income taxation, where some tax reductions for lower income earners are planned. In the field of corporate income tax, the main agreement is to further promote the common consolidated corporate tax base throughout the EU. Given the lack of agreement on this at EU level, the introduction of this measure in the foreseeable future remains questionable.

On an imminent basis, it is expected that the thresholds for the application of **real estate transfer tax in share deals** in Germany will be lowered. Currently, control of over 95% of the shares in an entity holding real estate will result in a taxable event for RETT purposes. It is expected that this threshold will be lowered to around 90% or even lower in the course of summer 2018.

Also, the introduction of a financial transaction tax has been agreed at government level; details on this are, however, pending.

More generally, the administration has stated that it is willing to revise the German CFC rules. The timing for this, however, is unspecified.

* * *

Endnotes

1. German Federal Ministry of Finance of 23 May 2016, Federal Tax Gazette I 2016, 490.
2. German Federal Constitutional Court of 29 March 2017, 2 BvL 6/11, DStR 2017, 1094.
3. Draft of a Council Directive from 21 February 2017, 6333/17 FISC 46 ECOFIN 95, amending Directive (EU) 2016/1164.
4. For the concrete implementation of opting out in the case of Germany, see also: http://www.oecd.org/tax/treaties/beps-mli-position-germany.pdf.

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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 book, the issue of recapitalisation of banks was mentioned as likely to be a significant development in the coming years. The central bank has subsequently raised the minimum capital requirements for banks in Ghana with the end of 2018 being the deadline for all banks to comply. Industry players have 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 is withdrawal of the offending institution's banking licence. The likely impact of this new capital requirement is a number of mergers between financial institutions to enable them to meet the deadline.

The major tax implications for this capitalisation requirement are 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 two banks being put into receivership by the regulator for failing to meet the capital requirements, and their subsequent takeover by one of the major banks.

Significant deals and themes

M&A

One of the major transactions in the last year was the merger of two of Ghana's telecom giants. Tigo mobile, owned by Millicom Ghana Limited, merged with Airtel to become AirtelTigo. This was a major transactional deal involving the merging of the operations of the two companies, making them the second-largest telecom operator in the country. Typically, the sale of assets during a merger should give rise to tax liabilities on the gain 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 new company will benefit greatly from the economies of scale, and with the highly profitable telecom market in the country, shareholders will benefit from their company taking a higher proportion of profit for being the second-largest telecom operator. Significantly, the merged company enjoys an exemption from payment of tax on the realisation of assets arising out of the merger.

Tax disputes

Major tax disputes over the last year centred on the interplay between the transfer pricing regulations and the technology transfer regulations. Disputes included that of another major telecom company, which challenged its assessment arising out of the cross-border transfer of management and technical fees which were deemed to not have been done at arm's length. Eventually, the company discontinued its suit in the courts as it sought to settle the matter with the Revenue Authority.

Under Ghanaian investment law, the technology transfer regulations allow registered investors to transfer an approved percentage of their turnover as management and technical fees to their principals. The previously unfettered transfer of such fees is now a point of dispute with the tax authorities, as the transfer pricing audits challenge the basis of such transfers on the arms' length principle.

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

- An excise tax stamp law which was due to be implemented was pushed to 2018 due to organisational issues.
- A national fiscal Stabilisation Levy which was passed in 2013 and set to end in 2017 was extended for another two years. This levy imposes an extra 5% tax on selected industrial and commercial sectors.
  The extension of this levy impacts on corporate income taxation, as it is payable on profits before tax.
- A special import levy, which was introduced in 2013, was also extended in 2017 for another two years. The special import levy is imposed on imported goods and paid at the point of entry and is calculated on the cost, insurance and freight value of the goods.
  The main policy driving these domestic tax measures is aimed at stabilising the economy whilst efforts are also being made to improve compliance.
- A tax amnesty law has been passed. This law grants amnesty to persons who failed to register with the Revenue Authority, file their tax returns or pay taxes as required by tax law. This amnesty is dependent on the applicant submitting a return containing a full disclosure of all previously undisclosed liabilities up to the 2017 year of assessment by 30 September 2018.

Tax climate in Ghana

As noted in the previous edition of this book, the tax climate 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, 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)

Four DTAs were signed with the Czech Republic, Mauritius, Morocco and Singapore.

The policy behind widening the treaty network is to make Ghana an attractive investment destination and a hub for the sub-region.

Industry sector focus

As a result of the complete overhaul of the tax laws between 2013 and 2017, there has been relative stability in taxation measures. As in the previous edition, there have been no significant changes in the taxation of any sector compared to the previous year.

The year ahead

The current stable taxation regime is expected to continue, though the possibility of a marginal reduction in corporate tax rates cannot be ruled out, since it is a long-term government target. The tax amnesty law is expected to widen the tax net, as it offers an opportunity for tax defaulters to re-engage the system without incurring statutory penalties for past infractions. A new taxpayer identification registration system is under development and is expected to have a significant impact in the coming year via the Revenue Administration Act, discussed in the 5th edition of this book, which will make the production of a taxpayer identification number a mandatory requirement in all official and commercial transactions.

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Melisa has undertaken due diligence and advisory regarding the acquisition of an 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, environmental issues, corporate matters, and tax issues.

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India

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Background and tax regime in the past

Over the last year, the Indian economy was marked by a number of key initiatives to build strength within macro-economic parameters for continuous growth in the future. According to the estimate of the World Bank and the International Monetary Fund ("**IMF**"), the world economy is expected to grow by 3.7% in 2018, while the Indian economy is expected to grow by 7.4% in 2018.[1] The IMF has also projected a 7.8% growth rate for India in 2019. A report by the World Economic Forum has projected that, by the year 2050, the Indian economy is expected to be the world's second-largest, behind only China.[2]

However, the Indian economy in the year 2017 faced a temporary slowdown on the back of reform measures such as demonetisation (in November 2016) and implementation of a landmark reform: "Goods and Service Tax" (GST) (from 1 July 2017), though India continues to be the seventh-largest economy in the world.

In February 2018, the Annual Budget was presented by the Finance Minister of India with a focus on infrastructure, aimed at uplifting the rural economy, strengthening the agricultural sector, improving the quality of education and providing the best healthcare facilities to the economically less privileged. Moving from the old age era of "*Black board*" to the new advanced "*Digital board*", the Government of India continues to keep its core focus on the use of technology in various sectors and explore the use of blockchain technology proactively to develop the digital economy.

The Government of India has sought to improve the dual aim of "Ease of Living" along with "Ease of Doing Business" in India. On this backdrop, the Indian Government ushered in the landmark concept of e-assessment across the country to bring in a more transparent, effective and stable tax regime. Start-ups are being encouraged and continuous efforts are being made to lure global investors to "Make in India". The corporate tax rate for domestic companies with turnover of less than INR 2.5 billion has been reduced from 30% to 25% (subject to certain conditions); however, the applicable cess on taxes and surcharge has been marginally increased from 3% to 4%.

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**"). The concept of "business connection" under the domestic tax law has been expanded and a new concept of Significant Economic Presence has been introduced. Guidelines have 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. The provisions relating to Country-by-Country Reporting ("**CbCR**") have been rationalised. Long-term capital gains tax, at 10%,

has been imposed on listed equity shares, units of equity-oriented fund and units of business trust (which was otherwise exempt, subject to certain conditions).

Key developments affecting tax laws and practice

Domestic tax

Measures to promote start-ups

To encourage entrepreneurship and accelerate economic growth through its "Start Up India Scheme", the Government of India has provided a tax holiday (including a certain relaxation in the latest round of amendments in 2018) to start-ups.

The tax holiday is available for three consecutive tax assessment years out of seven years to eligible start-ups which were incorporated on or after 1 April 2016 but before 1 April 2021. Some of the key conditions to be satisfied in order to claim tax holiday benefits are as follows:

(i) the start-up should be engaged in an "*eligible business*". An eligible business means a business engaged in innovation, development or improvement of products or processes or services or a scalable business model with a high potential for employment generation or wealth creation;
(ii) the total turnover of the business should not exceed INR 250m in the previous year relevant to the tax year in which the tax holiday is being claimed; and
(iii) the business should obtain a certificate of eligible business from the Inter-Ministerial Board of Certification (as notified by the Government).

Under the current tax regime, if a closely held company receives consideration for issue of shares in excess of fair market value (computed in a prescribed manner), it will be liable to tax on the difference between the consideration received and the fair market value. This provision created significant uncertainty and a tax burden for start-ups receiving capital contribution from investors based on its future potential value. In order to address this hardship, the Central Board of Direct Taxes ("**CBDT**") issued a notification in April 2018 and provided that eligible start-ups, after obtaining specific approval from the Inter-Ministerial Board of Certification and subject to certain prescribed conditions, will not be liable to tax in respect of share capital received in excess of the fair market value. This notification has brought in much needed clarity and certainty for start-ups.

Electronic tax scrutiny (e-assessment)

With a view to impart greater efficiency, transparency and accountability, an e-assessment scheme has been 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 interaction between the tax officer and the taxpayer in the course of proceedings to the extent technologically feasible, optimise resources through economies of scale and functional specialisation and introduce a team-based assessment with dynamic jurisdiction.

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

Strengthen and improvise internal compliance

With a view to curb drawn-out litigation, the CBDT has initiated the Central Action Plan, which aims to link performance evaluations of the Revenue authorities with the disposal of appeals against tax demands.

This Action Plan has been initiated to meet the core objectives of: reduction in outstanding demand; litigation management; bringing focus on optimising disposal in terms of numbers; and on maximising disposal of appeals involving a high quantum of demand.

Individual targets have been provided by the CBDT to income tax officers to dispose of drawn-out appeals, collect outstanding demands and pass orders (where hearings have been completed).

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.

According to the Economic Survey 2018, the appeals filed by the Revenue authorities constitute 85% of the total appeals filed in direct tax matters. The success rate of the Revenue authorities 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.

A brief snapshot is as follows:

Direct tax cases as on 31 March 2017

Court	Number of cases	Tax amount (INR)
Supreme Court	6,357	0.08 lakh crore
High Court	38,481	2.87 lakh crore
Income Tax Appellate Tribunal	92,338	2.01 lakh crore

Petition rate and success rate of the Indian Revenue Authorities, as on 31 March 2017

Jurisdiction	Direct Tax Cases	
	Petition rate	Success rate
Supreme Court	87%	27%
High Court	83%	13%
Income Tax Appellate Tribunal	88%	27%

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 1m. The 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 and has committed to implementing the BEPS initiatives. On 7 June 2017, India signed the Multilateral Convention in order to implement tax treaty-related measures (i.e. the Multilateral Instrument – "**MLI**"). On this backdrop, the Government of India is consciously and gradually aligning the domestic tax law with the BEPS recommendations.

*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 1 April 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 has 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 BEPS Action Plan 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 Action Plan also includes the concept of 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.
  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 of 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 regard) 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 0.1m 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 download 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 interaction 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 into 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 PE 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 Plan 13 regarding Three Tier TP Documentation, India introduced CbCR requirements effective from financial year 2016–17 (i.e. beginning 1 April 2016).

This required certain Indian-headquartered multinational 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 OECD's recommendations and 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.

Other changes

India-Hong Kong double tax avoidance agreement negotiated

India signed a tax treaty with Hong Kong Special Administrative Region (HKSAR) of China ("**Hong Kong**") on 19 March 2018. The tax treaty is yet to be notified, after which it will come into force. Some of the salient features of the India-Hong Kong tax treaty are:

- Capital gains arising on sale of shares of an Indian company will be liable to tax in India as per the domestic tax law.
- Interest income will be taxed at the rate of 10% (subject to satisfying the beneficial ownership test).
- Fees for technical services payable to a resident of Hong Kong are to be taxed at the rate of 10% (subject to satisfying the beneficial ownership test).
- The article on PE includes, amongst others, a Service PE clause with a threshold of 183 days within a 12-month period.

POEM rules clarified

The concept of POEM was introduced into the ITA, effective from financial year 2016–17, for purposes of determining whether a foreign company is tax resident in India. Under the ITA, POEM is defined to mean the place where key management and commercial decisions necessary for the conduct 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 POEM for an entity. In October 2017, the CBDT issued a

new circular that clarifies the application of the POEM rules for multinational companies with a regional headquarters in India that is merely conducting routine activities for the entire group that are 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 an 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 at 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.

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 30 places to 100 in the Ease of Doing Business Report for 2018,[3] 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 CBDT on a continuous basis for the ease and convenience of taxpayers. Initiatives have been taken by the Government to digitise 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 aggravation of taxpayers. 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 from 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 to enter 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,[4] CBDT has entered into a total of 186 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 employing the Permanent Account Number ("**PAN**") and Tax Account Number system. 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 the physical PAN Card, to all applicants, including individuals, to which a PAN is allotted.

In the last two years, the Government of India renegotiated tax treaties, *inter alia*, with Mauritius, Singapore and Cyprus. These tax treaties provided an exemption to tax residents of these countries from Indian capital gains tax on transfers of Indian securities. The amendments give India the right to tax capital gains on transfers of Indian shares acquired on or after 1 April 2017, though existing investments have been grandfathered. Considering global resentment against companies failing to pay their fair share of taxes, BEPS Action Plan initiatives and the Government's promise to take action on black money stashed abroad, these changes were not entirely unanticipated.

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. 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 GAAR and sometimes a thin line between taxpayers availing of legally available benefits under tax law and what can considered as artificial transactions undertaken with the main purpose of avoiding tax, GAAR has the potential to significantly increase litigation.

The year ahead

New direct tax code proposed

In order 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 August 2018 and is likely to give relief to individual taxpayers and small businesses, reduce tax evasion and improve compliance.

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

Google India Private Limited vs ACIT (ITAT Bangalore) (2017)

- Background and issue for consideration
  Google India was appointed as a non-exclusive authorised distributor of the Adwords program to advertisers in India by Google Ireland Ltd. Under this arrangement, Google India was provided with access to intellectual property rights, Google brand features, and a secret process embedded in the Adwords program as tool of trade for generation of income. Google India credited a certain sum to Google Ireland without deduction of tax at source. The issue for consideration was whether such sum credited was in the nature of a "royalty" under the ITA or India-Ireland tax treaty.
- Ruling
  The Income Tax Appellate Tribunal ("**ITAT**") in Bangalore held that payment made by Google India to Google Ireland for granting the distribution right for the Adwords program is taxable as a royalty under the ITA as well as under the India-Ireland tax treaty; therefore, such payment is subject to withholding tax in India.
  The ITAT observed that Google India had access to all personal information and data pertaining to the user of the website in the form of age, gender, eating habits, etc., which it then used for focused, targeted marketing. On this ground, the contention raised by Google India that it was merely acting as a reseller of advertising space, and had no rights in the intellectual property of Google that was transferred to it, was rejected by the ITAT.
  The ITAT also went beyond the scope of the relevant Adwords program agreement and emphasised on the substance of the transaction which was to facilitate the display and publishing of an advertisement to the targeted customer with the help of various patented tools and software. Thus, it was observed that provisions of the tax treaty were being misused by structuring the transaction with the intention of avoiding payment of taxes in India.

Given the importance of this case, both in terms of the structure of the transaction and the amounts involved, it is likely to travel right up to the Supreme Court of India for a final word.

In view of the GAAR provisions under the ITA and India's commitment to implement the MLI under the BEPS initiative, appropriate caution should be taken before entering into any arrangement/structure especially if it is to avail of the tax benefit under the ITA and/or under the relevant tax treaty.

Flipkart India Private Limited vs ACIT (ITAT Bangalore) (2018)

- Background and issue for consideration
  Flipkart India (a taxpayer) is engaged in the business of trading and distributing books, electronics, mobiles, computers and related accessories. The taxpayer purchases goods for the purpose of trading from unrelated parties and, thereafter, sells these goods to retailers at a lower price. This resulted in significant business loss for the taxpayer. The retailers then sell such goods on the taxpayer's web portal "flipkart.com". The customers buy these goods by browsing products on the website and placing orders electronically.
  The Indian Revenue authorities alleged that goods were being sold at less than the cost price, which was not a normal business practice. It was further alleged that the strategy for selling goods at lower than the cost price was to establish customer goodwill and brand value in the long run and, therefore, the profits foregone by selling goods at less than cost price were to be regarded as "capital expenditure" incurred in creating intangibles/brand value or goodwill.

- Ruling
  The ITAT in Bangalore held that in cases where the taxpayer was selling goods to retailers at a price less than their cost price in view of the fact that transaction was a *bona fide* one, the Revenue authorities could not take into account the market price of those goods, ignoring the real price fetched to ascertain profit from said transaction.
  By no stretch of imagination can it be presumed that profits foregone were in the nature of capital expenditure incurred and that such expenditure incurred was used for acquiring intangible assets such as goodwill and brand. It is not correct to say that profits foregone created goodwill or any other intangible or brand for the taxpayer.
  The ITAT thus held that expenditure incurred was revenue in nature, used for the purpose of business and thus allowable as a tax deduction. The ruling came as a respite to several taxpayers in the online retail space.

Significant deals in India – highlights illustrating key aspects of corporate tax

After the Vodafone tax controversy, which invited worldwide attention, the ITA was amended retrospectively to tax indirect transfer of shares outside India.

Under the ITA, income or gains arising from transfer of shares or interest in an entity outside India, which derives its value substantially from assets situated in India, is subject to tax in India to the extent value is attributable to assets located in India. A share or interest in a company/entity incorporated outside India is deemed to derive substantial value from assets situated in India if the value of such assets in India exceeds INR 10m and represents at least 50% of the value of all the assets (without reduction of liabilities) owned by the company or entity on the specified date. Further, certain exceptions (like investment through a Foreign Portfolio Investor) are provided from the applicability of indirect transfer provisions.

Recently, global retail giant Walmart Inc. agreed to acquire an approximately 77% stake in Indian e-commerce leader Flipkart for US$16bn. Based on the information available in the public domain, it seems that Walmart will acquire shares of the Singapore parent of the Indian Flipkart entity from the existing shareholders.

In the event the value of the Singapore parent entity is substantially derived from India, the shares of such entity would be treated as a capital asset situated in India, and transfer of such shares of the Singapore entity will be taxable in India under the ITA (subject to tax treaty benefits available to the non-resident shareholders and exceptions provided in the ITA, if applicable).

The Indian Revenue authorities are believed to be closely monitoring the deal to ensure the fair share of tax is deposited in India.

* * *

Endnotes

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Indonesia

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Overview of corporate tax work over last year

Introduction

The classification of Indonesian taxes by the collections institutions can be categorised into two types, i.e. Central Taxes and Regional Taxes. Central Taxes are the taxes administered by the Central Government and managed by the Director General of Tax, such as Income Tax and Value Added Tax. Regional Taxes are administered by the Provincial and District Government, such as Restaurant and Hotel Tax, and Vehicle Tax.

The Indonesian legal system is primarily based on the civil law model, the laws and regulations of which 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: "*Taxes and other compulsory levies required for the needs of the state are to be regulated by Law*."

There are currently 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 relevant Regional Government Regulation and Governor/District Head Regulation.

Tax law is also influenced by Director General of Tax (circular) letters, which are not considered part of the formal laws, but in practice are generally followed by tax officials.

Taxpayer's supervision post-tax amnesty

Indonesia has just recently finished its Tax Amnesty program in 2017. By using the Tax Amnesty facility, taxpayers were able to declare their net assets (in Indonesia or overseas) that were not previously reported in their tax returns and/or repatriate their undeclared overseas net assets to Indonesia by paying a redemption charge. Taxpayers that used the Tax Amnesty gained several benefits, such as:[1]

- elimination of the tax payable for the tax assessment that was issued;
- elimination of the tax administrative sanction in the form of interest or a fine;
- not being subject to a tax audit, preliminary evidence audit or tax crime investigation; and
- termination of existing tax audits, preliminary evidence audits and tax crime investigations.

The total additional declared and repatriated net assets from the Tax Amnesty amounted to Rp 4,881tn. The figure surpassed the government's initial target (set at Rp 4,000tn). This figure was nearly 40% of Indonesia's gross domestic product (GDP). Total redemption

charges amounted to Rp 114.5tn. Around 75% of the declared net assets came from domestic asset declaration, while the remainder were overseas assets declaration and repatriation. 58.6% of the declared assets were financial assets.[2] This fact has also proven that there were significant financial assets that were not previously reported by the taxpayers in their tax returns.

The Tax Amnesty program served as a "reconciliation point" between the DGT and the taxpayers. Further, this program has laid a solid foundation for taxation system improvement before Indonesia entered a new era of financial information sharing and data transparency for taxation purposes. The start of this new era was indicated by the issuance of a Government Regulation in *lieu* of Law No. 1 of 2017 on Financial Information Access for Taxation Purposes, which was subsequently enacted as Law No. 9 of 2017. This law provides the legal foundation for the provision of financial information and data from the financial institutions to the Directorate General of Taxes (either automatically or by request).

The DGT has also strengthened its law enforcement efforts, in particular for post-tax amnesty tax supervision and tax audit activities. For the taxpayers that did not use the Tax Amnesty program, the DGT was given the rights to trace any unreported assets acquired by taxpayers since 1 January 1985 (~30 years) and considered the unreported assets as additional income for taxpayers in the year of discovery.[3] For the taxpayers that have applied to the Tax Amnesty program, the DGT conducted asset tracing based on the available data and information to ensure that there were no other unreported assets. Further, since the Tax Amnesty program only covers the fiscal year or fiscal period until the end of 2015, the DGT continued to monitor the tax compliance of those taxpayers starting fiscal year 2016 onwards.

In the case the DGT finds any assets that have not been reported by the taxpayer in their Tax Amnesty application, the taxpayer will be subject to a final income tax on their net assets,[4] plus a 200% administrative sanction. If the taxpayer voluntarily declares the unreported assets before the DGT's assessment, the taxpayer will only pay the final income tax and will not be subject to the 200% administrative sanction.

Implementation of BEPS Action 13 – Transfer Pricing Documentation and Country-by-Country Reporting

In line with BEPS Action 13, Indonesia has launched Ministry of Finance Regulation No. 213/PMK.03/2016 ("**PMK-213**") and DGT Regulation No. PER-29/PJ/2017 ("**PER-29**"), which provides detailed provisions on Country-by-Country Reporting ("**CbCR**").

Article 18 paragraph (3) of the Indonesian Income Tax Law provides the regulation related to the application of the arm's length principle and the transfer pricing methodology. However, there was previously limited guidance on the definition, format and minimum information to be included in the transfer pricing documentation by the taxpayer. PMK-213 and PER-29 do not revoke the previous regulation on application of the arm's length principle.

The transfer pricing documentation consists of Master File (MF), Local File (LF), and/or Country-by-Country Reporting (CbCR). The content of MF, LF, and CbCR is generally similar to the recommendation set out in BEPS Action Plan 13. There are several additional requirements, such as the Local File must be supplemented with the copy of the agreement/contract for significant transactions, and information related to the financial statement. For CbCR, the DGT requires the taxpayer to also attach the working paper (according to the format regulated by DGT) as part of the CbCR report.

An Indonesian taxpayer must prepare a Master File and Local File if they have met either one of the following criteria:

a) the previous fiscal year's turnover is more than Rp 50bn;
b) the affiliated party transaction in the previous fiscal year is:
   - more than Rp 20bn for tangible goods transactions; or
   - more than Rp 5bn for intangible goods transactions; or
c) the affiliated party is located in the country or jurisdiction with an income tax tariff of less than 25%.

For the total affiliated party transaction value criteria, it is not clearly regulated whether the domestic affiliated party transaction is excluded in the calculation of the affiliated transaction value. The determination of the turnover and affiliated party transaction value is based on the previous year's data.

If the Indonesian taxpayer is the ultimate parent entity of a business group with a consolidated turnover in the particular fiscal year of at least Rp 11tn (€750m), the Indonesian taxpayer must also prepare and submit the CbCR (Primary Filing). Further, if the Indonesian taxpayer is a constituent entity, whose parent entity is a foreign entity, the Indonesian taxpayer must also submit the CbCR in Indonesia (Local Filing), in case the parent entity is located in a country that:

a) is not required to submit CbCR;
b) does not have an international treaty with the government of Indonesia on information exchange (Qualifying Competent Authority Agreement ("**QCAA"**));[5] or
c) has an international treaty with the government of Indonesia for automatic exchange of CbCR, but the Indonesian government is unable to obtain the CbCR.

The Local Filing of CbCR is not mandatory in case the ultimate parent entity appoints another surrogate parent entity to submit CbCR, which is located in a country or jurisdiction that has a QCAA with Indonesia and the CbCR can be obtained through automatic exchange of information ("**AEOI**").

A summary of the availability of the Master File and Local File must be submitted four months after the end of the relevant fiscal year, enclosed with the Corporate Income Tax return of the taxpayer. After the submission deadline, the Master File and Local File can be requested at any time by the DGT, e.g. for tax supervision or tax audit.

A notification to the DGT must be submitted by all of the Indonesian subsidiaries or entities that have related party transactions in order to declare whether they have CbCR obligations or not. If a taxpayer has the obligation to submit CbCR, it must be submitted along with the notification. The CbCR notification and the CbCR submission deadline is 16 months after the end of the fiscal year for fiscal year 2016 and 12 months after the end of the fiscal year for fiscal year 2017 onwards. The first applicable fiscal year for this new regulation is fiscal year 2016; therefore, the Indonesian companies that have related party transactions must submit their CbCR notification to the DGT by the end of April 2018.

In case CbCR is unable to be obtained from the automatic exchange mechanism, the Indonesian taxpayer must submit the CbCR three months after the DGT's announcement of the countries from which CbCR is unable to be obtained.

Key developments affecting corporate tax law and practice

New anti-DTA abuse rule

In general, a withholding tax of 20% will be applied to payments to foreign tax residents, in the form of:[6]

a) dividends;
b) interest, including premium, discount, and remuneration in connection with loan repayment guarantees;
c) royalties, rent, and other income in connection with the use of assets;
d) remuneration in connection with services, works and activities;
e) prizes and rewards;
f) pensions and other periodic payments;
g) premium swap and other hedging transactions; and/or
h) profits from debt release and discharge.

Further, in relation to income from the transfer of shares of an Indonesian corporate tax resident by a foreign tax resident, the income from the sale or transfer of shares is subject to a withholding tax of 20% of the estimated net income. The total estimated net income is calculated as 25% of the sale price, so that the total withholding tax is 20% × 25% or 5% of the sale price.[7]

The DGT introduced DGT Regulation No. 10/PJ/2017 ("**PER-10**"), a new guideline for Double Taxation Agreement ("**DTA**") implementation, which replaced the previous DGT Regulation No. PER-61/PJ/2009 regarding the DTA Application Procedures, as amended by DGT Regulation No. PER-24/PJ/2010, and DGT Regulation No. PER-62/PJ./2009 regarding the Avoidance to DTA Abuse, as amended by DGT Regulation No. PER-25/PJ./2010.

Foreign tax residents are eligible for a reduced rate, as provided in the DTA, in case:
1) there are differences between the provisions in the Indonesian Income Tax Law and the DTA;
2) the income recipient is not an Indonesian tax resident;
3) the income recipient is an individual or a corporate that is a domestic tax resident in a DTA country or jurisdiction;
4) the foreign tax resident provides the Form DGT-1 or Form DGT-2[8] that has fulfilled the "administrative conditions" and other "certain conditions";
5) there is no DTA abuse; and
6) the income recipient is the beneficial owner, if it is required in the DTA.

The main administrative requirement is to completely prepare and submit the copy of the original or the "legalised" copy of the Form DGT-1 or Form DGT-2 in the withholding tax returns. The Form DGT has also been updated from the previous version to accommodate the above changes in PER-10.

In addition to the administrative requirement, the DGT requires the foreign taxpayer to also meet "certain conditions" in order to be eligible for DTA benefits. The foreign taxpayers must meet all of the criteria, as follows:
1) have a relevant economic motive for the establishment of an entity;
2) conduct business activities that are run by its own management and the management has the sufficient authority to conduct transaction;
3) have fixed and non-fixed assets, which are sufficient and adequate to carry on business activities in DTA countries or jurisdictions, other than income-generating assets in Indonesia;
4) have sufficient and adequate employees with specific skillsets in accordance with the relevant business field; and
5) carry on activities or business that generate income other than from dividends, interest, and/or royalties originating from Indonesia.

PER-10 does not specify the criteria of "sufficient" and "adequate" in the third and fourth criteria; therefore, there may be significant uncertainty in practice to decide what is considered "sufficient" and "adequate".

Moreover, as part of the "certain conditions" criteria, the foreign tax resident must also pass the beneficial owner test. Indonesia has introduced more prescriptive criteria to meet the definition of a beneficial owner, as follows:

1) as an individual foreign taxpayer, they do not act as an agent or nominee; or
2) as a corporate foreign taxpayer, it does not act as an agent, nominee, or conduit, which must fulfil certain conditions:
    a) it has the power to use or enjoy funds, assets, or rights, which generate income in Indonesia;
    b) not more than 50% of the income is used to fulfil its obligations to other parties (the 50% income threshold does not include the payment of fair remuneration to employees in relation to work, other disbursed expenses in conducting the business activities, and profit distribution in the form of dividends paid to shareholders);
    c) it bears the risk on assets, capital, and/or the liabilities that it owns; and
    d) it does not have a written or unwritten obligation to transfer all or part of the income it receives in Indonesia to another party.

The new beneficial owner test removes the requirement of the "earned income is subject to tax in the recipient county" or "subject to tax" test. The previous regulation required the foreign taxpayer to be subject to tax on the income in its home country. Moreover, there is no further elaboration on the definition of "unwritten" obligations in the last criterion.

In case there is a difference between the legal form of a transaction scheme/structure and its economic substance, the tax treatment is applied based on the prevailing regulations based on the "substance over form" principle.

Since the introduction of the Form DGT requirement in 2009, there have been many cases of DTA application issues, not only regarding the beneficial owner matter, but also regarding administrative matters, e.g. taxpayers have not completely filed or are late in submitting the Form DGT-1 to the Tax Office. The Tax Office takes the strict position that if the Form DGT does not fully meet the administrative requirements, the taxpayers cannot apply the reduced rate given in the relevant DTA and must apply the standard 20% withholding tax rate.

In the appeal stage in the Tax Court, several panels of judges have made favourable decisions for taxpayers in the case of DGT's corrections due to a failure to comply with the administrative criteria. Taxpayers must prove that the transaction with the foreign entity has economic substance, and the foreign party is tax resident in the other contracting state of the DTA. Further, Articles 1–3 of the DTA itself does not require certain particular forms to be completed by each of the residents of the contracting states in order to apply the DTA.

Updated controlled foreign corporation ("**CFC**") rule

There is a general provision in Indonesia for the CFC rule in Article 18 paragraph (2) of the Income Tax Law. Indonesia has amended its implementing regulation on CFC by issuing Ministry of Finance Regulation No. 107/PMK.03/2017 ("**PMK-107**"). This rule does not apply to listed companies and only applies to income from dividends and not to the other types of passive income such as interest and royalties. The Indonesian taxpayer must pay tax by recognising a deemed dividend to the extent the profits of the CFC are not distributed to the Indonesian taxpayer in form of actual dividends ("**Deemed Dividend**").

There is no change in the timing for the recognition of the Deemed Dividend, i.e. the fourth month after the deadline submission of the CFC annual income tax return, or the seventh month after the end of the fiscal year if the CFC has no obligation to submit an annual income tax return or if there is no submission deadline for the annual income tax return.

PMK-107 regulates that the Deemed Dividend must be imposed on directly owned CFCs ("**Direct CFCs**") and indirectly owned CFCs ("**Indirect CFCs**"). The definition of a Direct CFC is similar to that given in previous regulations and in line with Article 18 paragraph (2) of the Income Tax Law, which states that a Direct CFC is a foreign non-listed company that is directly owned at least 50% by an Indonesian taxpayer; or is directly owned at least 50% collectively by several Indonesian taxpayers.

Although Article 18 paragraph (2) of the Income Tax Law has already provided the definition of a CFC (which is similar to the Direct CFC definition) and mandated the Ministry of Finance to only determine the timing of the recognition of the Deemed Dividend, PMK-107 has "expanded" the definition of CFC and indirectly introduced the definition of an Indirect CFC, which is a foreign non-listed company in which at least 50% of the shares are: owned by a Direct CFC and/or an Indirect CFC; jointly owned by an Indonesian taxpayer and another Indonesian taxpayer through a Direct and/or an Indirect CFC; or jointly owned by a Direct and/or and an Indirect CFC.

For an Indirect CFC, the 50% threshold is determined based on the percentage ownership of the indirectly owned CFC (not proportionately). For example, PT A (Indonesia) has 60% ownership in B Ltd, and B Ltd has 50% ownership in C Ltd. Even though the effective ownership of PT A in C Ltd is less than 50%, i.e. 30% (60% × 50%), C Ltd is still considered as an Indirect CFC. This is because the ownership at B Ltd level is still 50%.

The 50% ownership criterion applies only for ownership in the form of shares; either the shares issued by the CFC or the shares with voting rights issued by the CFC. The amount of shares is determined at the end of the fiscal year of the Indonesian taxpayer.

With this new regulation, the Deemed Dividend is calculated from profit after tax of the Direct CFC and profit after tax of the Indirect CFC multiplied by the percentage ownership of the Direct CFC. Profit after tax is generally based on the accounting standard in the CFC country of residence, deducted by the income tax payable in the respective country. Based on this calculation, it can be inferred that, generally, all of the profit after tax from the CFC in that particular year should be recognised as Deemed Dividend income for the Indonesian taxpayer.

When the CFC decides to distribute actual dividends for a particular year, the amount of recognised dividend income by the Indonesian taxpayer can be offset by previously recognised Deemed Dividends for the past five consecutive fiscal years. In case the actual dividends received are greater than the previously recognised Deemed Dividend, then the dividend income is subject to general Corporate Income Tax in the fiscal year when the actual dividend is received.

Further, the previous CFC regulation will not apply when the CFC already has an actual dividend distribution (regardless of the distributed dividend amount). However, unlike the previous regulation, even if the CFC already has an actual dividend distribution (but is still less than the total profit after tax), this new CFC rule would still apply to the Indonesian taxpayer.

Indonesian law does not recognise trusts and similar entities. It is now explicitly stated in this new CFC rule that this rule disregards ownership through trusts and similar entities. In case an Indonesian taxpayer owns a CFC through a trust, the Indonesian taxpayer is deemed

to directly own the CFC. Moreover, this CFC rule does not differentiate the types of trust, e.g., revocable *vs.* irrevocable trust.

A more attractive tax holiday

To further attract potential investors for economic growth, Indonesia has introduced a simpler regulation on tax holidays. The government aims to streamline the procedures for potential investors to obtain this fiscal facility. The Ministry of Finance issued Ministry of Finance Regulation No. 35/PMK.010/2018 ("**PMK-35**") on the Corporate Income Tax Reduction Facility. Corporate taxpayers in the "pioneer industries" can apply for this fiscal facility. A pioneer industry is defined as an industry that has broad relevance, provides added value and high externality, introduces new technologies and has strategic value for the national economy.

PMK-35 has expanded the coverage of the pioneer industries from eight to 17 sectors, which includes the upstream base metal industry, the oil and gas refinery industry, the communication equipment component industry, and the power plant industry. The details of the business fields and production types of these sectors will be provided in an Investment Coordinating Board (BKPM) Regulation.[9]

The Corporate Income Tax reduction can be up to 100% of the Corporate Income Tax payable,[10] for certain periods depending on the investment value, as follows:

Investment Value (Rp)	Facility Period (years)
Rp 500bn – < Rp 1tn	5
Rp 1tn – < Rp 5tn	7
Rp 5tn – < Rp 15tn	10
Rp 15tn – < Rp 30tn	15
≥ Rp 30tn	20

After the applicable facility period has lapsed, the taxpayer will be given a 50% Corporate Income Tax reduction for the two following fiscal years.

The above Corporate Income Tax reduction facility can be utilised by the taxpayer starting in the fiscal year in which it commenced its commercial production. The commencement of commercial production is the first time the manufacturing products from the main business are sold to the market and/or self-used for post-production. Based on a field visit, the DGT will determine the timing of the commencement of commercial production. The field visit will be conducted after the DGT receives a written notification from the Investment Coordinating Board regarding a request for determination of the commencement of commercial production from the taxpayer.

To apply for the Corporate Income Tax facility, the taxpayer must meet all of the following criteria:

a) the taxpayer's business is a pioneer industry;
b) there has been a new capital investment;
c) the taxpayer has a plan for new capital investment at a minimum of Rp 500bn;
d) the taxpayer meets the debt-to-equity ratio criterion for income tax regulation, as stated by Ministry of Finance (currently is set at maximum of 4:1);
e) the taxpayer has not previously received a decision regarding the granting or rejection of the Corporate Income Tax facility by the Ministry of Finance; and
f) the taxpayer is an Indonesian legal entity.

Taxpayers that are not in included in the 17 sectors that are determined as pioneer industries, but have fulfilled the other criteria, and who argue that the industry can be considered a pioneer industry, can apply for this tax holiday to the Investment Coordinating Board, which will be discussed between the ministries.

A corporate taxpayer who has been accepted by the Ministry of Finance Regulation for this tax holiday must file an annual report to the Ministry of Finance at the latest 30 days after the end of the fiscal year, which contains:

a) a capital investment realisation report, starting when the Ministry of Finance decision is received until the commencement of commercial production; and
b) a production investment realisation report, starting in the fiscal year of the commencement of commercial production until the end of the Corporate Income Tax reduction period.

Tax audit procedure revitalisation

The DGT has updated the audit procedures, which aims to increase the efficiency and effectiveness of tax audits, to maintain the integrity and professionalism of tax auditors, as well as increase the quality of tax audit findings. There have been several new procedures introduced compared to the previous ones. Taxpayers are now summoned to attend an initial meeting with the Tax Auditor and to submit any requested documents. Taxpayers can be accompanied by an employee or a tax consultant. The meeting will be conducted within at least five working days from the issuance of the summon letter and will be recorded (audio and visual). In case the taxpayer does not attend the initial meeting without prior confirmation, the Tax Auditor will prepare an official report of absence and will continue to conduct a field visit at the taxpayer's location.

During the field visit, the Tax Auditor will also be accompanied by an official appointed by DGT to ensure the tax audit procedures have been conducted properly, are based on good governance, and that taxpayers can properly exercise their rights and obligations. The field visit will be conducted on an incidental basis one month after the initial meeting. Field visits can be conducted more than once depending on the data/documents needed. In case the taxpayers are uncooperative during the field visit, the tax auditors may issue an official assessment or proposal for a tax criminal investigation. It is now regulated that, prior to declaration of the final tax audit findings, a notification letter is given to the taxpayer, and the tax auditor will discuss the temporary findings with the taxpayer as part of its consideration.

DGT is also planning to initiate a tax audit revitalisation program in 2018. The tax audit revitalisation program aims to improve tax audit quality and governance, reduce potential disputes, and increase fairness to taxpayers. This program covers three main initiatives:

1) Human resource efficiency. In previous years, 20–25% of tax auditors were deployed for routine VAT restitution processes. Therefore, DGT will introduce a preliminary refund of tax overpayment mechanism, whereas taxpayers must first be verified by the account representative in the registered tax office. The spare capacity of the tax auditors can be allocated for more targeted audits for high-risk taxpayers to increase potential tax revenue.
2) Taxpayer selection. DGT will emphasise risk analysis to determine which taxpayers will be audited, based on valid and accurate data/information. Further, DGT will also form audit planning committees in its head office and regional offices, which will determine which taxpayers will be subject to a tax audit.
3) Audit (quality) increase. Tax audits will be based on an integrated IT system for the entire process (from planning until finalisation). With an integrated IT system, the audit's progress can be monitored and evaluated at each step. Further, DGT will also form an audit quality control committee that will monitor the audit process.

Tax appeal and lawsuit improvement process

In case the taxpayer receives an unfavourable tax assessment letter, the taxpayer can file an objection to the regional tax office. The head of the regional tax office will then issue an objection decision. If the taxpayer disagrees with the objection decision, it can file an appeal to the Tax Court.[11] If the taxpayers or the DGT disagrees with the court's decision, the parties can file for Civil Review at the Supreme Court.

Taxpayers can file a lawsuit to the Tax Court for:

a) the implementation of a distress warrant, confiscation order, or auction announcement;
b) a decision on prevention in the context of tax collection;
c) a decision related to the execution of a tax decision, other than an objection decision; and
d) the issuance of a tax assessment letter or an objection decision that is not in accordance with the procedures and mechanism stipulated in the provisions of taxation legislation.

The Tax Court handles central taxes, regional taxes, and customs cases. In the past few years, there has been an increasing number of appeal and lawsuit cases filed to the Tax Court, of which has been dominated by central tax and customs cases. Statistically, taxpayers have quite a high chance of getting a favourable decision in the Tax Court (~57%).[12]

In recent years, the Tax Court has also started to improve its efficiency and effectiveness in handling disputes cases. The Tax Court has internally determined the timescale for Tax Court decisions, as follows:[13]

a) Lawsuit cases: at the latest three months after the last hearing.
b) Appeal cases, which do not fulfil the formal requirements: at the latest three months after the last hearing.
c) Other appeal cases: at the latest nine months after the last hearing.

The Tax Court has also issued a guideline for preparing appeal and lawsuit letters.[14] This guideline contains the format of the appeal and lawsuit letters and the information to be stated in such. This guideline also outlines the formal requirements that need to be fulfilled and the supporting documentation to be attached. This guideline is helpful not only in standardising the appeal and lawsuit letter format, but also in assisting taxpayers when filing their letters.

Automatic Exchange of Information ("**AEOI**")

The OECD has developed a Common Reporting Standard ("**CRS**") for AEOI. Currently, 105 countries have committed to implementing the CRS.[15] As of April 2018, the DGT has announced 79 Participant Jurisdictions and 69 Jurisdictions for Reporting Purposes.[16] Some of the countries that have an active exchange relationship with Indonesia in 2018 are China, Hong Kong, Japan, Korea, Mauritius, the Netherlands, the Seychelles and Singapore.

One of the conditions for the implementation of AEOI is the existence of domestic legislation which requires the financial institution to collect and report financial information to the tax authority and provide the tax authority the rights to exchange the financial information with other countries. In order to comply with this requirement, the government of Indonesia has established the domestic legal ground and revoked the previous regulations related to bank secrecy.

For the primary legislation, the government of Indonesia has issued a Government Regulation in *lieu* of Law No. 1 of 2017 regarding Financial Information Access for Taxation Purposes, which was subsequently enacted as Law No. 9 of 2017. For the secondary legislation, the Ministry of Finance has issued MoF Regulation No. 70/PMK.03/2017 on Technical Guidance on Financial Information Access for Taxation Purposes, which was most recently

amended by MoF Regulation No. 19/PMK.03/2018. The financial service authority ("**OJK**") has also issued OJK Regulation No. 25/POJK.03/2015 on Foreign Customers Account Reporting to Partners' Country of Jurisdiction and OJK Circular Letter No. 16/SEOJK.03/2017 on Foreign Account Reporting for Automatic Exchange of Information using the Common Reporting Standard.

After the success of the Tax Amnesty program in Indonesia, the issuance of both primary and secondary legislation for the purpose of exchange of information has shown the commitment of the government of Indonesia to becoming a transparent tax jurisdiction. These new regulations apply for both foreign accounts and domestic accounts (i.e., for Indonesian taxpayers' financial accounts in Indonesia).

The financial information that will be automatically exchanged is: the identity of the financial account holder; the financial account number; the financial account balance or value; and the income related to the financial account, e.g. interest and dividends.

The financial institution must conduct due diligence on its foreign accounts. The due diligence requirement began on 1 July 2017. There are four categories of clients: pre-existing individuals; new on-board individuals; pre-existing entities; and new on-board entities. The procedure for due diligence is generally identical to the OECD standard.

There are two types of financial information exchange: automatic; and by request:

1. **Automatic submission of financial information**

   For AEOI purposes, the minimum threshold for foreign accounts to be reported is USD 250,000 (as of 30 June 2017, 31 December 2017, and 31 December each year). The submission deadline for financial institutions to OJK is on 1 August. The OJK then submits the financial information to the DGT by 31 August every year, starting in 2018. Other financial institutions, such as micro-finance institutions, must submit their financial information directly to DGT by the end of April.

   For all other domestic accounts, other than foreign accounts that have been reported for AEOI purposes, financial institutions must also report similar financial account information to the DGT. The thresholds for domestic financial accounts that must be automatically reported are:

   - For saving institutions: 1) for individuals: accounts with a minimum balance of Rp 1bn; and 2) for entities: no minimum threshold.
   - For certain insurance institutions: for individuals or entities with an insurance policy with a minimum coverage value of Rp 1bn.
   - For custodian institutions and investment entities: no minimum threshold.

   The submission deadline for financial institutions for domestic accounts is by the end of April every year. The first submission is due on April 2018 for the information as of 31 December 2017.

2. **Provision of financial information by request**

This exchange of financial information by request aims to support the following activities:

a) taxpayer supervision, e.g. extensification activity, intelligence, or assessment;

b) tax audits;

c) tax collection;

d) preliminary evidence audits;

e) tax crime audits; or

f) tax dispute settlements, such as objection, reduction or cancellation of tax assessment, or reduction or nullification of administrative sanction.

The DGT will submit a financial information request to the financial institutions with the details of the taxpayer's identity. The financial institution must provide the requested financial information at the latest one month from the DGT's initial request.

For financial institutions that do not comply with the above requirements, the DGT may issue a clarification letter and then a warning letter. In case there is still no response from the institutions, the DGT may conduct a preliminary evidence audit, followed by a tax crime investigation.

Tax climate in Indonesia

After the Tax Amnesty program, 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.[17] 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, such as non-requirement to submit a nil periodic tax return with regard to Articles 21 and 25 of the Income Tax Law, 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[18] 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 by the Minister of Finance and Financial Service Authority Commissioner was needed. With the information from the Tax Amnesty and improved access to financial information through 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 also will 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). There are few critical points to note in 2018, such as the development of a sophisticated IT system (core tax system), financial information/data access (and other third-party data) management, and balancing service and supervision activities from DGT.

* * *

Endnotes

1. For fiscal year/fiscal period up to 31 December 2015 or the latest fiscal year/fiscal period which ends in 2015.
2. Financial Information Access for Taxation Purposes, DGT Presentation (PJ.091/PL/S/02/2017-00).
3. In the three years since the enactment of Tax Amnesty Law (until 30 June 2019), the DGT was given the rights to trace any unreported assets for the taxpayers that did not use the Tax Amnesty Facility for asset acquisition from 1 January 1985.
4. 25% for corporate taxpayers; 30% for individual taxpayers; and 12.5% for other certain taxpayers.
5. As of 11 April 2017: 43 countries have QCAAs starting fiscal year 2016, such as Japan, Korea, Netherlands, Mauritius; six countries have QCAAs starting fiscal year 2017, such as Singapore; and three countries have QCAAs starting fiscal year 2018: Malaysia; Pakistan; and Switzerland.
6. Article 26 paragraph (1) of Law No. 7 of 1983 on Income Tax, as most recently amended by Law No. 36 of 2008 ("**Income Tax Law**").
7. Article 26 paragraph (3) of the Income Tax Law and Article 2 paragraph (3) of Ministry of Finance Decision No. 434/KMK.04/1999.
8. Form DGT is a domicile letter form that is used by the DGT to identify the beneficial owner and the nature of the transactions with the foreign tax resident, which must also be legalised by the competent authority in the DTA partner country or jurisdiction. Form DGT 2 is used by: 1) the foreign tax resident that receives and/or earns income from a custodian in relation to the income from transfer of shares or bonds that are traded or reported in the Indonesian capital market, other than interest and dividends; 2) the bank foreign tax resident; and 3) pension fund tax resident. Form DGT-1 is used by foreign tax residents not using Form DGT-2.
9. At the time of writing this article, the new Investment Coordinating Board (BKPM) decision is still under discussion.
10. The previous regulation only provided partial exemption.
11. The Indonesian Tax Court was established under Law No. 12 of 2002. Prior to the establishment of the Tax Court, the tax dispute cases were handled by a Tax Dispute Settlement Agency. The Tax Court's decision is considered final and binding.
12. Including Tax Court decisions which decide to fully grant, partially grant, and revoke objection decisions from the period of 2012–2017.
13. Tax Court Circular Letter No. 007/PJ/2015.
14. Tax Court Circular Letter No. 008/PJ/2017.
15. As of November 2017, the total countries that have committed to conducting the first exchange in 2017–2020.
16. Based on MoF Regulation No. 70/PMK.03/2017, as most recently amended by MoF Regulation No. 19/PMK.03/2018, a Participant Jurisdiction is a foreign jurisdiction that is bound with the government of Indonesia in an international treaty for automatic exchange of information. Jurisdiction for Reporting Purpose is the Participant Jurisdictions that are the destination jurisdictions for automatic exchange of information by government of Indonesia.
17. Currently, Indonesia's tax ratio is relatively low at ~11% compared to ~34% for average OECD countries.
18. Based on the World Bank Ease of Doing Business Report 2018, Indonesia ranks 72 out of 190 countries.

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Ireland

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Overview of corporate tax work

Key features of Irish tax lawyers' work in the last 12 months have included North American inward investment, intellectual property ("**IP**") exploitation, corporate restructuring, overseas financing of Irish real estate deals and M&A activity, especially involving Ireland as a Brexit alternative. There has also been a continued focus on Irish tax-exempt funds and the use of Irish debt issuance and securitisation vehicles.

North American inward investment

Ireland's 12.5% corporate tax rate on trading income continues to be attractive to non-EU groups wishing to access the EU market. Whilst the US Tax Reform of late 2017 reduces the attractiveness of Ireland's offering, Ireland remains one of the most tax-efficient locations in the EU for US groups to establish EU operations. The introduction of the US Global Intangible Tax Regime ("**GILTI**") can cause a US Federal charge to tax of 10.5% (50% of the US Federal rate of 21%) on certain non-US income located in an Irish subsidiary, but with 80% credit for Irish tax against US tax, there is typically no increase in a US group's overall tax burden by reason of their Irish presence. In contrast, US groups with significant operations in other EU States with relatively higher corporate tax rates than Ireland are likely to have excess foreign tax credits that are surplus for US tax purposes and hence the US tax changes are likely to lead to an increase in the group's overall effective tax rate. Any group contemplating restructuring may wish to consider using an Irish platform going forward. Of course, the distraction of the US tax code should not deflect from the fiscal attractiveness of Ireland to Canadian and indeed Asian, especially Chinese, based groups that are focused on the use of Ireland as a springboard to the EU.

Intellectual property exploitation and Ireland's intangible asset risk

The Irish tax regime provides an allowable tax deduction for the acquisition of a range of IP. The write-off is over the expected useful life of the IP or alternatively companies may opt for a 15-year write-off period. The annual allowance, together with any associated interest expense, cannot exceed 80% of trading income for the relevant period but the excess is carried forward. The continued focus on tax avoidance using offshore IP holding companies has caused many groups to onshore their IP to Ireland and take advantage of the intangible asset regime. Under the US tax changes, the US has introduced a tax rate of 13.125% on Foreign Derived Intangible Income ("**FDII**") in an effort to encourage US-based groups to onshore their IP to the US. However, it is not clear whether the FDII provisions violate Organisation for Economic Co-operation and Development ("**OECD**") rules in relation to

preferential tax regimes and any group considering onshoring IP back to the US should be conscious that there may be negative withholding tax and other consequences in the event that the regime is found to violate these international standards. The continued availability of the R&D tax credit regime in Ireland, which provides an additional tax credit of 25% for qualifying expenditure, means that Ireland remains an attractive location for carrying out R&D activities.

Corporate restructuring

Corporate restructuring activity was strong in 2017. For commercial real estate, the introduction of a 6% stamp duty on shares or fund units deriving their value from Irish land, together with the introduction of a 20% tax charge on funds in respect of gains on Irish real estate or loans deriving their value therefrom, has caused major restructuring of overseas investors' interest in Irish property.

The OECD and EU's continued focus on tax avoidance using tax havens has caused many groups to dismantle offshore structures and move activities to Ireland.

The various Base Erosion and Profit Shifting ("**BEPS**") initiatives that align substance with commercial profits have caused the dismantling of commissionaire arrangements and realignment of supply chain arrangements.

M&A

M&A activity picked up substantially in 2017. Ireland's focus on technology and innovation is driving foreign buyers into the Irish market. With Brexit looming large, Ireland is beginning to see some acquisitions as part of Brexit play from both non-EU buyers and UK purchasers.

Funds and securitisations

Ireland remains a popular domicile for investment funds and there has been some movement of the associated fund management activities from London.

The continued growth of bank loan books is again driving the securitisation market through the use of Irish Section 110 special purpose vehicles ("**SPVs**").

Key developments affecting Irish tax law and practice

Implementation by Ireland of the EU Anti-Avoidance Directive ("**ATAD**") is due to commence in stages with effect from 1 January 2019. A key change will be the introduction of a controlled foreign company ("**CFC**") regime which will tax profits of certain passive subsidiaries of Irish parent companies. The precise form of the CFC regime remains unclear at the time of writing as ATAD leaves some discretion with Member States, but it is expected to have a wide exemption for trading operations carried on in overseas subsidiaries. There is also a possibility that Ireland may amend its regime for the taxation of foreign dividends by introducing a dividend participation exemption rather than the current system of giving credit for underlying foreign taxes.

ATAD also requires Ireland to introduce an exit tax on companies ceasing to be tax resident in Ireland. Currently, it is possible for certain foreign parented groups to change the residency of their Irish subsidiaries free of corporation tax, whereas a disposal of IP or other capital assets could attract tax at 33% on any gain. It is possible that any exit tax may be aligned with Ireland's 12.5% tax regime. Details at the time of writing remain unclear.

Tax climate

The Irish tax system facilitates inward investment. Conscious of the need to deal with increasing international tax controversy, the Irish tax authority has increased resources in its international tax group, particularly in the area of transfer pricing and advance pricing agreements.

The Irish tax regime is stable and based around its 12.5% corporate tax rate. Despite challenges from some parts of the EU, Ireland's 12.5% tax regime is expected to continue for many years to come.

From an EU perspective, Ireland remains opposed to the introduction of a Common Consolidated Corporate Tax Base ("**CCCTB**"). It is engaging with other EU Member States on adopting common rules for a common corporate tax base, but is very much opposed to the CCCTB.

Ireland is aligned with the OECD and the US in respect of tax changes to the digital economy. It opposes EU initiatives to tax digital transactions outside the current norms of international tax principles as agreed through the OECD. Following the EU Commission's state aid finding against Apple, Ireland conducted an independent review of its corporate tax regime (the "**Coffey Report**"). It is anticipated that as a consequence of the Coffey Report, Ireland will shortly extend its transfer pricing rules and such change may impact on existing interest-free loan arrangements.

Ireland as a holding company location

Ireland continues to remain attractive as a holding company location. Whilst US anti-inversion rules have hampered the attractiveness of Irish holding companies, the Irish low-tax regime provides a strong basis to consider their use. Ireland has a generous substantial shareholding capital gains tax exemption that enables disposals of shares in trading subsidiaries and joint ventures free of tax where such subsidiary or joint venture is located in the EU or a country with which Ireland has a double tax treaty. Whilst Ireland taxes foreign dividends, the rate of tax on certain dividends is limited to 12.5% with credit for foreign underlying and withholding taxes and an ability to pool foreign tax credits; the net effect being no incidence of Irish tax on foreign dividends. When introducing a CFC regime, Ireland may also introduce some form of participation exemption for foreign dividends, which will further enhance the Irish offering.

Finally, it should be noted that share transfers in Irish incorporated companies are currently subject to stamp duty of 1%. American Depository Receipt and equivalent programmes over Irish shares avoid the 1% charge. At the time of writing, the Irish Government is considering abolishing or reducing this charge to stamp duty on shares.

Industry focus

Pharmaceutical and medical devices

Ireland's low tax offering and educated workforce continues to attract and retain the world's largest pharmaceutical and medical devices employers.

Asset financing and financial services

Ireland's attractiveness as an aircraft leasing and securitisation hub continues to grow. A key attraction is the low Irish corporate tax regime and the ability to reduce or eliminate any withholding tax by reason of Ireland's EU membership and double tax treaty network.

Financial services groups are taking advantage of Ireland's intangible assets regime and locating worldwide innovation centres in Ireland.

Technology

The technology sector continues to thrive in Ireland. The Irish privacy regime under the General Data Protection Regulation can be aligned with Ireland's tax offering to give technology companies a "one stop shop" to access the EU market.

Ireland's 6.25% tax on income qualifying for the knowledge development box is also of interest to those groups using Ireland as a software development hub.

The year ahead

The Irish tax offering faces challenges from the new US tax regime as well as EU efforts to move towards CCCTB and changes in the taxation of the digital economy. There are signs that groups are already adapting to the new international tax environment and seeking to align profit generation with substance by expanding their Irish real estate investment and operations in Ireland. The EU state aid Apple case is likely to come before the European Courts later this year, although this should not distract from Ireland's overall tax offering.

The Irish Government is alive to the issue of too few large companies bearing the burden of paying a disproportionate share of corporate tax and may address the issue by measures to tackle base erosion of the Irish corporate tax base.

The introduction of tariffs and increased protection, coupled with Brexit, is driving business to Ireland for an EU tariff-free access point.

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Italy

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Overview of corporate tax work over last year

The types of corporate tax applicable in Italy are: IRES (corporate income tax: 24%); and IRAP (standard regional tax: 3.9%).

Significant deals and themes

Transfer pricing rules

Paragraph 7 of article 110 of the TUIR (transfer pricing rules) now states that income deriving from transactions carried out with enterprises not resident in the territory of the State, which directly or indirectly control the resident enterprise, are controlled by it or are controlled by the same company which controls the enterprise, is determined by considering condition and prices which would have been applied in transactions performed at market value between non-related subjects operating in similar circumstances if this results in an increase in income. The same provision also applies to a reduction in income, as per article 31-*quater* of Decree no. 600 of the President of the Republic, dated 29 September 1973.

This article was added, envisaging that reduction of income (as per paragraph 7, Article 110 of the TUIR) can be recognised:

(1) in implementing the agreements concluded with the appropriate authorities of foreign States further to the special mutual agreement procedure (MAP) provided by international double tax treaties (DTTs) or by the Arbitration Convention 90/436/EC, dated 23 July 1990;
(2) upon finalisation of controls made within the scope of international cooperation whose outcomes are shared by both States; and
(3) following the request of the taxpayer, according to terms and modalities as set forth by the Measure of the Director of the Revenue Agency, in light of a final increase duly compliant with the principle of free competition performed by a State with which a DTT allowing fair exchange of information is in force. The possibility for the taxpayer to start a MAP, should the requirements be met, remains untouched.

The recent changes to the transfer pricing regulations have been largely inspired by the OECD guidance contained in the following documents:

(1) OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017.
(2) BEPS Actions 8–10 – Transfer Pricing: intangibles; risks & capital; high-risk transactions; and aligning transfer pricing outcomes with value creation.
(3) BEPS Action 13 – Transfer Pricing Documentation and Country-by-Country Reporting. Italian legislation has incorporated the principles contained in Action 13, introducing an obligation to prepare country-by-country reports under given conditions.

Investment incentives

Recent measures have been introduced to enhance the competitiveness and attractiveness of the Italian tax system and thus facilitate and promote investments for both Italian and foreign investors. The most significant among them is the so-called *"Industria 4.0"* National Plan, which is designed to facilitate the technological transformation of companies and help them take advantage of the opportunities offered by the Fourth Industrial Revolution.

The principal measures introduced by the Plan (which may be applied in combination) are:

- Hyper- and super-depreciation.
- Training 4.0.
- The "Nuova Sabatini" law.
- Tax credit for R&D expenses.
- Innovative startup companies and SMEs.
- Patent box.
- Development agreements.
- Agreements for innovation.
- Technology transfer centres.

Regarding hyper- and super-depreciation, please note that these measures are part of the Fourth Industrial Revolution, which has an impact on the efficiency and productivity of the manufacturing process, and on the possibility to revisit business models. The Industria 4.0 technologies cover three main areas:

(1) availability of digital data and Big Data analytics;
(2) robotics and advanced automation; and
(3) high connectivity.

Hyper- and super-depreciation/amortisation

What is it for?	Supporting and offering incentives to companies that invest in new capital assets, tangible and intangible assets (software and IT systems) for the technological and digital transformation of their production processes.
Benefits	**Hyper-depreciation**: For depreciation purposes, investments in new tangible assets, devices and technologies, enabling the companies' transformation to "Impresa 4.0" standards will be valued at **250%** of the investment value. Applies for outright purchases and finance lease agreements. Investments in intangible assets, such as software and IT systems, are valued at 140%, in case the company benefits from the hyper-depreciation on tangible assets. **Super-depreciation**: For depreciation purposes, investments will be valued at **130%** of the investment value. Applies for purchases and finance lease agreements.
Who is it for?	Everyone with business income, including sole proprietorships subject to enterprise income tax (IRI), which are based in Italy for tax purposes, including PEs of companies based abroad, regardless of their legal form, size and business sector.
How is it accessed?	1) It is automatically accessible when preparing financial statements and through self-certification. 2) Eligibility for tax benefits is satisfied when an order is placed and an advance payment of at least 20% is made by **31 December 2018**, and the assets are delivered by **31 December 2019** (for hyper depreciation/amortisation) and **30 June 2019** (for super-depreciation/amortisation). 3) For hyper-depreciation/amortisation purposes, investments with a value of more than **€500,000 per asset** must be supported by a sworn technical report prepared by an expert or engineer registered with the appropriate professional registers.

Training 4.0

An interesting incentive introduced by the 2018 Italian budget act (the Stability Law 2018 – *Legge di Stabilità 2018*) concerns costs for staff being trained to meet Industria 4.0 standards: all companies, regardless of their legal form, business sector and accounting regime, who incur costs for training activities during the fiscal year subsequent to the one in progress on 31 December 2017 are entitled to a tax credit corresponding to **40%** of labour costs for the period during which such staff is involved in a training programme under the Industria 4.0 plan. The tax credit (which cannot exceed **€300,000** p.a. for each beneficiary) is granted in respect of training activities agreed under corporate or territorial bargaining agreements.

What is it for?	Supporting expenditure for employees' training concerning the technology envisaged by Italy's national plan, Impresa 4.0, and filling the skills gap.
Benefits	1) The incentive, equal to **40%**, refers to expenses related to labour costs involved in training courses, agreed through collective or territorial bargaining agreements with trade unions. 2) Tax credit can be used by companies up to an amount of **€300,000** for training courses on technologies provided by Italy's Impresa 4.0 national plan. 3) The training activities must be agreed upon by collective or territorial bargaining with trade unions and must concern the following areas: • sales and marketing; • computer science and techniques; and • production technologies. 4) These benefits only apply in 2018.
Who is it for?	All legal entities with business income, regardless of their legal form, size, business sector or accounting system, adopted and methods for determining income for tax purposes.
How is it accessed?	Automatically when preparing financial statements and specifying expenditure in income tax returns.

Tax credit for R&D expenses

The purpose of this measure is to stimulate R&D expenses in order to innovate products and processes and maintain competitiveness. The benefit consists in a tax credit corresponding to **50%** of the increments in R&D expenses up to a maximum of €20m a year per eligible entity, based on the average R&D expenses incurred in FYs 2012–2014.

Eligible expenses are expenses for fundamental research, industrial research and experimental development, costs for highly qualified and skilled personnel, research agreements with universities, research institutions, enterprises, innovative startups and SMEs, depreciation allowances for laboratory instrumentation and equipment, technical know-how and industrial IP rights.

Cont'd Overleaf

Tax credit for R&D expenses

What is it for?	Encouraging private investment in research and development for product and process innovation, to ensure the competitiveness of enterprises in the future.
Benefits	1) 50% tax credit on incremental research and development costs up to an annual ceiling of €20m a year per beneficiary, calculated on the basis of the average expenditure on R&D in the years 2012–2014. 2) The tax credit can be used to cover a wide range of different taxes and contributions, even if companies report losses. 3) Applies to all expenditure on basic research, industrial research and experimental development: hiring of highly qualified and technically specialised employees; research agreements with universities, research institutes, enterprises, innovative startups and SMEs; depreciation on laboratory equipment and instrumentation; technical know-how; and industrial property rights. This measure is applicable to research and development expenditures incurred in the period 2017–2020.
Who is it for?	1) All legal entities with a business income (enterprises, non-commercial institutions, consortia and networks of enterprises), irrespective of their legal form, size or business sector. 2) Enterprises based in Italy or abroad with a permanent establishment in Italy, which perform their own research and development or commission research and development work. 3) Enterprises based in Italy or abroad with a permanent establishment in Italy which perform research and development work on commission for companies based abroad.
How is it accessed?	Automatically when preparing financial statements and specifying expenditure in income tax returns. There is an obligation to provide certified accounting documents.

Innovative startups and SMEs

Innovative startups benefit from a dedicated legislative framework in areas including administrative simplification, the labour market, tax incentives and insolvency law. Most of the relevant provisions extend to innovative SMEs, i.e. small and medium-sized enterprises engaged in technological innovation, regardless of their incorporation date or corporate objects.

The legislation in support of innovative startups does not apply to all newly established enterprises, but only to those which show a clear character of **technological innovation**. Besides this distinction, no industry-specific restriction has been made; the legislation is potentially applicable to companies operating in any economic sector, from digital to manufacturing, and from trade to agriculture.

Innovative startups are companies with a share capital (i.e. limited companies, "*società di capitali*"), including cooperatives, whose capital shares – or equivalent – are not listed either on a regulated market or on multilateral trading facilities and which meet specific conditions, such as, for instance:

(1) they are newly incorporated or have been operational for less than five years (in any case, not before 18 December 2012);
(2) they have their headquarters in Italy or in another EU country, but with at least a production site branch in Italy;
(3) they have a yearly turnover lower than €5m; and
(4) they do not distribute profits.

Certified incubator: a "**certified startup incubator**" – introduced into the Italian legal system by Decree-Law 179/2012, art. 25(5) – is an entity that satisfies a number of specific

qualitative requirements, defined by Ministerial Decree of 22 December 2016. The legal criteria concern the physical facilities of the company, its management, and its track record in the incubation and acceleration of new innovative companies, aiming to identify and enhance those national structures that are able to offer efficient incubation services for hi-tech innovative enterprises. The certification can be intended as a mark of excellence: the certified incubator shall demonstrate to have proven experience in supporting the launch and development of innovative enterprises.

#ItalyFrontiers…

…is a new online platform aiming to enrich and expand the existing information assets available for Italian innovative enterprises. This platform provides an opportunity for innovative startups and SMEs to manage a public profile, which is totally customisable, both in Italian and English. Each company can manage a detail sheet, which not only includes the institutional data already available, updated weekly, on the special section of the Business Register, but also contains a wide range of more in-depth information that can be optionally inserted by each company. This includes the stage of development of the business, the characteristics of its team members, the type of products or services offered, funding needs, capital raised and target markets.

Key developments affecting corporate tax law and practice

Abuse of law

The Supreme Court intervened on the new definition of abuse of law with reference to extraordinary transactions, by clarifying that there is no abuse when such transactions are based on relevant extra fiscal purposes (for the sake of example, when the main purpose is the reorganisation of the company from an entrepreneurial point of view) (for example, see the Judgment of 21 February 2018, no. 414). According to the definition of the abuse of law, any facts, actions and contracts – whether interrelated or otherwise – producing no significant effects other than a tax advantage, are considered to have no economic substance. The domestic approach is consistent with EC Recommendation no. 2012/772/EU, dated 6 December 2012 on aggressive tax planning (ATP scheme).

European – CJEU cases and EU law developments

Domestic group taxation – ECJ Papillon, SCA Holding, Felixstowe, Philips Electonics

Legislative Decree no. 147/2015[1] introduced significant changes to domestic group taxation (Horizontal group taxation – *Consolidato orizzontale*). The changes have been introduced in order to make the regulations compliant with the European principles (see the ECJ's decision dated 12 June 2014, cases C-39/13, C-40/13 and C-41/13). These cases referred to the exclusion from group taxation of a company indirectly owned by a non-resident company (*Papillon*, *SCA Holding and Felixstowe*), of two resident companies controlled by the same non-resident company (*SCA Holding*) and of a PE of a non-resident associate (*Philips Electonics*).

With the Horizontal group taxation (*Consolidato orizzontale*) prescribed by article 117(2*bis*) of the Italian Income Tax Code, parent companies resident in EU or European Economic Area white-listed States can opt for domestic group taxation for subsidiaries resident in Italy and the PE in Italy of subsidiaries resident in European States or European Economic Area white-listed States, with prior appointment of an Italian subsidiary or a PE of a company resident in European States or European Economic Area white-listed States, acting as a parent company.

Vat Group – ECJ Skandia

In implementing the principles expressed in the *Skandia* judgment issued by the EU Court of Justice, dated 17 September 2014, VAT Group rules have been amended. Specifically:

(1) sales of goods/provisions of services performed by a subsidiary or PE part of a VAT Group to its PE or to its own subsidiary located abroad are considered to be made by the VAT Group to a subject which is not part of such Group;
(2) sales of goods/provisions of services performed to a subsidiary or PE which is part of a VAT Group by its PE or by its own subsidiary located abroad are considered to be made to the VAT Group by a subject which is not part of such Group;
(3) sales of goods/provisions of services performed to a subsidiary or PE which is part of a VAT Group, located in a different EU Member State, by its PE or its own subsidiary located within the state territory, are considered to be made to the VAT Group located in the other EU Member State by a subject which is not part of such Group; and
(4) sales of goods/provisions of services performed by a subsidiary or PE which is part of a VAT Group, located in a different EU Member State, to its PE or to its own subsidiary located within the state territory, are considered to be made by the VAT Group located in the other EU Member State to a subject which is not part of such Group.

Further, please see "Legislative changes affecting holding companies in particular" below.

BEPS

The Italian Tax Administration has recently introduced legislation wholly or partly implementing the OECD guidance under the BEPS Project.

First of all, the definition of PE under article 162 of the Italian Income Tax Code has changed. The PE is defined as a fixed place of business through which the business of a non-resident enterprise is wholly or partly carried on. The new definition of PE incorporates the guidance contained in **Action 7** – Permanent Establishment status – Preventing the artificial avoidance of Permanent Establishment status – with particular regard to the following issues:

(1) commissionaire arrangements and similar strategies;
(2) artificial avoidance of PE status through the specific activity exemptions;
(3) splitting up contracts; and
(4) profit attribution to PEs and interaction with the BEPS actions on transfer pricing: in order to determine the income to be attributed to a PE, there has been an alignment to the transfer pricing rules. As provided by article 152 of the Italian Income Tax Code, the PE must be regarded as a separate and independent entity carrying out the same or similar activities, in the same or similar circumstances, having regard to the functions performed, risks assumed and assets used. The PE's free capital must be determined in line with the OECD criteria, again having regard to the functions performed, risks assumed and assets used. Thus, the approach adopted by the Italian legislation in the attribution of profits to PEs is that of transfer prices, having regard to the functions performed, risks assumed and assets used.

The domestic definition of PE is basically aligned to the **post-BEPS wording** of article 5 of the OECD Model Tax Convention (MTC) and relevant Commentary (see the following table with the main changes).

Article 5 of OECD MTC and Commentary post-BEPS	English translation of article 162 of the Italian Income Tax Code
Principal role "1) […] where a person is acting in a CS on behalf of an enterprise and in doing so, habitually concludes contracts, or habitually plays the **principal role leading** to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are: a) in the name of the enterprise, or b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or c) for the provision of services by that enterprise, that enterprise shall be deemed to have a PE in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in para. 4 […] 2) if activities of an intermediary are intended to result in the regular conclusion of contracts to be performed by the foreign enterprise, this should create a PE under Article 5(5) if: a person habitually plays the principal role leading a person acts in a CS on behalf of an enterprise and habitually concludes contracts that are routinely concluded without material modification by the enterprise or negotiates material elements of contracts and contracts are in the name of the enterprise, or for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or for the provision of services by that enterprise."	"[…] where a person is acting in the territory of the [Italian] State on behalf of a non-resident enterprise and habitually concludes contracts or plays a role leading to the conclusion of contracts without material modification by the enterprise and these contracts are in the name of the enterprise, or for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or for the provision of services by that enterprise, that enterprise shall be deemed to have a PE in the territory of the [Italian] State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in para. 4 [which are not deemed to create a PE] which, if carried out through a fixed place of business would not result in such fixed place of business being regarded as a permanent establishment pursuant to the provisions of the same paragraph."
New anti-fragmentation rule "1) An enterprise cannot **fragment** a cohesive operating business into several small operations to argue that each is merely engaged in a preparatory or auxiliary activity. 2) It should not be possible to avoid the PE status using the exceptions of Art. 5, para. 4 OECD MTC by **fragmenting a cohesive operating business** into several small operations in order to argue that each party is merely engaged in preparatory or auxiliary activities that benefit from these exceptions."	**New anti-fragmentation rule** (and business operations constituting a single whole) "A permanent establishment exists when a fixed place of business is used or managed by a company where such enterprise or a closely related enterprise carries out its activity in the same or in another place of the [Italian] territory and such place or such other place constitutes a permanent establishment for the enterprise or for the closely related enterprise pursuant to the provisions of this article, or the overall activity resulting from the combination of the activities carried out by the two companies in the same place, or by the same company or by closely related companies in the two places, is not of a preparatory or auxiliary character, provided that the activities carried out by the two enterprises in the same place or by the same enterprise or by the closely related enterprises in the two places are complementary functions forming part of business operations constituting a single whole."

Article 5 of OECD MTC and Commentary post-BEPS	English translation of article 162 of the Italian Income Tax Code
Closely related person or enterprise "1) A person or enterprise is **closely related** to an enterprise if, based on all the relevant facts and circumstances one has control of the other or both are under the control of the same persons or enterprises. 2) In any case a person or enterprise shall be considered to be closely related to an enterprise if: one possesses directly or indirectly more than 50% of the beneficial interest in the other (or, in the case of a company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person or enterprise possesses directly or indirectly more than 50% of the beneficial interest (or, in the case of a company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises."	**Closely related person** A person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person. In any case, a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than **50%** of the other or, in the case of a company, more than **50%** of the aggregate vote and value of the company's shares, or if another person possesses in both of them directly or indirectly an equity interest of more than **50%** or, in the case of a company, more than **50%** of the aggregate vote and value of the company's shares.

The new article 162 of the Italian Income Tax Code has also regulated the definition of **digital permanent establishment**, *de facto* implementing in our legislation the BEPS Project guidance. Italian legislation provides that the definition of permanent establishment includes a significant and continuing economic presence in the territory of the State, structured in such a way as to avoid a physical presence therein. This new case of permanent establishment is based on the conclusions of **Action 1** – Digital Economy (Addressing the tax challenges of the digital economy) – of the BEPS project and somehow attempts to solve the difficulties and complexities triggered by the digital economy.

Tax climate in Italy

A new tax on entrepreneurial income (IRI), replaces both corporate income tax (IRES) and the individual income tax (IRPEF) for income derived from business activities such as sole proprietorships, artisans, and self-employment. The IRI's top rate is **24%**. The option for the IRI regime has a term of five tax years, is renewable and must be indicated in the Tax Return, effective from the tax period to which the statement relates.

Developments affecting attractiveness of Italy for holding companies

Legislative changes affecting holding companies in particular

VAT Groups

Paragraphs 24 to 31 of Article 1 of the Law dated 11 December 2016, no. 232, on "*State provisional budget for year 2017 and multiyear budget for the three-year period 2017-2019*" regulate VAT Groups[2]: it is envisaged that taxable subjects established in the territory of the State carrying out business activities, trades or professions, for which financial, economic and organisational links recur jointly can become a **single taxable person**. The VAT Group concept is reserved only for subjects which have financial, economic and organisational links.

VAT Groups are formed as a result of an option chosen by **all taxable subjects** (all-in all-out principle) established in the State for which the above-mentioned financial, economic and organisational links are jointly verified. This option is binding for three years, commencing in the year in which it becomes effective.

The year ahead

The proposal to introduce a **flat tax regime** is currently being evaluated for both companies and individuals. In the case of individuals, the flat tax regime at issue would repeal the existing graduated taxation (graduating by income brackets) system and amend the system of detraction and tax deductions.

* * *

Endnotes

1. Named "*Provisions including the measures for growth and internationalization of firms*".
2. See new article 70-*bis* of the VAT Decree.

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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 actions to address the requirements under the BEPS Action Plans. Those legislative actions include:

- Transfer price taxation has been made applicable to indirect affiliate transactions (2014).
- Double non-taxation of dividends paid from foreign subsidiaries has been precluded (2015).
- An exit tax has been introduced (2015).
- A consumption tax has been made applicable to digital content services provided from foreign countries via the Internet (2015).
- Transfer price taxation documentation requirements have been strengthened (2016).
- Inheritance taxation on overseas assets has 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).

This article will summarise the two legislative actions which occurred in 2018 – namely, amendments to the definition of PE and the CFC Rules. Thereafter, it will discuss an important judicial precedent relating to the application and interpretation of the CFC Rules.

Amendments to the Definition of PE

Background of the 2018 Tax Reform

If foreign corporations have a PE in Japan, the income that they derive from their businesses in Japan is subject to Japanese corporate tax. Under the Corporate Tax Act ("CTA"), there are three types of PE: (i) a branch-type PE; (ii) a construction-type PE; and (iii) an agent-type PE. PEs are defined not only in domestic tax acts, but also in tax conventions between two countries and the Model Tax Convention, which is formulated by the OECD.

In recent years, multinational companies have been conducting their businesses in such a way that they can artificially avoid being treated as having a PE in a foreign country. As a result, this has become an international issue. In December 2017, the OECD addressed this issue by updating the Model Tax Convention and amending the definition of PE. To remain consistent with international standards, the 2018 Tax Reform amended the definition of PE under the CTA. This amendment, which is set forth in more detail below, shall apply to companies' fiscal years that commence on or after 1 January 2019.

Branch-type PE

Before the 2018 Tax Reform, a location used solely for storage did not fall within the definition of a branch-type PE. This exclusion created an issue because a huge warehouse used solely to store products did not fall within the definition of a branch-type PE even if it was the location where the foreign corporation conducted activities essential to its product-selling business (the majority of the foreign corporation's employees worked in the warehouse). Now, under the 2018 Tax Reform, a location used solely for storage, display, delivery and other specific activities does not fall within the definition of a branch-type PE, provided that the identified activities are limited to preparatory or auxiliary functions of the foreign corporation's business.

Construction-type PE

Before the 2018 Tax Reform, a foreign corporation was deemed to have a construction-type PE when it conducted any construction work, etc. in Japan for more than one year. The 2018 Tax Reform, however, addresses efforts by foreign corporations to avoid PE status by dividing an agreement of more than one year into several agreements of one year or less. Now, under the 2018 Tax Reform, in determining whether the one year requirement has been satisfied, multiple contracts can be aggregated. Thus, when an agreement is divided into several agreements in order for each agreement to be one year or less, and one of the main reasons for such division is to avoid a construction-type PE in Japan, the relevant time period for purposes of the PE requirements will be determined by aggregating the periods of the agreements.

Agent-type PE

Before the 2018 Tax Reform, an agent-type PE required, among other things, that an entity have the authority to conclude contracts in Japan on behalf of a foreign corporation. However, as a result of this requirement, the following problem was noted: if foreign company A executed a commissionaire contract (i.e., a contract pursuant to which an agent sells products in its own name, but on behalf of a foreign enterprise that is the owner of those products) with Japanese company B as a trustee, and then company B, on behalf of itself, executed a sales agreement concerning foreign company A's products, foreign company A would not have an agent-type PE in Japan.

To address this problem, the 2018 Tax Reform expanded the definition of an agent-type PE. Now, if a person acts in Japan on behalf of a foreign company, and in doing so, habitually concludes contracts or habitually plays a principal role leading to the conclusion of contracts concerning the transfer of ownership of the foreign company's property, etc., that person will fall within an agent-type PE of the foreign company.

Additionally, the CTA stipulates that a person who carries out an agent business as a regular business ("independent agent") does not fall within an agent-type PE. However, under the 2018 Tax Reform, the scope of this independent agent exemption will be narrowed so that an agent who acts exclusively or mainly on behalf of those closely related to the agent (the phrase "those closely related to the agent" means a non-resident individual or a foreign corporation that controls or is controlled by the agent such as those having a direct or indirect ownership of more than 50% of the agent) will not fall within the scope of an independent agent.

Further reform of Japan's CFC Rules

The 2017 Tax Reform made numerous changes to the CFC Rules ("2017 CFC Rules Reform"). However, additional revisions were made by the 2018 Tax Reform ("2018 CFC

Rules Reform"). The 2018 CFC Rules Reform is applicable beginning from the fiscal year of foreign-related entities commencing on or after 1 April 2018; this is the same effective date as the 2017 CFC Rules Reform.

In order to maximise synergy arising from foreign M&As, Japanese entities sometimes reorganise unnecessary paper companies which are placed under the umbrella of the Japanese entities as part of their post-merger integration ("PMI"). An example of this is described below:

1) A Japanese entity ("Company X") acquires a company located in the United States ("Company A").
2) A paper company ("Company B") is a subsidiary of Company A and has shares of a company in the United States ("Company C") and shares of a company in Europe ("Company D").
3) Company Y is the traditional European business hub of Company X Group. In furtherance of the PMI, after the acquisition of Company A, Company B transfers its shares of Company C to Company A, while also transferring its shares of Company D to Company Y. Company X then makes Company A the U.S. business hub of the Company X Group, while Company X makes Company D a direct subsidiary of Company Y.
4) Company X dissolves Company B.

Under the 2017 CFC Rules Reform, capital gains arising from the transfer of the shares of Company C from Company B to Company A and capital gains arising from the transfer of the shares of Company D from Company B to Company Y were supposed to be aggregated with the taxable income of Company X. Nevertheless, since the capital gains arising from the transfer of shares as a result of restructuring following the acquisition of foreign groups are capital gains arising from unrealised profits of the foreign companies outside Japan, such capital gains are considered not to erode the Japanese tax base. Under the 2018 CFC Rules Reform, such capital gains can be excluded from the calculation of the amount subject to the CFC Rules if certain requirements are fulfilled.

An outline of the requirements is as follows:

- The transfer of such shares shall be carried out within two years from the day on which the direct or indirect shares of specified foreign-related entity, etc. (in the above example, Company B) held by a Japanese company exceeds 50%.
- The transfer of such shares shall be carried out in accordance with a plan document describing a basic policy relating to the integration of a foreign company which falls within the category of a foreign-related entity, the implementation method of the reorganisation accompanying the integration and so on.
- It is expected that the specified foreign-related entity, etc. that transfers such shares (in the above example, Company B) will be dissolved within two years from the day of the transfer of such shares.

As a result of the 2018 CFC Rules Reform, when a Japanese company acquires a foreign enterprise group, it is necessary to pay attention to the plan for reorganisation and consider the detailed requirements stipulated by the CTA and the regulations thereunder.

A recent judgment of the Supreme Court of Japan which is important to the application and interpretation of the CFC Rules

This section summarises a recent important judicial decision by the Supreme Court of Japan (October 24, 2017) in the Denso Case regarding the CFC Rules. In that case, the issue was

whether the exemption criteria (specifically, the business criteria) under the CFC Rules were satisfied. The Nagoya District Court upheld the claim of the plaintiff, Denso Corporation ("Denso"). Although the Nagoya High Court later quashed the decision, the Supreme Court then quashed the High Court's decision.

The decision of the Supreme Court is important for a number of reasons. First, it shows the relationship between a regional management business (i.e., controlling and managing issuing companies which are in a certain region) and a shareholding business ("shareholding business" as used herein refers to the term as stipulated under the Act on Special Measures Concerning Taxation). Second, it identifies the criteria for determining the "principal business" when a foreign-related company operates multiple businesses.

Facts

Denso is a Japanese corporation which manufactures and sells automobile parts. It set up business enterprises in 35 countries and regions and had more than 200 group companies throughout the world. As of March 31, 2007 and March 31, 2008, Denso wholly owned a company in Singapore (the "Subsidiary").

The Subsidiary held the shares of more than 10 subsidiaries in ASEAN countries during the fiscal years 2007 and 2008. The tax burden rate on the Subsidiary's income in Singapore was 22.89% in fiscal year 2007 and 12.78% in fiscal year 2008. The Subsidiary conducted a regional management business for those subsidiaries, a shareholding business (shareholders' meetings and processing dividends, etc.), a programing business and an agency business. Denso filed a tax return in Japan without including the Subsidiary's income in its income.

However, because the Nagoya Regional Taxation Bureau considered the regional management business to be subsumed in the shareholding business, the Subsidiary's principal business was deemed to be the shareholding business. As a result, the Nagoya Regional Taxation Bureau included the Subsidiary's income in Denso's income for tax purposes. In response, Denso filed an objection to the Director-General of the Regional Taxation Bureau and an examination request with the Director of the National Tax Tribunal. Thereafter, Denso filed a lawsuit for cancellation of such reassessment.

The CFC Rules at issue in the Denso Case

The applicable CFC Rules at the time of the Denso Case were somewhat different from the current rules, as they have been revised several times. Generally, the applicable CFC Rules at the time were as follows:

> A domestic corporation that held a certain percentage of shares in a foreign company which had a head or principal office in specified low tax countries would be subject to the CFC Rules in principle. Furthermore, such domestic corporation was required to add the income of that foreign company to its own income for Japanese tax purposes. However, the CFC Rules would not apply if such domestic corporation satisfied all applicable exemption criteria (i.e., (i) business criteria, (ii) substance criteria, (iii) control criteria, and (iv) (a) location criteria, or (b) unrelated party criteria). The business criteria required, among other things, that a company's principal business not be a shareholding business.

Nagoya High Court decision

The Nagoya High Court ruled that the Subsidiary's regional management business was subsumed in its shareholding business, which the court deemed to be the Subsidiary's principal business. In its decision, therefore, the Nagoya High Court held that the Subsidiary did not satisfy the business criteria since its principal business was the shareholding

business. Based on this decision, the issues before the Supreme Court were: (i) whether the Subsidiary's regional management business was subsumed in its shareholding business; and (ii) which business among the multiple businesses operated by the Subsidiary was its principal business.

Supreme Court decision

The Supreme Court held that a regional management business cannot be subsumed in a shareholding business since the regional management business has its own purpose which is different from that of the shareholding business. This is true even though the regional management business results in an increase in dividends and the asset value of the managed subsidiaries. On that basis and in light of the specific facts of the Denso Case, the Supreme Court ruled that the Subsidiary's regional management business was not subsumed in its shareholding business. In other words, the Supreme Court determined that the Subsidiary was separately engaged in a regional management business and a shareholding business, respectively.

The Supreme Court then held that a company's principal business is determined by identifying the particular business that was actually conducted by the company during the relevant fiscal year. If a company conducts multiple businesses, the principal business should be determined by comprehensively considering with respect to each business being conducted, factors including: (i) the gross income or net profit earned by each business; (ii) the number of necessary employees; and (iii) the status of tangible fixed assets, etc. When considering the businesses of the Subsidiary, the Supreme Court found the following:

- The sales from the Subsidiary's regional management business accounted for about 85% of the Subsidiary's gross income. Furthermore, although the dividends from its subsidiaries accounted for about 80% to 90% of the Subsidiary's net income, the extent to which the profit arose from the regional management business was considerably reflected in the dividend income.
- Most of the local employees were engaged in the regional management business.
- Most of the Subsidiary's tangible fixed assets were used in connection with the regional management business.

Based on these factual findings, the Supreme Court concluded that the regional management business was the Subsidiary's principal business. Moreover, the Supreme Court judged that all applicable exemption criteria were satisfied, and therefore CFC Rules would not apply to Denso.

Interplay between the Supreme Court decision in the Denso Case and the recent tax reforms

After the 2017 Tax Reform and 2018 Tax Reform, the framework of the CFC Rules has been fundamentally revised. By contrast, although the recent tax reforms changed the requirements relating to the determination of a company's principal business, the substance of the requirements are almost the same. Accordingly, notwithstanding the recent tax reforms, the Supreme Court decision in the Denso Case, which addressed not only the relationship between a regional management business and a shareholding business, but also the "principal business" criteria, remains a valuable judicial precedent.

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Kosovo

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Overview of corporate tax work over the last year

The corporate tax practice and the types of corporate tax work carried out in Kosovo during the last year were driven considerably by the country's efforts to harmonise its tax legislation with relevant EU Directives. As an aspiring EU Member State, Kosovo's legal framework is continuously evolving to meet EU standards and best practices. In this respect, Kosovo's tax legislation is also undergoing significant changes to reflect those in the international tax environment, with a particular focus on addressing profit shifting and base erosion.

To this end, last year saw the enactment of important legislation and government measures to supplement the recently introduced Law on Corporate Income Tax that has been in force since September 2015. The most notable changes were the introduction of the Administrative Instruction MoF – No. 02/2017 on Transfer Pricing and the approval of the Government's Fiscal Package 2.0 which consists of a series of measures to improve local business competitiveness.

Although important pieces of tax legislations were introduced in 2017, significant measures that were previously planned for the year were not implemented. The long-anticipated merger of Kosovo Customs and the Tax Administration has not gone through and seems to be postponed indefinitely. Tax breaks and incentives for new businesses that were expected to be implemented via the issuance of a sub-legal act as discussed in last year's edition have not been implemented, whilst the implementation of the aforementioned Fiscal Package 2.0 has been muted due to a change in central government and political events.

Still, the relatively effective implementation of the Stabilization Association Agreement (SAA), which Kosovo signed in 2015, the entry into force of new Double Tax Treaties (DTTs) and the changes that were enacted have overall had a significant positive effect on the corporate tax practice and types of corporate tax work in Kosovo.

Types of corporate tax work

With the highlighted changes in mind, 2017 saw a significant increase in demand for tax advisory services in respect of transfer pricing and the application of Double Tax Treaties. The increase in demand for such services was driven by the firm's dominant position in the Kosovan market and its success in closing deals with major international clients operating in Kosovo. Notably, the majority of clients continue to be subsidiaries or PEs with fixed domicile in Kosovo as well as local companies operating in the domestic market.

The expansion of Kosovo's service sector, which represents the largest sector in the economy, has attracted attention from international firms, resulting thereby in a steady increase in tax due diligence and international tax planning services.[1] In this respect, M&A activity is

gradually picking up, but the associated corporate tax work remains low, comparatively speaking.

Notwithstanding the growth in international corporate tax work, corporate tax practice has also seen a growth in demand for domestic services, such as:

- Assistance during tax audits and tax appeals.
- Tax review services.
- General tax advisory services.
- Analysis and feedback to the Kosovan government and tax authorities in respect of legislative and regulative changes circulated for consultation with groups of interest.

Tax review services continued to be in high demand as companies have been taking advantage of the Law on Public Debt Forgiveness, which was applicable until 1 September 2017. In addition, general tax advisory services and assistance in obtaining individual ruling requests from the tax administration have been important services. The gradual implementation of the SAA and the Fiscal Package 2.0 measures have also resulted in increased demand for general tax advisory services.

Key developments affecting corporate tax law and practice

Domestic legislation

The Administrative Instruction on Transfer Pricing (AI) has been published in the context of Kosovo's efforts to follow global trends in tackling base erosion and international tax avoidance. In this regard, the TP instruction was drafted with the framework of the OECD's Transfer Pricing Guidelines in mind, and entered into force on 28 July 2017.

The Administrative Instruction sets out to regulate controlled transactions between related parties from different tax jurisdictions.[2] The Instruction specifies that parties are deemed to be related in case of the existence of a special relationship that may materially influence the economic results of the transactions between them. Additionally, the AI has also stipulated that transactions conducted by a Kosovan taxpayer with persons located in certain jurisdictions designated as tax havens fall within the scope of controlled transactions.

The AI sets out the minimum required elements for fulfilling local documentation requirements. Further, it is stipulated that documentation prepared in accordance with the EU Code of Conduct and its annexes on transfer pricing documentation, and the OECD TP Guidelines (BEPS Action 13), are also deemed to fulfil local requirements. To this end, the required documentation includes both a Master File and a Local File.

As per the AI, transfer pricing documentation must be made available to the tax administration within 30 days upon request and must be submitted in one of the official languages of Kosovo; however, authorities may accept documentation prepared in English. In terms of non-compliance with the above, failure to submit the TP documentation will result in administrative penalties, though the greatest risk pertains to the tax authorities conducting their own analysis.

Taxpayers involved in related party transactions exceeding €300,000 in a given fiscal year are required to submit a notice on their annual controlled transactions along with the annual CIT return and statutory financial statements by 31 March of the subsequent year.

In 2017, the Tax Administration unexpectedly required taxpayers to submit a Notice of Annual Controlled Transactions for the fiscal year 2016 in November, though to our knowledge no transfer pricing audits ensued as a result.

Fiscal Package 2.0

Fiscal Package 2.0 consists of 22 measures designed to ease the process of doing business in Kosovo and to improve the competitiveness of local businesses. With respect to corporate tax work, the relevant measures include the following:

- Temporary tax breaks designed to encourage investments in strategic sectors (agro-processing, tourism and IT) to be implemented via the issuance of an Administrative Instruction.
- Issuance of a sub-legal act regulating conditions under which losses from breakdown, evaporation or loss of weight of oil and its products are recognised, with a possibility of extending weight loss recognition for other products.
- Amendments to the Law on Corporate Income Tax specifically addressing the taxation of insurance companies.

However, it should be noted that the implementation of the above has been stalled due to a change in government and political events in Kosovo. Nonetheless, important measures have been passed, including the following:

- an exemption from customs duties for all products considered to be raw materials for production;
- the issuance of authorisation procedures for local producers that can benefit from exemptions for inputs and machinery used in the production process; and
- the abolition of excise tax on heavy oil for production.

Changes resulting from the application of ECJ cases

The Law on Tax Administration and Procedures foresees that, where questions arise on the correct interpretation of the Law on VAT, the Law shall be interpreted in line with the Sixth Directive and Decisions of the European Court of Justice.[3] Last year marked one of the first applications of the above provision which resulted in the publication of a Public Ruling from the Tax Administration.

The case at hand relates to the insurance industry, where due to frequent changes in VAT legislation that caused confusion among taxpayers, insurance companies did not apply the reverse charge mechanism during the period when insurance and reinsurance transactions were VAT-able. The Tax Administration then instructed insurance companies to apply a reverse charge while not deducting the input VAT for tax periods older than two years due to the time limit for deducting input VAT. The inability to deduct input VAT resulted in potentially high costs for insurance companies.

In response, based on ECJ cases C-95/07 and C-96/07, our firm argued that the time limit on the right to deduct input VAT could not be applied to a person who applied a reverse charge because, by previously not applying the reverse charge, the taxpayer did not harm the budget of the state nor did he profit from any tax advantage. After many discussions and opinions from international experts, it was determined that the Law on VAT should be interpreted according to the aforementioned cases, whereby insurance companies retained the right to deduct input VAT regardless of the time limit. This was also followed up by the issuance of a Public Explanatory Decision from the Tax Authorities.

In addition to being a big victory for the insurance industry, the inclusion of ECJ Decisions set a new standard in tax law enforcement practices in Kosovo, paving the way for future interpretation of Kosovo tax legislation in accordance with EU Directives and ECJ Decisions.

Tax climate in Kosovo

The tax climate in Kosovo remains very favourable and competitive in relation to its Balkan neighbours. As of the time of writing, the World Bank ranks Kosovo very favourably compared to its Balkan peers in terms of both paying taxes and the overall ease of doing business. Kosovo ranks 45th in terms of paying taxes and 40th in terms of overall ease of doing business, with only Macedonia among its neighbours ranking higher in both categories.[4]

Key contributions in terms of this favourable ranking pertain to the convenient electronic filing system that has been gradually extended to enable the electronic filing of most declarations. Congruently, the favourable ranking reflects the declining number of required tax filings/payments as well as the reduced time required to complete tax returns.

Bilateral treaties for avoiding double taxation

Kosovo has concluded, in total, 12 bilateral treaties for avoiding double taxation with the following countries: Albania; Belgium; Croatia; Finland; Germany; Hungary; Macedonia; Slovenia; the Netherlands; Turkey; and the United Arab Emirates (UAE).

It should be noted that four of these treaties were inherited from the Yugoslavian Federation,[5] which makes them non-compliant with all the disputes arising in today's market. In this respect, the government has taken measures to rectify the situation and negotiations with Germany have commenced on a new double tax treaty. Additionally, negotiations with several other states are in place, including with the Republic of Malta, the Republic of Lithuania and the State of Kuwait, amongst others.

Similarly to the provision on the interpretation of the Law on VAT as per the Sixth Directive, domestic tax legislation contains a reference to the OECD Model Convention, whereby the OECD Model Convention is recognised as a source of law only in circumstances where cross-border taxation is not regulated by domestic law, and there are no DTTs in force with the other state.

Developments affecting attractiveness of Kosovo for holding companies

The CIT Law exempts dividends independent of their source, which arguably favours structures such as holding entities, whose structuring may be adapted to their ownership in diverse industries. According to the CIT Law, a Kosovar resident may credit against any income derived from and taxed in a foreign jurisdiction.[6]

It is important to highlight that there is still no CFC or thin capitalisation rules, and the tendency has been for the enforcement of such obstacles to remain at the level of discussion. Moreover, Kosovo has signed only a few DTTs, and though practice and legislation is oriented towards unilateral recognition of the OECD Model Convention, the primary source of law for avoiding double taxation remains to be domestic legislation.

The legal infrastructure is adapted towards favouring non-resident companies establishing themselves in Kosovo. CIT is flat and at a rate of 10% for entities with a revenue of over €50,000 per year. This places Kosovo among the most tax-competitive jurisdictions, though neighbouring jurisdictions share similar rates and conditions, which makes the impact of company migrations still not a distinguishable aspect of the system.

The year ahead

Looking ahead to the next year, significant changes in corporate taxation may be in line. Specifically, the new central government, through working groups created by the Ministry of

Finance, has circulated a Draft Concept Document with proposed changes to tax legislation, touching upon the laws on Tax Administration and Procedures, Value Added Tax, Personal Income Tax and Corporate Income Tax.[7]

The Concept Document has been drafted in the spirit of improving the business environment in Kosovo and clamping down on the informal economy. It should be noted that relevant stakeholders, including our firm, have provided their input to the proposed changes. With respect to corporate income tax, the most important changes include the following:

- Amendment to the provisions on the taxation of insurance companies, whereby insurance companies are taxed on a real income basis. Currently, insurance companies are taxed at 5% of the collection of gross premiums.
- Reduction in the annual turnover threshold for corporations.
- Reduction of the carryforward of losses to four tax years from the current limit of six years.
- Removal of the exemption of dividends, whereby dividends shall be taxable at the ordinary income tax rate.

Further, it is possible that a very important double tax treaty with the Swiss Confederation will enter into force. This DTT is particularly important given the strong economic ties between Switzerland and Kosovo, and the large presence of the Kosovan diaspora in Switzerland.

* * *

Endnotes

1. http://pubdocs.worldbank.org/en/190611492717079013/Kosovo-Snapshot-April-2017.pdf.
2. https://gzk.rks-gov.net/ActDetail.aspx?ActID=14937.
3. Article 86 of the Law on Tax Administration and Procedures No. 03/L-222.
4. http://www.doingbusiness.org/rankings.
5. 8 September 1988, Article 11 states that dividends paid by a company which is resident in the Federal Republic of Germany to a resident of Yugoslavia may be taxed in the Federal Republic of Germany…, while the opposite possibility was not foreseen at all.
6. E.g. withholding tax.
7. http://konsultimet.rks-gov.net/viewConsult.php?ConsultationID=40317.

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Overview of corporate tax work over last year

Types of corporate tax work

Corporate structuring and restructuring for managers' interest, private equity houses, multinationals and funds are strong activities in Luxembourg. Due to the regime's flexibility, transfer of seats and exit strategies is also a key area in Luxembourg. Tax matters deriving from financing, either via third parties or between companies, are also very popularly conducted in the jurisdiction. Lenders still like to provide financing to Luxembourg entities due to the strong guarantee mechanism offered to lenders in Luxembourg. Inter-company financing is also popular in particular due to the possibility to avoid withholding tax on interest payments. The intellectual property ("**IP**") box regime also offers strong advantages which attract both start-ups and multinationals in their new IP projects.

A clear focus has been put on substance aspects due to the international context, the new rules on exchange of information and potential challenges for holding structures. Transfer pricing has become in recent years a strong field of activity, while advance tax agreements have become less important. Structures have become more conservative and are strongly documented or backed by the presence of the players on Luxembourg soil. Additionally, corporate governance helps to organise decisions processes and secures the tax organisation of larger groups through and in Luxembourg.

Securitisation and reinsurance of large groups are also activities which keep Luxembourg busy.

The number of tax disputes has slightly increased in the context of tax challenges by the tax authorities and the liability of directors, as well as in the context of exchange of information.

Significant deals and themes

- Assistance to one of our clients, an ultra-high-net-worth individual, on the Luxembourg tax aspects of the acquisition and debt refinancing of a London real estate property through Luxembourg corporate vehicles for an amount of £67,500,000.
- Assistance to one of our clients, a major international insurance/reinsurance group, with regard to the Luxembourg tax and corporate aspects of the restructuring of its life insurance portfolio detention through securitisation vehicles used to back a U.S. SPV, which issued private placement notes to U.S.-based insurance carriers.
- Assistance to a bank on the tax aspects of an exchange of information request received from both the German Federal Financial Supervisory Authority (BaFin) and the Fiscal Authority of the city of Hamburg pursuant to the disclosure of the so-called "Panama Papers" on the basis of which both authorities requested the bank to forward tax data previously held by a Luxembourg branch of the bank.

- Assistance on the Luxembourg corporate and tax aspects of the reorganisation of the top holding level of a group, involving, *inter alia*, hybrid instruments, tax transparent vehicles, the creation of an SPF (*Société de Gestion du Patrimoine Familiale*, i.e. the private wealth management company), the tranfer of debt instruments to the SPF and an analysis of the tax consequences.
- Corporate and tax assistance for the largest and fastest-growing online and mobile consumer lending group in Europe regarding the issuance of $325m of 10.75% senior notes due 2022 and listed on the Irish Stock Exchange.
- 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.
- Ongoing tax assistance to a Brazilian-owned top corporate group offering products and services in the ICT (Information and Communications Technology), Agribusiness, Services and Tourism markets to over two million customers on the reorganisation of the top holding level of the client group for the purpose of a family succession plan, by creating a family private foundation holding the shares of the family owners.
- Ongoing advice on the Luxembourg tax and corporate aspects of the refinancing of the acquisition of a Luxembourg entity owning a £160,000,000 real estate property in London.
- Tax advice on the substance requirements in Luxembourg, both from a corporate governance point of view and economical perspective (amount of capital, ratios, margins).

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

New tax measures

Pursuant to the tax reform dated 23 December 2016, the corporate income tax ("**CIT**") rate has been reduced from 19% to 18% as from tax year 2018. In addition, the taxable profits not exceeding €25,000 are subject to CIT at the rate of 15%, and an intermediate bracket has been introduced for taxable profits between €25,000 and €30,000, taxed at €3,750 plus 33% (from 2018) of the taxable income exceeding €25,000 (39% in 2017). A solidarity surcharge (*contribution au fonds pour l'emploi*) of 7% also applies. *Soparfis* (*société de participations financiéres*) are subject to municipal business tax at a 6.75% rate if located in Luxembourg City; the taxable base is the same as CIT, save for minor adjustments.

The aggregate 2018 maximum income tax rate consequently amounts to 26.01% for companies located in Luxembourg City.

This decrease is part of Luxembourg's strategy of maintaining its attractiveness and competitiveness.

2018 budget law

The budget law for 2018 was approved by the parliament and officially published on 21 December 2017, and provides several tax changes:

- *Investment tax credit*
  The investment tax credit was extended to zero-emissions cars and software that has been acquired – but not self-developed – by a company. Taxpayers can obtain credit against income tax for additional investments and global investments as follows:
  - for additional investments, the tax credit represents 13% of the acquisition price of the qualifying investments; and

- for global investments, it is 8% for a first tranche of the total acquisition price if it does not exceed €150,000 and 2% beyond this tranche.

- *Tax treatment of capital gains in the case of business restructurings*
  The capital gains realised by an absorbing company on the shares of an absorbed subsidiary are tax-exempt. This regime applies to mergers, divisions and other types of restructurings. If the conditions of shareholdings are not met, it is possible to benefit from the exemption if the absorbing company owns at least 10% of the shares of the absorbed subsidiary. This exemption may now apply even if the minimum 12-month holding period is not complied with, but not if the subsidiary is not eligible for the participation exemption regime.
- *Extension of the VAT exemption to the management of collective internal funds held by life insurance undertakings*
  The exemption for the management of investments funds under Article 44, 1, d) of the Luxembourg VAT law has been extended to the management of collective internal funds held by life insurance undertakings that are subject to the supervision of the Luxembourg Insurance Authority.
- *Taxation of stock options plans*
  The Head of the Luxembourg direct tax authorities issued Circular 104/2 on 29 November 2017 (the "**Circular**"), which (i) introduced a change regarding the taxable basis of irrevocable options, (ii) clarified the eligibility of employees to option/warrant plans, and (iii) amended the deadlines for reporting obligations to be made to the direct tax authorities.

CJEU cases and EU law developments

- *Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements ("**DAC 6**")*
  On 25 May 2018, the EU Council formally adopted the proposal for mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements.
  Any intermediaries (e.g. tax advisors, lawyers and others advisors involved in tax planning and which have the sufficient knowledge) will have to report any cross-border arrangement considered as aggressive. The text of the directive provides for elements permitting what will be considered as an "aggressive" cross-border arrangement within the scope of the directive to be defined.
  The intermediaries should report these arrangements to the Member State of their establishment and this Member State should automatically exchange such received information with the tax authorities of other Member States via a common platform. The Member States should, in case of breach of the transparency provisions, impose penalties that are proportionate but also have a sufficient dissuasive effect.
  The Member States must implement DAC 6 before 31 December 2019 and the reporting/disclosure obligation will enter into force on 1 July 2020. The first automatic exchange between Member States will take place by 31 October 2020.
- *VAT on immovable services*
  EU Regulation 1042/2013 introduced new VAT rules applicable from 1 January 2017 to clarify the immovable services regime. Further to the adoption of this EU regulation, in case services are connected with real estate, they become subject to the VAT applicable where the property is located (depending on the countries concerned, the reverse charge

mechanism may or may not apply). For services that are not connected with real estate properties, the applicable VAT will be that of where the recipient of the service is established. Among the guidelines provided: (i) it is explained that the services must have a sufficiently direct connection with immovable property; and (ii) non-exhaustive lists of examples of the scope of application are provided in articles 44 and 47.

- *End of the VAT exemption regime for financial IGPs and introduction of the Luxembourg VAT group regime*
  The CJEU declared that the Luxembourg legislation on independent groups of persons ("**IGP**") does not comply with the VAT Directive (CJEU, 4 May 2017, *Commission v. Luxembourg*, C-274/15) since (i) as clearly stated in the VAT Directive, the services rendered by the IGP should be directly necessary for VAT-exempt activities or for "non-VATable activities", (ii) IGP's members should not deduct the VAT payable or paid in respect of goods or services provided to the IGP from the amount of VAT which they are liable to pay, and (iii) any transaction between the IGP and one of its members must be regarded as a transaction between two distinct taxable persons and thus as falling within the scope of VAT.
  Further to this decision, Luxembourg introduced a draft bill implementing the VAT group regime.
  To enjoy this regime, the group members should be closely bound by financial, economic and organisational links (cumulative conditions) and the financial link shall be certified each year by a chartered accountant or an independent auditor. There are no limitations as regards the status of the group members – except that they must be Luxembourg companies or local establishments of foreign companies, nor with regard to the nature and the type of their activities. The members of the group should be established in the same Member State and the option must be expressly requested.
  The main advantage of applying for the VAT group regime resides in the fact that the members of the VAT group will be considered as forming one taxable person and consequently any supplies of goods or services realised between them will be treated as "self-supplies" for VAT purposes, i.e. VAT-free transactions.
- *Amendment of the VAT Directive by European Commission*
  On 25 May 2018, the European Commission proposed detailed technical amendments to EU rules on VAT to create a definitive EU VAT regime. Of the 408 articles in the VAT Directive, around 200 will have to be adapted. This reform has four main purposes:
  - to simplify cross-border transactions: the cross-border trade would be considered as a "single taxable supply" and the transaction would only be taxable in the Member State of destination. This change should reduce VAT fraud;
  - to create a single online portal for all business-to-business EU traders. The operators would only have to register in one Member State. This regime would also be applicable for companies outside the EU, which would have to appoint only one intermediary in the EU;
  - to simplify the administrative formalities for the trade of goods: sellers would have to comply with the rules of their respective Member State for invoicing; and
  - to clarify the question of the VAT collection liability: in a cross-border transaction, the seller would be responsible for VAT collection except where the customer is a Certified Taxable Person (i.e., a reliable taxpayer, recognised as such by the tax administration).

- *The Berlioz case*
  The long-awaited judgment for the Berlioz case was rendered on 16 May 2017 by the CJEU (C-682/15).
  In this case involving a Luxembourg investment fund which received a dividend from a French subsidiary, the CJEU ruled in substance that Luxembourg law was not in line with the Charter of Fundamental Rights of the European Union (the "**Charter**"). The main takeaway from the whole procedure is that Luxembourg law has to require tax authorities to ensure that the requested information is not devoid of any foreseeable relevance (i.e. thus confirming that fishing expeditions are not acceptable) and the possibility to lodge an appeal against the LTA requests.
  On the details of the legal aspects, Article 6 of the law of 25 November 2014 on the procedure applicable for the exchange of information in tax matters upon request (the "**2014 Law**") is not in conformity with Article 47 of the Charter due to the lack of an effective remedy foreseen by the 2014 Law. Therefore it is considered that Luxembourg law does not conform to and is in conflict with EU law, which is superior to Luxembourg law and of direct applicability.
  Indeed, Article 6 of the 2014 Law prohibits any appeal against requests for exchange of information and injunction decisions, while the CJEU has recognised that, on the basis of the Charter, an effective remedy against injunction decisions and pecuniary sanctions must be provided for.
  Further to this judgment, the Administrative Court (which referred the matter to the CJEU) held the following conclusions (CA 26 October 2017, n° 36893C):
  - the law is invalidated only in certain respects but still applies in its entirety;
  - it is possible to appeal against a decision pronouncing an administrative penalty taken on the basis of an injunction decision. However, such an appeal will not allow an indirect challenge of the injunction. Luxembourg law provides that, where a decision is based on a regulatory act, that regulation may be rejected if it does not comply with the law by way of the illegality exception. However, in the case of a decision taken on the basis of an individual administrative act, the law does not allow the dismissal of this administrative act by the sole fact that it is illegal or in breach of EU law; and
  - the 2014 Law is only in breach of EU law on a specific aspect, i.e. the absence of an effective remedy, which means that the injunction decision does not conflict as such with the Charter and therefore is not in itself in breach of EU law.

  The Administrative Court has not declared the legal consequences of these observations or given guidelines to challenge injunction decisions. On the contrary, the Court suggests that injunction decisions are made on the basis of a law that partially breaches EU law, but that it is not possible to use such breach as an argument in order to appeal against that decision.

<u>BEPS</u>

The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS ("**MLI**") was signed on 7 June 2017 by Luxembourg, among 68 other countries.

The draft bill approving the MLI was deposited by the government council on 15 June 2018.

The aim of the MLI is to permit all signatories to amend the application of their double tax treaties in order to meet the treaty-related minimum standards agreed in the context of the BEPS package. The minimum standards targeted are the prevention of treaty abuse under Action 6, and the improvement of dispute resolution under Action 14.

The MLI also aims at amending, in one go, all double tax treaties to include the measures derived from the BEPS discussions. Except for the above-mentioned Actions 6 and 14, the MLI mechanism allows each signatory to arrive at a tailor-made implementation of the BEPS recommendations.

Luxembourg opted for a maximalist approach and decided to amend all 81 of the double tax treaties it is party to through the MLI. In addition, Luxembourg decided that the amendments to the double tax treaties will include a preamble, stating that it intends to promote its economic relations, increase cooperation in the field of taxation, and avoid the possibility of double non-taxation in relation to taxes covered by the double tax treaty.

The options chosen by Luxembourg which will be introduced into its double tax treaties include: the neutralisation of certain effects of hybrid mismatch arrangements related to (i) transparent entities, (ii) dual resident entities, and (iii) elimination of double taxation; and the recognition of permanent establishments and mandatory binding arbitration, which would allow a person to request that a case for which the competent authorities are unable to find a mutual agreement under the mutual agreement procedure be submitted to arbitration.

Tax climate in Luxembourg

2018 is a year of continuity of Luxembourg's efforts initiated in previous years in the field of taxation. It is a year of continuity from a national point of view, since the last advantageous tax measures resulting from the 2017 budget law entered into force (a second decrease in the CIT rate, for instance). It is also a year of continuity from an international point of view, as the country is maintaining its efforts to comply with the OECD standards, BEPS recommendations and other international commitments by transposing DAC 6, the European Union (EU) Anti-Tax Avoidance Directive ("**ATAD**") and the MLI into national law.

The implementation of all these rules will contribute to an increase in tax transparency in Luxembourg and confirms its willingness to combat fraud and tax avoidance.

Luxembourg is, however, still under the pressure from the European Commission: on 20 June 2018, the country was requested to recover €120m of tax advantages granted to the energy group Engie, which paid – based on advance tax agreements granted by Luxembourg direct tax authorities and which would constitute illegal state aid according to the European Commission analysis – "an effective corporate tax rate of 0.3% on certain profits in Luxembourg for about a decade".

A similar request had already been addressed to Luxembourg in October 2017, requiring it to recover €250m of tax advantages granted to Amazon, considered as state aid by the European Commission.

Developments affecting attractiveness of Luxembourg for holding companies

A major tax reform in Luxembourg was implemented during 2017 and continues to produce effects. Except for limited changes and BEPS considerations (described above) and the introduction of the new IP Box Law (detailed below), no major developments occurred during/as from the tax year 2018 which could impact the attractiveness of Luxembourg for holding companies.

Industry sector focus

On 22 March 2018, the new IP box regime was adopted with effect from 1 January 2018, and includes article 50*ter* of the Luxembourg income tax law (the "**LITL**"). It was realised

by the law of 17 April 2018, which was published in the official journal (Memorial A) on 19 April 2018 (the "**IP Box Law**"). The new IP Box Law is in line with the provisions of bill n° 7163, tabled in the Chamber of Deputies on 4 August 2017.

The new IP Box Law replaces the previous IP box regime, which was abolished by the law of 18 December 2015. In this respect, article 50*bis* LITL of the previous IP box regime was closed to new taxpayers owning IP assets with effect from 30 June 2016. Nevertheless, previously qualifying IP assets can continue to benefit from the old regime until 30 June 2021.

The new article 50*ter* introduced in the LITL will allow a Luxembourg resident company, a Luxembourg permanent establishment of a foreign company or an individual to benefit from a partial exemption of 80% on the net income derived from eligible IP assets as well as a 100% exemption from net wealth tax. Therefore, for a corporate taxpayer based in Luxembourg City with eligible net income, the new IP Box Law leads to an effective tax rate of 5.202% in accordance with the rate of the corporate income tax applicable as from 2018 (19.26%) and municipal business tax in Luxembourg City (6.75%) for companies with a registered office there.

The income and gains qualifying for the 80% income tax exemption will equal the net eligible income (adjusted and compensated) from eligible assets multiplied by a ratio. This ratio equals the qualifying research and development ("**R&D**") expenditures over the total R&D expenditures.

Only IP assets which are not of a commercial nature may qualify as eligible assets. Thus, IP assets that have a marketing nature are now excluded from the scope of this new regime, in particular trademarks and domain names. The new IP Box Law provides that the above-mentioned assets are eligible for the preferential tax regime only if they result from an R&D activity performed by a taxpayer themselves.

The expenditures eligible for the exemption provided for by the new IP Box Law are only those expenditures necessary for R&D activities directly related to the constitution, development or improvement of an eligible asset that is made by the taxpayer for R&D activities carried out by the taxpayer, or for payments made by the taxpayer to an entity other than a related entity. All costs not directly related to an eligible IP asset, as well as certain expenses such as real estate costs, interest, financing costs and acquisition costs of IP assets are not eligible expenses.

In addition, the eligible types of income are all royalties, but also include: income in relation to the eligible asset that is included in the sale price of a product or service; income arising due to the disposal of an eligible asset; and the indemnities obtained in connection with a judicial or arbitration proceeding relating to an eligible asset.

The introduction of this new regime into the Luxembourg tax law permits the country to benefit from an attractive regime for start-ups and international groups of companies holding high-value IPs. It is also an opportunity to restore the country's position in a competitive international context, in a manner which is compliant with BEPS developments and rules.

The year ahead

Brexit consequences and business opportunities for Luxembourg

While certain major international insurance groups and banks already transfer their activity to, or have opened offices in Luxembourg, other major players have also announced their intent to follow this trend, but without any concrete moves.

For instance, M&G, the asset management arm of UK insurer Prudential, and the insurers AIG, FM Global and Hiscox, have already set up subsidiaries or divisions in Luxembourg. Henderson, Blackstone, Carlyle, PPRO, and Oversea-Chinese Banking Corporation have also identified the country as a potential European centre where they could relocate to/increase their presence in after Brexit. There are many business opportunities that permit Luxembourg to continue growing and developing financially.

ATAD transposition

The Luxembourg Council of Government adopted, on 15 June 2018, a draft law implementing the ATAD and a draft law ratifying the MLI.

The major provisions of the text of the ATAD bill of law are as follows:

- limitation of interest deductibility of expenses exceeding interest income to 30% of the taxable earnings of the taxpayer before interest, tax, depreciation and amortisation (taxable EBITDA);
- introduction of CFC rules;
- introduction of hybrid mismatch rules applying to hybrid mismatches deriving from hybrid instruments that have different treatment in two or more EU Member States;
- significant amendment of the current rules allowing taxpayers to defer the payment of the exit tax due upon an exit tax event, to replace the current unlimited deferral by a payment over a maximum period of five years; and
- modernisation of the existing general anti-avoidance rules ("**GAAR**") to reflect the content of the ATAD GAAR.

Certain practices that are no longer in line with international tax standards/BEPS recommendations will also be abrogated and/or amended; in particular the definition of permanent establishment will be amended to avoid double non-taxation or asymmetric recognition of permanent establishments.

MLI transposition

As a result of the MLI transposition into Luxembourg law, it is expected that all of the 81 double taxation treaties concluded by Luxembourg and currently in force will be amended by the MLI. No information is, however, currently available with respect to the MLI positions that will be taken by the government, but practitioners assume that they should remain in line with those adopted at the time the MLI was signed.

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Macau

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Introduction

The Macau Special Administrative Region of the People's Republic of China ("**Macau**") is considered a low-tax jurisdiction for its advantageous and uncomplicated corporate tax structure of low taxes levied against business income. The Macau Basic Law (which has the function of a Constitution) has enshrined the Principle of Low Taxation.

Macau is a gaming jurisdiction, where gaming is by far the major economic activity. Tourism, leisure, conventions, entertainment, hotels and integrated resorts are other types of sectors that have grown immensely in the last decade.

Macau has had international recognition for having a modern and trustworthy financial system that is closely linked to one the biggest regional financial centres, Hong Kong.

More recently, the Macau government, in coordination with China's central government, has promoted the city as the centre of the Macau Forum, a multilateral, intergovernmental co-operation mechanism aimed at promoting economic and trade exchanges between China and Portuguese-speaking countries. It is expected that further investments will be made in the city in the context of this broad policy initiative.

Overview of corporate tax in Macau

Corporate tax in the Macau SAR goes by the name of "*Imposto Complementar de Rendimentos*", which can be translated as Complementary Income Tax ("**CI Tax**"). CI Tax is a tax on profits on earnings from business activities – business income, interest income and realised capital gains.

Any income earned by Macau incorporated companies, even if generated abroad, is in principle subject to CI Tax. Foreign entities doing business in Macau are taxed on Macau-generated profits only.

CI Tax is imposed on a progressive rate scale ranging from 3% to 9% for taxable profits below or equal to 300,000 Macau Patacas ("**MOP**") and 12% for taxable profits over MOP 300,000. Taxable profits below MOP 32,000 are exempt from tax. However, these limits and brackets change yearly as per the successive annual Budget Laws, including the 2018 Budget Law: the tax-free income threshold is currently set to MOP 600,000 for income derived in the tax year 2017. Only the taxable income in excess of MOP 600,000 is taxed at 12%. Every year, with a new Budget Law, changes to the tax-free income threshold and the tax brackets can be introduced. It is expected that the 2018 Budget Law's tax exemptions and limits will be replicated in the coming Budgets Laws, thus ensuring the continuity of this policy of low corporate taxes.

According to the CI Tax Act, taxpayers are divided into two main groups:

- Group A taxpayers are companies with a share capital of MOP 1m or greater, companies whose average taxable profits reached MOP 500,000 per year for three consecutive years and companies that voluntarily choose to become Group A taxpayers. The profits of Group A taxpayers are assessed based on the actual accounting audited income.
- Group B taxpayers are all remaining companies that do not qualify as Group A taxpayers. Group B taxpayers are not required to be audited or to keep detailed accounting records. Profits of Group B taxpayers are assessed on a deemed basis if their reported income is below the internal parameters set by the Macau Finance Bureau for taxpayers in similar industries.

Dividends distributed by a Macau company to its shareholders are deductible against the assessable income. Dividends are then considered taxable income of the shareholder under the CI Tax rates; however, dividends received from another Macau company will be exempt from CI Tax if the dividends are paid out of after-tax profits.

Dividends received by a Macau company in the capacity of a shareholder of a foreign entity are considered taxable income. Exceptions can be those received from countries with which Macau has entered into a tax treaty.

Double tax treaties and exchange of tax information

Macau has signed international treaties with several jurisdictions for exchange of tax information. It can be expected that the exchange of tax information will continue to increase. In particular, the automatic exchange of tax information with several countries in the European Union is currently under negotiation.

On the other hand, Macau has also signed a number of international treaties to avoid double taxation, the most relevant being those signed with Mainland China, Portugal and some Portuguese-speaking countries.

Industry sector focus

Gaming

The special case of casinos: companies in the casino business are required to pay the Macau government a 39% gaming tax on gross revenues of the gaming operation. For this reason, casino business operators have enjoyed the benefit of a CI Tax exemption in relation to their casino profits, while non-gaming profits remain subject to CI Tax. In addition, casino operators in the jurisdiction have entered into agreements with the Macau government that provide for an annual lump sum payment, which acts as a substitute for the 12% tax otherwise due by casino shareholders on dividend distributions paid from the casino operators' gaming profits.

Real estate

During the last few years, Macau has seen a boom in the real estate market and many pundits have advocated the need for measures to cool down the market and mitigate rising prices and rents. As a response to this, Macau has enacted new taxes as an attempt to reduce price increases in the real estate market. Legislative measures that have been taken include special taxes on short-term re-sale of properties and new taxes on multiple ownership of property. Further announced by the government is the possibility for the introduction of yet another new tax on empty/unused property, following Hong Kong's lead.

Banking and AML

Macau's banking sector is in line with the best international standards. The city has

developed its anti-money laundering system and enacted laws to combat money laundering and the financing of terrorism, and has received "thumbs up" reviews by the Asia Pacific Group on Money Laundering in December 2017. As a result, the banks have raised the bar in terms of new client scrutiny. For instance, non-local account holders now need to supply additional information to the banks to ensure compliance.

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Francisco Gaivão is the Managing Partner of FG Law Firm. Francisco is admitted to the Portuguese Bar Association and Macau Bar Association and has been practising in Macau since 2002. Francisco served for nine years, before opening FG Law Firm, as the Head of the Macau Legal Department in a casinos and integrated resorts development company.

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Francisco was the winner of the International Law Office (in association with the Association of Corporate Counsel) 2012 Global Counsel Award in the category Corporate Tax, Individual.

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Mexico

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Overview of corporate tax

Introduction

Taxes in Mexico are levied on a Federal, State and Municipal basis. The main taxes levied by the Federal government are income tax, value-added tax and special goods and services tax. For income tax purposes: Mexican resident individuals and legal entities are taxed on a worldwide income basis; permanent establishments are subject to tax on their attributable income and on a basis similar to that of a Mexican resident legal entity; and non-residents are subject to tax in Mexico on a Mexican source income basis only, with the possibility of obtaining relief from Mexico's vast tax treaty network, if applicable.

Income tax

The Mexican Income Tax Law ("MITL") establishes that all commercial companies, government agencies engaged in business activities, financial institutions, civil companies, partnerships, associations, joint ventures, and trusts that are engaged in a trade or business, regardless of the source of their capital, are all taxed alike as corporations (hereinafter "corporate taxpayers"). Except for very limited exceptions, pass-though treatment does not exist for commercial companies for Mexican income tax purposes. Consequently, for Mexican tax purposes there is no preference on the type of legal entity which should be used to establish business operations in Mexico. However, the type of legal entity used for the establishment of a Mexican subsidiary may be of relevance in the home country of the shareholders; for example, in the United States, *Sociedades Anónimas* (S.A.) are considered, *per se*, corporations under the U.S. check-the-box regulations, and *Sociedades de Responsabilidad Limitada* (S. de R.L.) are eligible for pass-through partnership treatment in the U.S. under said regulations.

Legal entities, whose place of effective management is located in Mexico, are deemed to be Mexican resident corporate taxpayers. As such, they are taxed in Mexico on a worldwide income tax basis, regardless of the source of their capital. Foreign direct investment does not need to invest in Mexico through an independent legal entity or joint venture, but it may actively do so through a branch or passively through various means of investment which give way to proceeds or income that is also subject to income tax in Mexico on a source of income basis, as discussed further below. If the investments are made through a branch, the branch will generally cause the foreign principal to have a permanent establishment in Mexico. Under the MITL, a permanent establishment exists among other cases if there is a place of business through which the business of an enterprise is wholly or partly carried on. Permanent establishments are subject to the same general corporate rate as corporate taxpayers, but only on the income attributable to such permanent establishment.

The **income tax rate** applicable to corporations is 30% of the amount of taxable income (i.e. gross income minus allowable deductions, NOL carryovers, and employee profit-sharing).

Taxable income is comprised of all income from whatever source derived received in cash, kind, services or credit and the income generated from the offset between the effects of inflation (inflationary gain-loss) and fluctuation of the exchange rate (exchange gain/loss). It can also be comprised of constructive income assessed by the tax authorities.

Some other items specifically listed as taxable income include: income from payments in kind; capital gains; income from mergers and spin-offs; capital redemptions and liquidation of foreign subsidiaries; interest; income from controlled foreign companies or pass through investment vehicles anti-abuse provisions; third party expenses – unless properly supported as on-behalf payments; and income through accession, etc.

The MITL also lists certain items which are specifically classified as non-taxable income, which include: capital contributions; payment of losses by corporate taxpayer shareholders; premiums paid on the issuance of capital; and income resulting from the revaluation of assets or capital, etc. Also excluded from the taxable income listing are dividends received by corporate taxpayers from net after-tax profits distributions made by other Mexican corporate taxpayers.

For income tax purposes, corporate taxpayers must generally determine their taxable income upon accrual of the income which occurs upon the first of: (i) the issuance of the invoice or other documentation evidencing the price or consideration; (ii) upon shipment or delivery of the goods sold or provision of the service; or (iii) when the established consideration or price is due or payable or upon collection of the same, even if it is only an advance. There are certain exceptions to this accrual basis rule, mainly with respect to corporate taxpayers that obtain their income from the rental of goods, financial leasing activities, certain limited installment sales, bad debts, delinquent interest, leasehold improvements and construction contracts. Civil partnerships or associations which provide independent personal services are the only legal entities that can determine their taxable income on a cash basis.

Under the MITL, a 10% tax is levied on dividends or profits distributed by entities or permanent establishments in Mexico, when the recipient is a Mexican tax resident individual or any foreign resident (individual or legal entity), as well as in the case where a permanent establishment that a foreign resident has in Mexico remits profits to its main office or to another permanent establishment located abroad.

The taxpayer of this tax will be the beneficiary of the dividend or profit distribution, but it is the distributing entity who will be responsible to make a 10% withholding tax on the net distribution.

Under this mechanism, individuals will continue to, on one hand, accrue gross dividends (i.e., before corporate tax has been applied to the corporate profit from which the dividend is paid) and, on the other hand, get a tax credit for the Mexican corporate tax paid by the distributing entity. The additional 10% tax on dividends is a stand-alone levy that does not allow any tax creditability. After considering both the increase in the individuals' income tax rate and the new tax on dividends, the effective income tax rate when dividends are distributed could be between 37% and 42% of corporate profits. Individuals that receive dividends distributed by non-resident entities will also be subject to the 10% tax on the gross amount of received dividends, with no possibility to credit any tax paid abroad, besides accruing such income for purposes of their personal tax liability.

Concerning foreign tax residents acting as shareholders of Mexican entities, the 10% tax rate on dividends could be reduced by virtue of the tax treaties signed by Mexico, as applicable.

Finally, the exemption for foreign residents and Mexican tax resident individuals in respect of capital gains arising from the transfer of shares through stock markets has been repealed from 2014. In its place, a 10% excise tax is introduced that allows the amortisation of losses. The 10% excise tax will not apply where the beneficiary's residence jurisdiction has entered into a tax treaty with Mexico. Certain cases are established where capital gains will be subject to the general rates for individuals.

Types of corporate tax work

Below is a description of a significant case which occurred in Mexico:

Description of the transaction. A multi-billion-dollar corporate tax reorganisation of a publicly traded Mexican multinational. The undertaking divided the tax-free reorganisation of the company's beverage and snacks business into two separate Mexican sub-holdings that encompassed its operations and subsidiaries in other countries. In parallel, the Mexican multinational entered into a joint venture agreement with a foreign multinational company to integrate the beverage business of the Mexican multinational and some part of the business of the foreign multinational.

Complex tax issues. As a rule, Mexican groups of companies are entitled to conduct tax-free corporate reorganisations either per the application of the Mexican Income Tax Law or per the application of a tax treaty reorganisation clause. Nevertheless, in the case at hand, none of the reorganisation regimes applied for the jurisdictions in which the Mexican multinational had no subsidiary, but instead conducted its business through a branch. Therefore, restructuring the ownership of the foreign branch would have resulted in an excessive tax burden.

Given this background and with a very comprehensive understanding of the Mexican tax authorities, active lobbying allowed our firm to generate administrative regulations that extended the corporate reorganisation provisions to encompass the tax-free reorganisation of foreign branches of the Mexican principal. Thanks to this rule, now any Mexican multinational with a foreign branch will be entitled to restructure their foreign branches without being deemed to have disposed of their branch assets through a taxable transaction.

Significant themes

Enhanced tax treaty network

Through the years, Mexico has built Latin America's most extensive tax treaty network. In doing so, Mexico has followed a combination of the OECD and the UN model tax treaties, which result in different rules for the taxation of permanent establishments and a variety of reduced rates for Mexican source income, subject to tax withholding. Depending on the treaty, the withholding rates vary for dividends, interest, royalties, and capital gains. Also, depending of the treaty, there may be different rules for dual residence conflicts or exchange of information.

Mexico's current treaty network comprises 59 tax treaties entered into with the following countries:

Argentina	Finland	Kuwait	Russia
Australia	France	Latvia	Saudi Arabia
Austria	Germany	Lithuania	Singapore
Bahrain	Greece	Luxembourg	Slovak Republic
Barbados	Hong Kong	Malta	South Africa
Belgium	Hungary	Netherlands	Spain

Brazil	Iceland	New Zealand	Sweden
Canada	India	Norway	Switzerland
Chile	Indonesia	Panama	Turkey
Colombia	Israel	Philippines	United Arab Emirates
Czech Republic	Italy	Poland	United Kingdom
Denmark	Jamaica	Portugal	U.S.
Ecuador	Japan	Qatar	Uruguay
Estonia	Korea	Romania	-

The countries/agreements for which negotiation of tax treaties has been concluded, but the treaty is awaiting signature, legislative approval, or entry into force, are: Costa Rica; Guatemala; the MLI; and the Pacific Alliance Tax Harmonization Agreement.

Tax treaty negotiations are currently being held with: Egypt; Iran; Lebanon; Malaysia; Morocco; Nicaragua; Oman; Pakistan; Slovenia; Thailand; and Vietnam.

Countries with which exchange of information agreements are currently in force include: Aruba; Bahamas; Belize; Bermuda; British Virgin Islands; Canada; Costa Rica; Cayman Islands; Cook Islands; Gibraltar; Guernsey; Isle of Man; Jersey; Liechtenstein; Netherlands Antilles – Curacao; Turks & Caicos; Saint Lucia; Samoa; and the United States of America.

The exchange of information agreements under negotiation are: Marshall Islands; Monaco; and Vanuatu.

Mexico is party to the OECD-sponsored Convention on Mutual Administrative Assistance in Tax Matters. Moreover, Mexico is one of the 199 countries who are committed to the Standard for Automatic Exchange of Financial Account Information in Tax Matters.

All tax treaties entered into by Mexico are considered as exchange of information agreements, except for the tax treaties with Estonia, Greece, Indonesia and Ireland. The tax treaties with Belgium and Israel were considered as exchange of information agreements until 2010.

As Mexico is committed to expanding its tax treaty network, this list is continuously subject to change and is by no means exhaustive.

Transfer pricing

Corporate taxpayers must comply with transfer pricing provisions regarding transactions undertaken with related parties. Contemporaneous documentation supporting the prices or considerations in transactions with related parties residing outside of Mexico must be retained at all times. The documentation and information regarding such transactions must be recorded in the accounting books, identifying the transactions as being with non-resident related parties. If transactions are undertaken with residents of countries considered to be preferential tax regimes per Mexico's anti-abuse provisions, the transactions are presumed to be related party transactions and, thus, supporting documentation must be retained to evidence compliance with Mexico's transfer pricing provisions, thereby avoiding the severe sanctions which are imposed in the absence of strict compliance.

Mexican transfer pricing regulations specifically recognise the traditional transactional methods and the OECD guidelines profit-based transactional methods. Taxpayers must first apply the comparable uncontrolled price method as their first option, and only if such method is not appropriate to determine whether the transaction under review has been agreed at arm's length can the taxpayer apply another method to produce a more accurate result.

Preference is given to the traditional transaction methods over the profit-based methods. A lower threshold grants relief from the transfer pricing study obligation for taxpayers who undertake activities if their gross income during the previous tax year does not exceed approximately USD 1.04m.

As from 2016, following BEPS Action 13, a new article 76-A was introduced into the MITL, which provides that certain taxpayers must file informative annual returns regarding their operations with related parties in line with the requirements developed under the Action Plan on Base Erosion and Profit Shifting ("BEPS"). Specifically, Mexican entities are required to file a master file and a local file. This applies to legal entities earning at least MXP 12bn.

The new information returns are as follows:

Return	Who must file	What information must be included
Master file informative return	• Mexican tax resident entities having declared on the prior fiscal year's annual tax return accruable income equal to or exceeding MXP 644,599,005.00 (approximately USD 34,800,000.00). • Publicly traded companies. • Entities subject to the optional tax regime (the tax consolidation system). • State enterprises.	Information regarding the taxpayer's organisational structure, business description, intangibles, financial activities with related parties, and its financial and tax position.
Local information return		Description and analysis of the taxpayer and of its operations with related parties. Financial information of the taxpayer, together with the comparable operations or entities used as such in the analysis.
Country-by-country information return	Entities qualifying in any of the above and that also meet any of the following: 1. Multinational holding entities that: • are Mexican tax residents; • have subsidiaries or permanent establishments residing or located abroad; • are not subsidiaries of another entity residing abroad; • are obligated to file and provide consolidated financial statements; • report on their consolidated financial statements the results of other entities residing abroad; and • earned in the previous fiscal year consolidated income equivalent or higher than MXP 12bn (approximately USD 648,000,000.00). 2. Mexican tax resident entities or foreign tax residents with permanent establishments in Mexico appointed by the controlling entity of the foreign multinational group to be responsible for providing the country-by-country tax return. 3. Mexican subsidiaries of foreign multinationals, if the tax authorities are unable to obtain information from the parent company's country of residence through exchange of information mechanisms. These subsidiaries will only have 120 days to deliver the requested information.	Information regarding the worldwide distribution of income of entities forming part of the group, taxes paid, and an indication of the jurisdictions where the economic activities of the group are performed. This return must only be filed when the group earns an annual consolidated income of more than MXP 12bn (approximately USD 648,000,000.00).

Filing of the informative returns must take place by December 31 of the fiscal year following that which is subject to reporting.

Information concerning fiscal year 2016 was submitted by December 31, 2017. According to a report shown by the Head of the Transfer Pricing Section in the Tax Administration Service: 5,021 local file returns; 1,788 master file returns; and 78 country-by-country returns were filed pursuant to the December 2016 deadline.

Maquiladora industry – fast-track APAs

Companies engaged in the maquiladora industry have been required to comply with transfer pricing rules by following the safe harbour thresholds of profitability of 6.5% over total costs and expenses, or 6.9% over total assets used in the activity; or, by requesting an advance pricing agreement ("APA") with the Tax Administration Service.

Because of the large number of applications requesting negotiations for an APA, the Tax Administration Service created rules in late 2016 that allow for "fast-track" negotiations and approval through methodology already discussed and agreed with the U.S. government.

In case of eligibility, the Tax Administration Service will notify the maquiladora company that a fast-track APA is available by using the methodology and profit level discussed and agreed to with the U.S. Internal Revenue Service. The taxpayer is free to elect whether the proposed fast-track APA is consistent with its own analysis, or follow the unilateral process and continue discussions and negotiations with the Tax Administration Service in Mexico.

According to data shown by the Tax Administration Service, over 700 fast-track APAs have been completed.

Tax disputes

The Tax Administration Service has been increasingly active in reviewing all types of transactions and sectors of taxpayers. Particularly, the Large Taxpayers General Administration has been focusing on: complex cross-border transactions; and transfer pricing-related issues concerning reorganisation of manufacturing and distribution structures, among others.

A tax ombudsman institution was recently created in Mexico – *Procuraduria De La Defensa Del Contribuyente* ("PRODECON") – with a broad scope of authority to represent taxpayers against abusive practices conducted by the Tax Administration Service. With the use of a new process called Conclusive Agreement (*Acuerdo Conclusivo*), taxpayers and tax authorities have found a legal middle ground that dedicates time and resources to clarify and solve complex tax audits.

Through specific formalities, taxpayers involved in an open tax audit can request PRODECON to initiate the process by calling the tax authorities and discussing the merits of the audit and items under scrutiny, whether related to interpretation of law or appreciation of facts and documentary evidence. The process suspends the term for formal completion of the tax audit by the Tax Administration Service and provides safe ground to openly discuss and validate tax positions. Any opinion or recommendation by PRODECON will not be binding on the tax authorities, but may help in addressing a valid point.

If the tax authorities accept the arguments and position of the taxpayer, the Conclusive Agreement may be completed, bringing an end to the audit. On the contrary, if the taxpayer accepts the Tax Administration Service's observation, it will have the right to self-correct without paying fines. If no agreement is reached, the tax audit continues and the dispute may be appealed via an Administrative Appeal with the legal section of the Tax Administration Service or via a Nullity Claim before the Federal Administrative/Tax Court.

In 2017, PRODECON reported 4,985 Conclusive Agreement processes.

Key developments affecting corporate tax law and practice

Domestic – legislation

Electronic tax compliance

The Mexican Tax Administration Service has developed a robust tax compliance platform based on electronic systems that require all taxpayers to fulfil different obligations that range from the issuance of electronic invoices, to the use of accounting electronic systems with standardised charts of accounts, and the obligation to submit monthly and annual records.

The main objective has been to obtain accurate real-time information on any transaction that has a taxable effect, for any means of financial transaction. In line with this, the Tax Administration Service has evolved into an entity that has access to detailed and valuable information that allows efficient data analysis, which can be used to implement remote or electronic tax audits.

An electronic invoice has to be produced not only to document sales of goods or services in general, but when any transaction gives rise to any formal tax obligations such as withholding of taxes or payment of salaries. The electronic invoice must include information in a .xml format, which represents not only standard information such as the name, address, and tax ID numbers of the taxpayer and the customer, but also information related to the payment currency, the exchange rate and bank account details.

BEPS

Mexico is one of the earliest adopters of several of the BEPS initiatives discussed in the OECD in the recent years, and passed specific legal enactments even before the BEPS discussions and final reports were completed.

Mexico has enacted different pieces of legislation to reflect BEPS, aimed at preventing tax evasion, profit shifting and double non-taxation. In terms of BEPS implementation, Mexico has given special attention to certain Actions such as 2 (Hybrids), 6 (Treaty Abuse), 12 (Disclosure of Aggressive Tax Planning), 13 (Transfer Pricing Documentation) and 15 (Multilateral Instrument).

Since 2014, several recommendations from the OECD in connection with BEPS have been implemented in Mexican legislation, such as:

- limitation on the deductibility of hybrid instruments (Article 28, Section XXXI of the Income Tax Law);
- limitation on the payments made to transparent entities for tax purposes; and
- inclusion of an anti-avoidance provision by which, as per the requirement of the Mexican tax authority, the taxpayer should prove juridical double taxation in order to be able to apply tax treaty benefits (Article 4 of the Income Tax Law).

Mexico adopted and executed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS ("MLI"). An internal domestic process in the Mexican Congress to approve MLI is under way, and it is expected that it will be finalised during the second half of 2018.

With respect to treaty abuse, Mexico reserved its right not to apply the Principal Purpose Test ("PPT") clause contained in Article 7(1) for certain of its covered tax agreements, as they already provide that the benefits of a tax treaty will be denied when the principal purpose or one of the principal purposes of a transaction is to obtain a benefit from the respective treaty (Argentina, the Philippines and Spain).

Similarly, Mexico stated its decision to incorporate the simplified Limitation of Benefit ("LOB") clause and reserved its right not to apply the clause contained in Article 7(8) to (13) of

the MLI, as certain of its covered tax agreements already contain a similar clause (Argentina, Barbados, China, Colombia, Costa Rica, Guatemala, India, Israel, Jamaica, Kuwait, Panama, South Africa, Ukraine, the United Arab Emirates and the United States of America).

For the covered treaties for which Mexico made no reservations, Mexico applies a simplified LOB clause.

Regarding dispute resolution and arbitration, Mexico adopted the minimum standard rules for Mutual Agreement Procedures ("MAP"), whereby countries are obligated to implement rules that allow efficient resolution of treaty-related disputes. Taxpayers will be allowed to request a MAP in either country party to the relevant tax treaty dealing with the dispute, and a resolution therefor should be expected to occur within three years.

Mexico, however, did not accept the mandatory arbitration procedures under the MIL.

Tax climate in Mexico

Mexico will hold Federal elections in 2018. Depending on the outcome of such elections, we anticipate that Mexico will likely amend its tax legislation, which has not been substantively amended since 2014. We anticipate that the amendments will seek to respond to the United States' tax reform.

Until such reform takes place, we will likely continue to see the trend of aggressive compliance for cross-border transactions, whereby Mexico has challenged base erosion strategies by multinationals. Examples thereof include aggressive anti-abuse provisions for interest financing, which provide that:

- non-arm's length interest is not deductible and re-characterised as dividends;
- back-to-back re-characterisation risk;
- inflationary/exchange gain/loss can result in taxable income or deductions; and
- thin capitalisation: a 3:1 debt-to-equity ratio limitation.

These provisions have been enforced aggressively in debt push-down-style structures by the Tax Administration Service. Regarding audits, the Tax Administration Service has pierced through corporate structures in the audit process to show that the economics of financing transactions lack substance and has re-characterised such transactions, denying the interest financing costs and assessing important tax credits, which have been upheld in court.

Developments affecting attractiveness of Mexico for holding companies

In 2014, Mexico repealed its tax consolidation regime. However, given its integrated tax system, profits earned by Mexican corporate taxpayers and distributed to other Mexican corporate taxpayers are not subject to dividends tax and pre-tax earnings flow freely among legal entities. However, upon distribution to resident individual shareholders or non-resident shareholders, as of 2014, such distributions of dividend are subject to a tax on dividends at a 10% withholding rate. Regardless, given Mexico's vast treaty network, investments through treaty-eligible shareholders are often exempt from tax on dividends or can be subject to reduced rates. Examples thereof are the following:

Treaty relief of dividends tax

Treaty	Ownership	Treaty	Ownership
Australia	≥10%	Lithuania	≥10%
Bahrain	-	Netherlands	≥10% & part. exempt.
Colombia	-	Qatar	-

Treaty	Ownership	Treaty	Ownership
Denmark	≥25%	Singapore	-
Estonia	-	Slovak Republic	-
Finland	-	Switzerland	≥10%
Hong Kong	-	United Kingdom	-
Korea	≥10%	U.S.	≥80%
Kuwait	-	-	-

Examples of reduced dividends withholding tax rates in treaties

Treaty	Rate/Ownership	Treaty	Rate/Ownership
Austria	5% / ≥10%	Israel	5% / ≥10%
Barbados	5% / ≥10%	Luxembourg	5% / ≥10%
Belgium	5% / ≥25%	Panama	5% / ≥25%
Canada	5% / ≥10%	Peru	5% / ≥25%
Chile	5% / ≥20%	Spain	5% / ≥10%
Ecuador	5%	South Africa	5% / ≥10%
France	0% if French / 5% if >50% foreign	Sweden	5% / ≥10%
Germany	5% / ≥10%	Ukraine	5% / ≥25%
Hungary	5% / ≥10%	Uruguay	5%
Ireland	5% / ≥10%	U.S.	5% / ≥10%

Also, in a tax treaty context, it is interesting to see the shift from the traditional portfolio exemption for capital gains of Mexico tax treaties to a new tendency of retaining tax at source regardless of the percentage of stock holdings, but subjecting the tax liability to a reduced rate; examples thereof include the revised Belgian, Dutch, Spanish and Swiss treaties in which a 10% tax rate on net earnings is established.

Industry sector focus

Oil & gas

A recent opening in the energy sector in Mexico, allowing private investment, domestic and international, in almost any activity in the oil & gas and power sectors, has resulted in new legislation and modifications to specific tax provisions.

In the oil & gas industry, together with a new Hydrocarbons Law, a new Hydrocarbons Revenue Law was enacted to provide the general principles for the tax aspect of exploration and production agreements (government take), as well as for specific income tax and value-added tax rules applicable to the industry. The Hydrocarbons Revenue Law reflects international standards in different tax treaties with respect to the existence of a permanent establishment for activities performed in limited periods of 30 days.

Further, the Tax Administration Service has adapted to understand and prepare for an industry that was traditionally controlled by the government utilities companies PEMEX and CFE. A new Hydrocarbon General Administration was created to supervise taxpayers actively engaged in: exploration and production; midstream and related infrastructure projects; downstream projects; any taxpayer rendering services; and supply services in the industry.

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Ricardo is the Managing Partner of our Monterrey Office. He is a tax attorney with more than 20 years of experience, who co-chairs the firm's tax practice group. He has a broad-based transactional tax practice focused on: Mexican inbound and outbound tax planning and transfer pricing; tax treaties, their application and limitations; anticipation of anti-deferral and anti-abuse legislation; and overall income tax and VAT rationalisation. His expertise allows him to structure tax-efficient domestic and cross-border acquisitions, mergers, reorganisations, spin-offs, redemptions, liquidations, post-acquisition integrations and business restructurings. Ricardo's transfer pricing experience allows him to proactively advise clients on the design and implementation of intellectual property, financing, procurement and distribution of goods and performance of services transactions. His experience and sensitivity have afforded Ricardo prominent recognition in the market as a trusted private family advisor who can render guidance on tax optimisation and multigenerational family planning governance.

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Guillermo has more than 20 years of experience in tax litigation and planning. He has positive experience in handling complex tax audit cases and controversies that have resulted in favourable outcomes in different administrative or judicial stages, by implementing efficient strategies that reduce time and costs to the benefit of his clients. His experience involves tax advice in corporate taxation, restructuring transactions, mergers, acquisitions, and general advice, especially for business and multinational groups with operations in Mexico. His experience extends to transfer pricing, including the legal analysis of the implementation of policies, documentation and elaboration of economic studies and defence files.

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Overview of corporate tax work over last year

Types of corporate tax work

Due to excellent market conditions and the need for companies to innovate and complement organic growth, the past year has seen high volumes of M&A and real estate transactions in the Netherlands. At the same time, various national and international tax initiatives and developments have caused multinational companies to re-evaluate their operations. Uncertainty in respect of the Dutch fiscal unity regime, dividend withholding tax and the impact of the OECD Multilateral Instrument ("MLI") on the Dutch double tax treaty network make it challenging for taxpayers to assess the impact these developments may have on their tax position. Notwithstanding the government's intentions to tackle base erosion and profit shifting ("BEPS"), the Netherlands remains a jurisdiction of choice for holding, finance and licensing companies, in particular where such companies have substantial economic activities in the Netherlands.

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

One of the most significant recent changes to the Dutch corporate tax law is the introduction of a Dutch dividend withholding tax ("DWHT") obligation for so-called Dutch 'holding' cooperatives. Holding cooperatives are generally cooperatives whose activities consist of at least 70% holding participations and/or financing-related entities or individuals. As of 1 January 2018, profit distributions made by Dutch holding cooperatives to qualifying members (generally members that are entitled, either on a standalone basis or in a collaborative group, to at least 5% of the annual profits or liquidation proceeds) are subject to 15% Dutch DWHT, unless an exemption applies. In this context, as of 1 January 2018, the DWHT exemption for distributions made by Dutch companies to 'substantial' shareholders/members in the EU/EEA has been extended to substantial shareholders/members in countries with which the Netherlands has concluded a double tax treaty including a dividend article. However, the DWHT exemption does not apply if (i) the main purpose or the one of the main purposes of holding the interest in the Dutch entity is to avoid DWHT (the 'subjective test'), and (ii) there is an artificial arrangement in place (the 'objective test'). An arrangement is considered artificial if it is not put in place for valid business reasons that reflect economic reality. Currently, there is a debate amongst Dutch scholars as to whether the level of economic activity required under the abovementioned objective test is in accordance with recent EU Court of Justice ("CJEU") case law (see, for example, CJEU 20 December 2017, C-504/15). The Dutch government has announced that it will abolish Dutch DWHT as per

1 January 2020 and at the same time introduce a new (conditional) DWHT regime for intra-group dividend payments to low tax jurisdictions or in case of abuse.

Other Dutch corporate income tax changes as of 1 January 2018 are:

- The extension of an anti-abuse provision to counter situations involving rent or royalty payments within a fiscal unity (disregarded for Dutch tax purposes), when these payments are deductible at the level of a permanent establishment ("PE") of the fiscal unity. This would result in a higher amount of tax-exempt PE income for the fiscal unity than taxable profit of the PE. The anti-abuse rule already applied to internal interest.
- An amendment to the specific anti-abuse provision limiting interest deduction for situations in which a Dutch taxpayer grants a loan to a related entity or related individual, where this loan is connected to a 'tainted' transaction (e.g. an acquisition of, capital contribution in or a dividend distribution from, an (exempt) subsidiary). The limitation does not apply if there is a business motive for both granting the loan and entering into the tainted transaction. On 21 April 2017, the Dutch Supreme Court ruled that if a loan has been ultimately granted by a third party, the business motive test for the loan is, in principle, met, so that only a business motive for the transaction need be demonstrated. The Dutch tax authorities considered this ruling contrary to their practice. As a result, the anti-base erosion provision has been amended such that even if a loan has been ultimately financed by a third party, a business motive for both the granting loan and entering into the transaction still needs to be demonstrated.
- An amendment to the rule for calculating the adjusted cost price of a subsidiary that no longer forms part of a fiscal unity. Upon deconsolidation, the cost price must be re-assessed and will be determined at the fair market value, if this value is lower than the amount of fiscal equity of the subsidiary. As a consequence, any liquidation loss in respect of this subsidiary will be reduced.
- The extension of an anti-abuse provision to counter double loss realisation for situations in which a company is included in a fiscal unity and seeks to deduct a loss on debt owed by a non-included company, where this loss effectively relates to a loss incurred (or that will be incurred) by another company in the same fiscal unity. In such situations, no deduction for the loss on the debt is allowed.
- Dutch resident companies are subject to 20–25% statutory corporate income tax rates. The effective corporate income tax rate in respect of income from qualifying intangibles is lower, but has been increased from 5% to 7%.
- With regard to the Dutch Country-by-Country Reporting rules, additional legislation has been put into place that (i) increases the penalty for non-compliance to €820,000, (ii) allows a group entity to serve as the reporting entity, and (iii) allows a designated Dutch group entity to file an incomplete country-by-country report with all the information at its disposal.

With regard to the interpretation and policy of the Dutch corporate income tax laws, the Dutch tax authorities released a few new decrees. On 9 September 2017, a new decree was released with the aim of providing more guidance on the qualification of certain hybrid financial instruments as either debt or equity. The decree specifically focuses on perpetual and long-term loans. The new guidance has retroactive effect from 29 August 2017. Furthermore, on 20 January 2017, a revised decree was released in respect of the participation exemption. The revised decree provides for editorial changes as well as new approvals and clarifications, especially in respect of the Dutch tax treatment of losses incurred upon the liquidation of a qualifying participation.

European – CJEU cases and EU law developments

On 22 February 2018, the CJEU ruled in case C-398/16 that a certain specific element of the Dutch fiscal unity regime constitutes an infringement of the EU freedom of establishment. The CJEU ruled in this case that, briefly, if a specific anti-base erosion provision applies to a Dutch taxpayer with an Italian subsidiary, whereas this anti-base erosion provision would not apply if the Dutch taxpayer was allowed to form a fiscal unity with its Italian subsidiary, this constitutes an unjustifiable violation of the EU freedom of establishment. In response to the outcome of case C-398/16, and further to earlier announcements, on 6 June 2018 the Dutch government published a legislative proposal that contains remedial measures to deny the benefits of the fiscal unity regime for the purpose of article 10a of the Dutch Corporate Income Tax Act 1969 ("CITA") (specific interest limitation rule), 13l CITA (specific interest limitation rule), article 13, paragraphs 9–15 and 17 CITA (participation exemption in respect of low taxed portfolio investments and hybrid entities), the change of control provision of article 20a CITA and article 11, paragraph 4 of the Dutch Dividend Withholding Tax Act 1965 (specific fiscal unity provision). These proposed measures will have a significant impact on the Dutch fiscal unity regime, and (most of) the measures will apply with retroactive effect from 25 October 2017.

On 3 March 2017, the Dutch Supreme Court referred preliminary questions relating to a potential discriminatory DWHT levied on foreign investment funds to the CJEU. Should the CJEU rule in favour of the appellants, the Netherlands would be obliged to allow refunds of DWHT on (deemed) dividend distributions by Dutch companies to foreign investment funds, provided that these foreign investment funds are sufficiently comparable to a fiscal investment institution (*fiscale beleggingsinstelling*). On 20 December 2017, the CJEU Advocate General Paolo Mengozzi issued his opinion in respect of a comparable Danish case brought before the CJEU (*Fidelity Funds,* C-480/16). In his opinion, the Advocate General concluded that, briefly, Denmark violated the EU freedom of capital movement by imposing a withholding tax on dividend distributions made by Danish companies to foreign UCITS funds where dividend distributions made to Danish UCITS funds would, under certain circumstances, be exempt from such withholding tax. It remains to be seen how the CJEU, and subsequently the Dutch Supreme Court, will rule in the pending Dutch case. In anticipation of the judgment of the CJEU, in the past year many non-resident investment funds with equity investments in Dutch companies have filed requests (or objection or appeal notices) for a refund of DWHT with the Dutch tax authorities or Dutch courts.

On 29 May 2017, the Anti-Tax Avoidance Directive II ("ATAD II") was adopted. With effect from 1 January 2020, anti-hybrid mismatches rules based on ATAD II will be implemented in Dutch tax law. Hybrid mismatches can exist where tax deduction of certain costs is allowed in two or more countries or tax deduction of certain costs is allowed in one country without corresponding income recognition in another country. Such double deduction/non-inclusion situations could arise through, for example, hybrid entity mismatches, hybrid permanent establishment mismatches or hybrid financial instrument mismatches. The anti-hybrid mismatches rules are intended to neutralise the effects of hybrid mismatches. With the implementation of ATAD II, it is expected that the so-called 'CV/BV' structures will cease to be attractive, insofar as they are not already impacted by the recent US tax reforms.

BEPS

On 7 June 2017, the Netherlands signed the MLI. The MLI will automatically amend existing 'covered' bilateral double tax treaties to implement the tax treaty measures that have been recommended in the OECD BEPS Action Plans. The Netherlands has chosen

to implement almost all the provisions of the MLI, including the principle purpose test to counter treaty abuse (which satisfies the minimum standard). In this respect, the Netherlands has, in principle, not made reservations for existing anti-abuse provisions in tax treaties. However, the Netherlands has made reservations in respect of (i) the article on hybrid mismatches if a double tax treaty concluded by the Netherlands already includes a provision on hybrid mismatches, and (ii) the 'saving clause' rule that preserves a state's right to tax its own tax residents. Furthermore, the Netherlands will not implement the mandatory binding arbitration procedure for double tax treaties that already provide for such a procedure.

Where double tax treaties concluded by the Netherlands are amended due to the implementation of the MLI article on PEs, which provides for a broader agency PE rule, a narrower interpretation of the 'preparatory and auxiliary' exception and adoption of an anti-fragmentation rule, it is likely that the number of PEs located in the Netherlands will increase. For this reason, many multinational companies with activities in the Netherlands, which currently do not constitute a PE, will need to revisit their position in light of the MLI article on PEs.

On 12 May 2018, a new decree entered into force that sets out the Dutch tax authorities' interpretation of the arm's-length principle. It replaces and updates the earlier decree of 14 November 2013 to take into account recent developments, including the results of the OECD Base Erosion and Profit Shifting project that led to the revised July 2017 OECD Transfer Pricing Guidelines. It appears from the new decree that, in certain cases, the position of the Dutch tax authorities is more stringent than the interpretation in the OECD Transfer Pricing Guidelines. Since the Dutch tax authorities are of the view that the changes also apply to earlier years, Dutch taxpayers are advised to review their Dutch transfer pricing policy and documentation in light of the changes carefully.

Tax climate in the Netherlands

On 23 February 2018, the Dutch State Secretary of Finance published the Dutch government's policy agenda in which it clarified its policy plans for the years 2017 until 2021 (as set out earlier in the Coalition Agreement dated 10 October 2017). According to the policy agenda, the Dutch government wants to address tax evasion and tax avoidance by the use of the Netherlands as a pass-through jurisdiction, whilst at the same time it wants to maintain an attractive investment climate for Dutch and foreign multinational companies.

Important changes for Dutch corporate income tax purposes include:

- The mandatory implementation of the earnings before interest, tax, depreciation and amortisation ("EBITDA") rule, which will be more stringent than prescribed under ATAD I. The Dutch implementation entails that the deduction of the net interest expenses (e.g. the amount of interest expenses minus the amount of interest income if and to the extent recognised in the taxable profit) is limited to the highest of (i) 30% of EBITDA (as defined under Dutch tax law), and (ii) an amount of €1m if, briefly, the Dutch taxpayer is part of a consolidated group for international financial reporting standards/(Dutch) generally accepted account principles purposes, has an affiliated company or has a PE. Although allowed under ATAD I, the Dutch government has furthermore confirmed that a group-ratio exemption (either an earnings-based worldwide group ratio escape or equity escape), exemptions for loans which are used to finance infrastructure projects and exemptions for financial institutions will not be implemented in the Dutch EBITDA rule. No grandfathering will apply either, meaning that the EBITDA rule will also apply to existing loans. The Dutch government has

announced that as a result of the implementation of the EBITDA rule, a number of existing interest deduction limitation rules will be abolished, but to date there is no guidance on which provisions will be removed.

- The mandatory implementation of the CFC rule. The Dutch government has confirmed that it will proceed with Option A, meaning that the CFC rule will target passive income, including interest, dividends, royalties and financial lease income of controlled foreign companies without substantial economic activities that are resident in a low-tax jurisdiction or a jurisdiction that is included on the EU-list of non-cooperative jurisdictions. To date, it is unclear what consequences the implementation of the CFC rule will have on the application of the Dutch participation exemption.
- A restriction on the carry forward of losses (from nine to six years).
- The introduction of an interest deduction limitation rule for banks and insurers that would limit the deduction of interest on debt exceeding 92% of their commercial balance sheet total.

In addition, and together with the abolition of DWHT with effect from 1 January 2020, a conditional withholding tax will be introduced for intra-group (deemed) dividend distributions made by Dutch companies and cooperatives to shareholders or members resident in low-tax jurisdictions and jurisdictions that are included on the EU list of non-cooperative jurisdictions or in case of abuse. From 1 January 2021, a similar conditional withholding tax will be introduced for intra-group interest payments and intra-group royalty payments made by Dutch companies and cooperatives to residents of low-tax jurisdictions and jurisdictions that are included on the EU list of non-cooperative jurisdictions or in case of abuse. Although, to date, it is unclear what will be considered a 'low-tax jurisdiction', we expect that the conditional withholding tax on dividend, interest and royalty payments will be levied on payments made to residents of countries with no or a low statutory corporate income tax rate. The withholding tax rates that will apply to those payments are unclear at present.

Finally, the Dutch government has increased the minimum substance requirements by the introduction of two additional requirements: (i) a company should have a minimum of €100,000 of annual salary costs; and (ii) the company should have its own office space in the Netherlands for a period of at least 24 months. For companies that do not meet the (additional) substance requirement, with effect from 1 January 2019, it is no longer possible to obtain an advance tax ruling or advance pricing agreement. Furthermore, if the (additional) substance requirements are not met, the Netherlands may spontaneously exchange information on the lack of substance of the company in the Netherlands to the relevant source countries.

Developments affecting the attractiveness of the Netherlands for holding companies

In order to maintain an attractive investment climate, the Dutch government has announced that it will lower the Dutch corporate income tax rates gradually, from the current 20–25%, to 16–21% in 2021, and abolish DWHT. These announced changes should ensure the Netherlands remains an attractive jurisdiction for holding, financing and licensing companies, in particular where such companies have substantial economic activities in the Netherlands and are not part of a structure that involves dividend, interest and/or royalty payments made to low-tax jurisdictions.

Certain measures to combat tax evasion and tax avoidance that are discussed in the sections above will also impact Dutch holding and financing companies.

The year ahead

In this chapter we have discussed several announced measures that are intended to combat base erosion and profit shifting through the use of the Netherlands as a pass-through jurisdiction. As a result, and in anticipation, of these announced measures, we expect that multinational enterprises with a presence in the Netherlands will continue to (further) restructure their operations. We anticipate that these measures will, in particular, impact certain holding, finance and IP company structures that involve dividend, interest and/or royalty payments to low-tax jurisdictions, while on the other hand we expect that the expected introduction of lower Dutch corporate income tax rates and the abolition of DWHT will ensure the Netherlands maintains (and indeed increases) its attractiveness for companies and business activities that have or involve substantial economic activities in the Netherlands.

Furthermore, we expect that, due to the ongoing excellent market conditions, M&A and real estate deal volumes in the year ahead will be consistent with the past year's solid performance.

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Overview of corporate tax work

VAIDS filings

The Voluntary Assets and Income Declaration Scheme (**VAIDS**) was introduced by the Federal Government of Nigeria to incentivise all taxable persons to fully and honestly declare all or any previously undisclosed assets and income in exchange for which such taxpayers would (a) not be subjected to criminal prosecution for tax offences or to tax investigations, and/or (b) be granted a waiver of overdue interest and penalties in respect of the assets and income disclosed in the relevant taxpayer's VAIDS filing. The VAIDS filing window was initially scheduled to cover a nine-month period from 1 July 2017 to 31 March 2018, but was extended to 30 June 2018, after which time defaulting taxpayers identified by the Federal Government will be prosecuted for tax offences on the outstanding principal tax liability (for the last six years) and will incur penalties and interest on such tax liability. This scheme has resulted in an increase in engagement of tax consultants and accountants in the past 12 months as taxpayers seek to better understand and meet their tax obligations.

Mergers & acquisitions

As Nigeria continues to emerge from recession, there have been limited but significant M&A activities in the past year. Notable transactions in the past 12 months include the respective purchases by De-United Foods Industries Limited of food production lines from Dangote Noodles Limited and May & Baker Plc, and Zinox Technologies' acquisition of Konga and the subsequent merger of Konga and Yudala under the Konga brand.

Tax disputes

The administrative process for resolving new tax disputes has been on hiatus since 2016. The hiatus will be lifted once new Tax Appeal Commissioners are appointed to the Tax Appeal Tribunal (**TAT**), at which time the backlog of matters awaiting resolution at the TAT will be listed and new disputes can be initiated. The Government has not announced a timetable for the appointment of new Tax Appeal Commissioners to the TAT but it is expected that such appointments will be made in the coming months.

Key developments affecting corporate tax law and practice

Introduction of a new National Tax Policy

A new National Tax Policy (**NTP**) for Nigeria was approved by the Federal Executive Council on 1 February 2017, replacing the previous tax policy from 2012. The new National Tax Policy articulates fundamental principles to guide structured development of the Nigerian tax system and was introduced to address challenges such as:

(i) lack of an effective framework for the taxation of the informal sector, thereby limiting the revenue base;
(ii) an inadequate and disorganised database of taxpayers and a weak structure for exchange of information by tax authorities;
(iii) lack of clarity on taxation powers of the tiers of government;
(iv) unavailability of information available to taxpayers on tax compliance requirements, thereby breeding non-compliance;
(v) poor accountability for tax revenue;
(vi) use of aggressive and unorthodox methods for tax collection; and
(vii) lack of strict adherence to the direction of tax policy and guidelines for the operation of tax authorities.

The goal of the NTP is to address the challenges identified by placing a greater reliance on indirect taxes, which are easier to collect and administer and more difficult to evade, eliminating multiple taxation by various tiers of government and to establish a process for the regular comprehensive review of Nigerian tax laws and administrative provisions. The NTP gives implementation and monitoring strategies and identifies extensive tax reforms necessary to simplify Nigeria's tax system and ensure tax compliance, which are to be effected within all tiers of government. The National Tax Policy Implementation Committee, which was responsible for the development and drafting of the NTP, also identified 17 laws and regulations that it recommended be reviewed and amended to give effect to the new NTP framework.

Accordingly, the Federal Executive Council (**FEC**) approved two Executive Orders and five amendment bills geared towards implementing the new National Tax Policy. The Executive Orders are the Value Added Tax Act (Modification) Order and the Review of Goods Liable to Excise Duties and Applicable Rate Order. The amendment bills approved for presentation to the National Assembly for review and enactment are:

(i) Companies Income Tax Amendment Bill: proposed amendments include reducing the companies' income tax rate from 30% to 25% for large companies and to 15% for small and medium-sized companies, and changing the basis for computing minimum tax so that minimum tax will be computed as the higher of 0.5% of gross profit or 0.25% of capital plus 0.125% of turnover above NGN100,000,000;
(ii) Personal Income Tax Amendment Bill: proposed amendments include ratification of the double tax treaties that have yet to be ratified;
(iii) Value Added Tax Act Amendment Bill: amendments include introducing a turnover threshold VAT registration requirement for companies;
(iv) Customs, Excise, Tariff etc. Amendment Bill; and
(v) Industrial Development (Income Tax Relief) Act Amendment Bill: proposed amendments include extending the scope of the pioneer status tax incentive so that qualifying companies are exempt from certain other taxes such as education tax, in addition to companies income tax.

These proposed statutory amendments came as a result of the recommendations of the National Tax Policy Implementation Committee, set up in April 2017, to carry out its mandate under the new NTP.

Approval by the Federal Executive Council of Executive Orders on value-added tax and excise duties

By virtue of the provisions of the Value Added Tax Act (Modification) Order, residential property leases or rentals, services for use by the general public and life insurance premiums are now exempt from value-added tax (**VAT**).

The Goods Liable to Excise Duties and Applicable Rates Order, which took effect from 4 June 2018, increased excise duties on alcoholic beverages and tobacco as follows:

Tobacco

Rate type	Reviewed rates (Naira – NGN)		
	2018	2019	2020
Specific	NGN1.00k per stick (NGN20 per pack of 20 sticks)	NGN2.00k per stick (NGN40 per pack of 20 sticks)	NGN2.90 per stick (NGN58 per pack of 20 sticks)
Ad valorem	20%	20%	20%

Alcoholic beverages

Alcoholic beverage	Rate type	Reviewed rates (Naira – NGN)		
		2018	2019	2020
Beer and stout	Specific	NGN0.30k per cl	NGN0.35k per cl	NGN0.35k per cl
Wines	Specific	NGN1.25k per cl	NGN1.50k per cl	NGN1.50k per cl
Spirits and other alcoholic beverages	Specific	NGN1.50k per cl	NGN1.75k per cl	NGN2.00k per cl

VAIDS

The effect of the commencement of VAIDS in July 2017 is that taxpayers are taking their obligations more seriously as the Federal Government continues to warn of its intention to prosecute any and all tax evaders. To this end, the Federal Government has engaged the services of a forensic investigation company. The penalty for tax evasion is the total tax liability plus interest of 19% on such tax liability.

OECD Base Erosion and Profit Shifting

The enthusiasm of the current administration in relation to its fiscal policies and the international viability of the same saw the signing of two major multilateral instruments on 17 August 2017**,** these being the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (**MLI**) and the Common Reporting Standard Multilateral Competent Authority Agreement (**CRSMCAA**). The aim of the MLI is to prevent base erosion and profit shifting by multinational enterprises. The MLI, by bridging the wide gap inherent in existing tax treaties between international states, would ultimately make it easier for Nigeria in its relations with other countries regarding fiscal issues. On the other side of the spectrum, the CRSMCAA will facilitate the automatic exchange of financial accounts between Nigeria and other countries.

Nigeria has double tax treaties with 19 countries; namely: Belgium; Canada; China; the Czech Republic; France; Italy; Kenya; Mauritius; the Netherlands; Pakistan; the Philippines; Romania; Singapore; Slovakia; South Africa; Spain; Sweden; the United Arab Emirates; and the United Kingdom. A number of the treaty partners, including Canada, China, the Netherlands and the United Kingdom, have listed their double tax treaties with Nigeria for amendment under the MLI. As a result, matching treaty positions can be ascertained, and it is now easier to tell the changes that will be made to the existing double tax treaties between Nigeria and other countries.

Signing of additional double tax treaties

The double tax treaty signed between Nigeria and Singapore in August 2017 was given Presidential assent on 26 March 2018, but remains subject to ratification by the National

Assembly to take full effect. Nigeria also signed a double tax treaty with Qatar, which was approved by the Federal Executive Council on 28 February 2016, but is yet to be ratified by the National Assembly.

Cases

- *Esso Petroleum and Production Nigeria Limited & SNEPCO V NNPC.*
- *Shell Nigeria Exploration and Production & 3Ors v. Federal Inland Revenue Service & Anor.*

In these cases decided in July and August 2016, respectively, the Court of Appeal made pronouncements relating to the arbitrability of tax disputes in Nigeria. The Court of Appeal held that on a combined reading of the provisions of section 25 of the Federal Inland Revenue Service (Establishment) Act (**FIRS Act**) and section 251(1)(b) of the Constitution of the Federal Republic of Nigeria 1999 (as amended), which grants exclusive jurisdiction over certain subject matter disputes to the Federal High Court, tax disputes are outside the jurisdiction of arbitral tribunals and are therefore not arbitrable. The Court of Appeal also held that, although the primary dispute in the matters before it was contractual (as regards what rights and obligations flowed to the parties to a production sharing contract), some of the reliefs sought were issues which were, in substance, tax disputes, and therefore out of the jurisdiction of an arbitral tribunal.

- *CNOOC Exploration & Production Nigeria Ltd. & Another v. Nigerian National Petroleum Corporation & Another.*

In March 2017, the Court of Appeal affirmed the jurisdiction of the TAT to adjudicate tax disputes. In its decision, the Court of Appeal overruled the Federal High Court which had earlier decided that the TAT does not have the jurisdiction to entertain and adjudicate over tax disputes.

Since its establishment in 2007 by the National Assembly under the FIRS Act and its operation in eight zones in Nigeria, the TAT has been confronted with questions relating to its constitutionality. This is in view of the perceived conflict between the provisions of the FIRS Act establishing the TAT, which unwittingly provides that the TAT "shall be deemed to be a civil court for all purposes" on the one hand, and the provisions of Section 251(1)(a)&(b) of the Constitution of the Federal Republic of Nigeria, 1999 as amended (**Constitution**), which confers exclusive jurisdiction over matters relating to the revenue of the government of the Federation and taxation of companies on the Federal High Court on the other hand.

The apparent conflict between the provisions of the FIRS Act and the Constitution has given rise to conflicting decisions of the Federal High Court on the constitutional validity of the TAT and its jurisdiction to adjudicate tax disputes. This has left taxpayers confused as to the proper forum to air their grievances.

In the case under review, the Federal High Court decided that the TAT lacks the jurisdiction to entertain tax disputes, which the court held are within the exclusive preserve of the Federal High Court. However, on further appeal to the Court of Appeal, the decision of the Federal High Court was overruled. The Court of Appeal in affirming the jurisdiction of the TAT held that the TAT is an administrative appeal body below the status of a regular court and that the jurisdiction of the TAT does not conflict with the exclusive jurisdiction of the Federal High Court on matters relating to the revenue of the federal government and taxation of companies.

Being an appellate court, this decision of the Court of Appeal has settled the issue of the constitutionality and jurisdiction of the TAT for now. Until and if there is any contrary decision by the Supreme Court in future, the position remains the same.

- *Vodacom Business Nigeria Limited v. Federal Inland Revenue Service.*

The judgment in this case relates to the VAT tax liability incurred by a non-resident company rendering services to a Nigerian company. On 12 February 2016, the Lagos Division of the TAT held that a Nigerian company that receives services in Nigeria performed by a non-resident company should account for and pay VAT on such services provided. The Nigerian company appealed the TAT's decision at the Federal High Court. On 19 December 2017, the Federal High Court affirmed the decision of TAT and agreed with the TAT by applying the destination principle and reached the conclusion that VAT is levied in the jurisdiction where the service is consumed, not the supplier's jurisdiction.

The effect is that when a foreign company provides a service in Nigeria to a Nigerian company, the foreign company is required to register for and charge Nigerian VAT on any invoice issued to the Nigerian entity. The Nigerian recipient is then expected to withhold the VAT and remit such VAT payment to the FIRS.

Tax climate

The Nigerian tax climate in recent times has experienced diverse policy changes and a realignment of the erstwhile taxation system, geared at a more efficient administration of tax in the country.

The current government intends to implement a continuously evolving tax system of laws and regulations that is geared towards raising Nigeria's tax to GDP ratio from 6%. The new National Policy Tax is the foundation on which these changes will be implemented, and has led to major developments such as VAIDS and the recent approval of two executive orders and six amendment bills (see "*Key developments…*" above). There is a general expectation of other ground-breaking tax policy introductions that will further engender tax compliance amongst Nigerian taxpayers.

There is no gainsaying the fact that these new policy introductions would also bring about more aggrieved taxpayers. We expect the mechanism for addressing grievances related to taxation and other tax disputes through the Tax Appeal Tribunal to be ready for dispute resolution once the Tribunal is reconstituted, owing to the reforms taking place.

Developments affecting attractiveness of Nigeria for holding companies

Included in the tax reforms announced by the Nigerian Government in June 2018, is the intended amendment of Section 19 of the Companies Income Tax Act (the **CITA**) so that dividends paid out of already tax-retained earnings, exempt profits and franked investment income will no longer be treated as taxable profit that is liable to 30% companies' income tax. Section 19 of the CITA, known colloquially as the excess dividend tax provision, has been upheld by the courts as imposing a tax on companies (except for banking group companies) whose distributed dividend is higher than its declared profits. This is effectively a double taxation on companies' income, as dividends received net of 5% withholding tax are ordinarily exempt from taxable profits, that has been entrenched by the courts, which the government now seeks to correct by amending CITA. It is expected that this proposed amendment will become law sometime before February 2019.

Industry sector focus

<u>Oil and gas</u>

The Petroleum Industry Governance Bill was recently passed by the National Assembly. Its passing heralded the expectation that other bills that address the fiscal issues in the

petroleum sector would also be passed. The bill seeks to promote openness and transparency in the administration of the oil and gas sector whilst establishing a fiscal framework that encourages further investment in the oil and gas industry, which should optimise revenue accruing to the government.

Although the bill is yet to be assented to by the President, it received a high degree of acceptance from international oil companies and other stakeholders in the petroleum sector. It is expected that the legislature will soon approve the Petroleum Industry Fiscal Bill so that the bill can also be submitted for Presidential assent – along with the Petroleum Industry Administration Bill and the Petroleum Host Community Bill.

The year ahead

We expect continued efforts by the government to derive more revenue from taxation. The government appears firm in its resolve to sustain the tax reforms and other economic reforms to make the administration and collection of taxes more efficient and convenient. We note that the various executive orders on the Ease of Doing Business have had a positive impact on the ease of paying taxes. In the last year, Nigeria's ranking on the Paying Taxes Indicator of the World Bank Group's Ease of Doing Business Report moved up 11 places in 2017. We expect that these reforms and the impact of VAIDS will further move Nigeria up in this ranking in the coming year.

In the coming year, the period given for VAIDS would have lapsed. It will be time to assess the impact of the VAIDS on tax administration in Nigeria. It is expected that VAIDS would have expanded the tax net and increase revenue from taxation. This is especially relevant for the implementation of the 2018 budget with a rather ambitious 63% of the projected budget revenue from non-oil sectors, which is dominated by revenue from taxes. The flip-side of this is an expectation of an increase in tax disputes and litigation arising therefrom. Also, the government is expected to make concrete efforts to prosecute tax defaulters, if only to placate the taxpayers who have voluntarily submitted to taxation under the VAIDS programme.

Due to the projected increase in tax disputes, we expect the government to reconstitute the Tax Appeal Tribunal for the resolution of tax disputes between taxpayers and the tax authority. The tribunal has not been reconstituted since June 2016, when the tenure of the Tax Appeal Commissioners expired. We expect arbitrability of tax disputes to continue to be an issue until a dispute is taken to, and a decision is handed down by, the Supreme Court.

Proposed amendment bills have also been announced under the revised NTP, which would necessarily pass through legislative process of amendment of the relevant laws to become operational. The government is also considering increasing the rate of VAT, which is currently at 5%. However, it is not clear if and when this will be effected, in view of the obvious political implication for the government in an election year.

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A Senior Advocate of Nigeria and Notary Public, Kayode Sofola SAN is a renowned commercial litigator and tax specialist with a reputation of being an adviser to advisers. The first ever Chairman of the Lagos Zone of the Tax Appeal Tribunal (2009 to 2016), he sat as a panel member of the now defunct VAT Tribunal (Western Zone) from 2000 to 2007 and also sat in 2005 as acting Chairman of the VAT Tribunal (Eastern Zone). He is a member of, and a legal adviser to, the Chartered Institute of Taxation of Nigeria.

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Overview of corporate tax work

Current corporate tax work focuses on adapting not only to a constantly changing legal environment but also to the more restrictive approach of tax authorities in the interpretation and application of tax law. These two factors affect both day-to-day business operations of taxpayers as well as investments and transactions in all fields of the economy.

The most significant amendments related to corporate tax work were introduced in corporate income tax regulations and relate to: the separation of capital gains from other sources of taxable income; limitation of tax deductibility of debt financing costs (including exclusion of tax deductibility of interest resulting from debt push-down structures); limitation of tax deductibility of costs incurred on certain intangible services and royalties; new rules concerning Controlled Foreign Companies (**CFCs**); and a change in the rules regarding Tax Capital Groups (**TCGs**). Additionally, in the commercial real estate sector, taxpayers must adapt and take into account new regulations regarding the so-called minimum income tax.

All of these circumstances have resulted in an increasing market demand for tax compliance services.

Key developments affecting tax law and practice

Reform of the Polish Corporate Income Tax (**CIT**) law

The year 2018 brought about a substantial change to the corporate tax environment in Poland due to the entry into force of a complex reform of the CIT law, adopted in 2017. The reform introduced changes to Polish CIT regulations aimed at, primarily, closing some of the purported loopholes in corporate taxation, including provisions partially implementing the Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (the so-called **ATAD**).

The most notable changes effective since 1 January 2018 concern the following.

Separation of capital gains from other sources of taxable income

Until 1 January 2018, the entire taxable income (or loss) generated by a given CIT payer from various sources was amalgamated. Currently, capital gains are separated from income derived from other sources, i.e. there are two separate "baskets" of income. Taxpayers are required to recognise taxable revenues and tax-deductible costs related to each "basket" separately. This novelty in the Polish corporate tax system is intended to counteract practices aimed at reducing taxable income by deliberately generating losses on capital operations.

Capital gains include, in particular:

- revenue from shares in profits of legal persons;

- revenue resulting from an in-kind contribution made to a legal person or a joint-stock partnership;
- other revenue from shares in a legal person or a joint-stock partnership;
- revenue from disposal of all rights and obligations in a partnership;
- revenue from selling debts previously acquired by the taxpayer and debts resulting from revenues classified as capital gains; and
- revenues from property rights, securities and derivative instruments (excluding instruments used to secure the cash flow or revenues, or costs not recognised as capital gains) and revenues from investment fund units or collective investment institutions, including revenues from rental, lease or other similar agreements, as well as revenues from their disposal.

There is no possibility to compensate income derived from one "basket" with a loss incurred on the other "basket". If a taxpayer earns both income from capital gains and income from other revenue sources during the year, then CIT will be due on the total income derived from both sources. However, in case the taxpayer derives income from only one of the "baskets" and incurs a loss on the other, income tax is levied on the income generated from one source and cannot be reduced by the loss from the other source.

The taxpayers may deduct a loss from revenue earned from the same "basket" in the next five consecutive tax years, but the deducted amount in any of those years must not exceed 50% of the loss.

Change of rules regarding TCGs

The Polish tax law provides for a possibility for one or more companies (meeting specific criteria) to form a TCG and benefit from fiscal unity for CIT purposes. On 1 January 2018, the rules concerning forming and operating a TCG underwent significant changes, particularly:

- the average share capital requirement for the companies forming a TCG was decreased from PLN 1m (*ca*. EUR 250k) to PLN 500k (*ca*. EUR 125k);
- the minimum direct shareholding requirement for a dominant company in its subsidiaries (together forming a TCG) was decreased from 95% to 75%;
- the profitability ratio requirement (minimum revenue-to-income ratio of the TCG) was decreased from 3% to 2%; and
- a rule has been introduced that in case of breach of certain conditions required for the TCG to operate as a standalone taxpayer, the TCG will lose such status retroactively (from the date of registration as a TCG); in such case, the companies forming the tax group will be obliged to reconcile for CIT purposes as independent taxpayers retroactively for the previous years.

The aforementioned changes were driven by, on the one hand, the intention to make TCGs more accessible for smaller enterprises, and, on the other, to tackle the possibility for corporate taxpayers to take advantage of common tax optimisation schemes via the use of TCGs.

New rules concerning CFCs

A major change dictated by the requirements of the ATAD concerns regulations on CFCs, aimed at preventing tax avoidance or evasion through transferring profits to countries offering preferential tax regimes.

Under the modified CFC rules, Polish taxpayers are subject to taxation at the 19% rate on the income generated by their CFCs, i.e. subsidiaries that meet any of the following criteria:

- are located in a country applying "harmful tax practices";
- are located in a country that does not engage in exchange of information with Poland or the EU; and
- are a foreign company which derives at least 33% of its revenue from passive revenues and the amount of tax actually paid by that foreign company is lower than the difference between the tax that would have been applied had the company been a Polish resident and the tax the foreign company actually paid – provided that the Polish company holds (independently or jointly with its related entities), for an uninterrupted period of at least 30 days, over 50% of the shares in such foreign company.

Under the modified CFC rules, passive revenues include revenue from:

- dividends and other revenues from a share in profits of legal persons;
- sale of shares;
- receivables;
- interest and benefits from all kinds of loans;
- interest on financial leases;
- guarantees and warranties;
- copyrights or industrial property rights, including from the disposal of those rights;
- disposal and exercise of rights attached to financial instruments;
- insurance and banking activities or other financing activities; and
- transactions with associated enterprises if they do not create added value (in the economic sense) or the added value is insignificant.

It should be noted that the CFC rules do not apply if the foreign company is subject to taxation on its worldwide income in an EU/EEA Member State and carries out genuine economic activities in such State. The modified provisions concerning CFCs provide for an open list of criteria which should be taken into account when determining if the foreign company carries out such genuine economic activities.

Limitations of tax deductibility of debt financing costs

The CIT law reform significantly remodelled rules concerning thin capitalisation, limiting the tax deductibility of debt financing costs. The new regulations directly implement the mechanisms set forth by the ATAD.

As of 1 January 2018, tax deductibility of debt financing costs exceeding interest or interest-type income generated by a given CIT payer has been limited to 30% of the so-called "tax EBITDA" – earnings before interest, tax, depreciation and amortisation. Unlike in the case of the regulations previously in force, currently the limitation applies not only to interest, but also to other types of costs incurred in relation to debt financing (e.g. arrangement fees). Moreover, the new method of calculating tax-deductible debt financing costs relates not only to loans received from related parties, but also to financing (in a broad meaning) granted by third parties.

The statutory limit does apply to the excess of debt financing costs over interest (and interest-type) income in amounts less than PLN 3m (*ca*. EUR 750k).

Disallowed deductions may be, under specific conditions, carried forward for the next five consecutive tax years.

The new thin capitalisation restrictions do not apply to specified financial institutions, such as national banks, credit institutions, insurance and reinsurance companies, etc.

Limitation of tax deductibility of costs incurred on certain intangible services and royalties

The possibility of treating expenses paid to related parties for advisory, management, data processing, marketing, market research, insurance, guarantees, royalties, transfer of risk

connected with bad loan receivables (e.g. via insurance, derivatives, guarantees) as tax-deductible has been limited to 5% of the so-called "tax EBITDA" generated by the taxpayer. There are some exceptions, concerning, e.g., costs of services covered with advance pricing agreements (**APAs**) as well as costs of intangible services directly related to the production of goods or provision of services. The limitation applies to the extent the aforementioned excess of costs over 5% of tax EBITDA is higher than PLN 3m (*ca*. EUR 750k).

Further changes

Some other changes introduced by the amendment to the CIT law effective since 1 January 2018 include:

- introduction of the minimal income tax applicable to owners of commercial real estate of considerable value (*cf*. "Industry sector focus" below);
- exclusion of tax deductibility of interest resulting from debt push-down structures;
- introduction of a regulation aimed at tackling schemes using gratuitous transfer of assets to related parties; and
- modification of the rules for the determination of taxable revenues and tax-deductible costs related to spin-offs.

Multilateral Instrument to Modify Bilateral Tax Treaties (**MLI**)

In November 2017, Poland finalised the ratification process of the MLI. The MLI globally implements mechanisms aimed at tackling operations which lead to a reduction of the tax base (base erosion) and transfer of income to jurisdictions offering reduced taxation or non-taxation (profit shifting), particularly by replacing the tax exemption method used for avoiding double taxation through the tax credit method. Poland declared 78 double taxation treaties (**DTTs**) for the MLI's purposes, including, among others, DTTs with Belgium, Cyprus, Denmark, France, Ireland, Luxembourg, Malta, the Netherlands, Norway, Sweden, and the United Kingdom.

Publication of data on the largest CIT taxpayers

On 1 January 2018, another change to the Polish CIT law came into force. It entitles the Polish Ministry of Finance to annually publish the individual tax data of CIT payers achieving the highest revenues, as well as all TCGs.

The individual tax data to be published by the Ministry of Finance includes information on: the taxpayer's name; his tax identification number; taxable revenues; tax-deductible costs; taxable income generated or tax loss incurred; tax base; and tax due.

The published information may be also supplemented with information on the effective tax rate applicable to a given taxpayer.

The presented goal of this regulation was to increase transparency in terms of corporate taxation.

First practical examples of application of the General Anti-Abuse Regulation

The General Anti-Abuse Regulation (**GAAR**) was introduced to the Polish tax system in 2016 in order to provide the tax administration with means to challenge artificial operations, structures and schemes aimed solely or primarily at tax avoidance (obtaining undue tax benefits).

As at the moment of its introduction the GAAR was a new concept in the Polish tax system, for some time it was uncertain what the practice of the tax administration and courts in terms of its application would be. Recently, two significant developments have occurred in this respect.

Firstly, in December 2017, the first so-called "protective opinion" was issued by the tax authorities, in which it was confirmed that a specified incentive scheme – allowing the manager (employed on the basis of an employment contract) of a franchise store owned by an international capital group to invest in the company operating the store with a prospect of generating profit taxable at a flat 19% personal income tax (**PIT**) rate (and not according to the progressive tax scale applicable to employment remuneration) – has business merits, and therefore should not be challenged with the use of the GAAR. The said opinion shed some light on the criteria that should be met while devising a tax-effective incentive scheme.

Then, in May 2018, the first verdict of the administrative court concerning the application of the GAAR was issued. The District Administrative Court in Warsaw ruled in favour of the tax authorities, which refused to issue a protective opinion which was intended to confirm that a scheme devised for the purpose of generating tax loss on a share sale transaction cannot be challenged under the GAAR. The court agreed with the tax authorities that an operation consisting of the acquisition of publicly traded shares in a Polish joint-stock company through a special purpose vehicle (**SPV**) and subsequent reverse merger of the target with the SPV (leading to dilution of shares in the target and decrease in their unit value), followed by the sale by the target of its own shares issued as a result of the merger is artificial, and that the tax benefit obtained as a result thereof (in form of a tax loss) does not deserve protection against being challenged with the use of the GAAR.

Both cases discussed above are important from the perspective of corporate taxpayers, as they indicate the approach of the Polish tax authorities and administrative courts to the application of the GAAR.

Tax climate

After the 2015 elections and after the change of government, Polish fiscal policies changed significantly. One of the elements of the governing party's programme was not to introduce new taxes and not raise existing ones. Trying not to break this promise, the government eliminated loopholes in the existing tax system and tightened the scope of allowances and deductions. In other words, the government aims to increase the budget by broadening the income tax base without raising its relatively low 19% CIT regular rate.

As far as implementation of tax law is concerned, taxpayers are facing more tax audits because tax authorities have become more scrupulous and restrictive in assessing taxpayers' actions. Many optimisation schemes have ceased to function not so much due to a change in law, but due to changes in the practice and approach of the tax authorities.

Developments affecting the attractiveness of Poland for holding companies

Although the liberal attitude of the tax authorities is a thing of the past, tax burdens in Poland are still at an attractive and competitive level. Changes in tax law have not negatively affected the economy. As a result, Poland is still one of the most dynamic and fastest-growing markets in the EU, and is definitely attractive from the investors' perspective.

Poland still has not imposed a holding company regime; however, Polish holding companies can benefit from the broad network of treaties on avoidance of double taxation as well as from taxation regimes for dividends and interest. The recent separation of capital gains from other sources of taxable income should be a neutral event for typical holding companies or even make their operations a little more transparent, provided that they do not engage in other business operations.

Industry sector focus

Real estate is the sector on which the Polish tax administration has been focused recently.

Minimum income tax

The 2018 CIT reform introduced the so-called minimum income tax, payable by the owners of commercial real properties worth more than PLN 10m (*ca*. EUR 2.5m). Originally, the minimum income tax applied to commercial buildings classified as shopping centres, shopping malls, independent shops and boutiques and other commercial real properties, as well as those classified as office buildings.

The taxable base was determined as revenue corresponding to the initial value of the asset determined on the first day of each month, less PLN 10m (*ca*. EUR 2.5m). The monthly tax rate is 0.035%.

Taxpayers are not obliged to pay the minimum tax if it is lower than the general CIT advance for the month. Furthermore, the tax is deductible from the CIT due for the fiscal year.

Recently, after consultations with the European Commission, the government proposed some changes in the regulations concerning the minimum income tax.

Under the new rules, the minimum income tax will apply to buildings that are tangible assets and meet the following conditions:

- are owned or co-owned by the taxpayer;
- have been leased out in whole or in part pursuant to a lease, tenancy or a similar contract; and
- are situated in Poland.

The new rules will also change the application of the PLN 10m exemption threshold, from being applied separately to each property to being available per taxpayer. This means that the PLN 10m deduction may be applied by the given taxpayer only once, regardless of the number of the buildings he owns (one tax-free amount per taxpayer and not per building).

The new regulation will also introduce an anti-avoidance clause applicable in case a taxpayer disposes of or leases his building out in whole or in part without justified commercial reasons in order to avoid the minimum income tax.

Polish REITs

For some time now, the Polish Ministry of Finance has been working on introducing the concept of Real Estate Investment Trusts (**REITs**) to the Polish tax system. The latest proposal in this field is to provide public joint-stock companies whose core operations consist in leasing residential real properties (and also meeting some other specific requirements) with tax preferences. Such companies would be subject to a preferential 8.5% CIT rate on income generated on leasing residential premises. Moreover, it is proposed for the income derived by CIT and PIT taxpayers on investing in such companies to be exempt from taxation. However, the legislative work concerning Polish REITs is in progress and its final outcome may differ from the proposal described above.

Activity in the area of tax control proceedings

Entities from the real estate sector also remain under the scrutiny of the Polish tax authorities in terms of tax audit proceedings. After a period of time in which the tax authorities have been targeting real estate transactions and challenging their classification for VAT purposes (as asset deals or sale of business as a going concern), recently there have been more and more cases in which the tax authorities have tried to question the tax implications of operations involving TCGs, which were used relatively often by the taxpayers operating in this sector. Time will tell whether these attempts will prove effective before the administrative courts.

The year ahead

The corporate taxation environment in Poland is constantly evolving. The Polish Ministry of Finance has already presented some preliminary proposals concerning further changes to the income tax regulations, aimed at reducing bureaucracy and providing taxpayers with favourable solutions. The indicated changes include, among other things:

- the introduction of the possibility to reduce taxable revenue by hypothetical interest cost on equity;
- the introduction of favourable rules for the tax settlement of conversion of debt into equity (possibility to recognise the amount of converted debt as tax-deductible);
- the introduction of a new B+R relief ("Innovation Box");
- the introduction of a possibility for one-off (i.e. in a single fiscal year) compensation for tax loss not exceeding PLN 5m (*ca*. EUR 1.25m); and
- the introduction of a third CIT rate of 9% (besides the standard 19% rate and the preferential 15% rate applicable to small entrepreneurs), that would apply to micro-entrepreneurs.

At the same time, the Polish Ministry of Finance continues to work on the entirely new Tax Code that would lay ground rules for the general tax law in a more modern and business-friendly manner than the one currently in force. Particularly, it is being communicated that the new Tax Code will put emphasis on co-operation between the tax authorities and taxpayers by promoting instruments such as tax mediation, agreements between the tax authorities and the taxpayer, consultation procedures and co-operative compliance – all of which are currently unavailable in Poland. It is estimated that the new Tax Code could come into force at the beginning of the year 2020.

Moreover, it will be required for Polish lawmakers to implement into the Polish tax system, before 1 January 2020, further anti-avoidance measures provided for in ATAD, i.e. exit taxation and rules on hybrid mismatches.

The tax administration has also been continuously pointing out the need to reshape the income tax system by replacing the currently binding acts on personal and corporate income taxes with new ones, which should clearly reflect the distinction between different sources of revenue (e.g. separate acts would regulate taxation of business profits, capital gains and income from work). One of the indicated drivers for those changes is the need to further seal up the income tax system. However, the possible timeframe for implementing such changes remains unknown at this stage.

Taking the above into account, it should be expected that, in the short and medium term, there will be a number of further legislative developments affecting the system of corporate taxation in Poland.

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Russia

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Overview of corporate tax work over the last year

Russia is a member of the Group of Twenty (G20), the Financial Action Task Force (FATF), the Global Forum on Transparency and Exchange of Information for Tax Purposes (OECD). Russia confirmed its activity in the international BEPS project in 2017 by signing the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI). The first round of automatic exchange based on the Standard for Automatic Exchange of Financial Account Information in Tax Matters/Common Reporting Standard (AEOI/CRS) by OECD is expected in September 2018. Seventy-four countries have suggested an opportunity of automatic exchange on financial accounts with Russia, while 23 of them have confirmed their intention to exchange in 2018 (among them – the United Kingdom, China, Australia). Therefore, within the last five years, Russia has been following all the latest taxation trends and actively reforming the tax system according to the international principles of transparency.

The main notable aspects of taxation in 2017–2018 are stated below:

Transfer pricing

Russian Transfer Pricing (TP) rules represent the partial adaptation of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations that were originally approved by the OECD Council in 1995, despite the fact that Russia is not a member of OECD. Russia introduced its TP rules in 2012 for the first time and they are still being reviewed by jurisprudence. Talking about developing practice, it is important to mention that the Russian transfer pricing law is distinguished by two fundamentally different methods of TP rules application:

(a) First way – the "general order", is intended for large holdings operating within the country (the threshold is that the group's transaction turnovers exceed 1bn rubles, equivalent to €14m or $16m). Advance pricing agreements (APAs) as well as a corresponding adjustment of income and expenses in the affiliated companies are available to this category of taxpayer. Moreover, tax audits in this category are conducted by the specialised body that was created as a part of the Federal Tax Service (FTS) of Russia. Since June 2018, for the largest Russian taxpayers, the conclusion of APAs in regards to cross-border transactions with foreign companies is available, which allows a unification of approaches in determining the price between the Russian and foreign body and avoids the double taxation of international holdings. Despite all of this, the practical application of the "general order" of the TP rules in 2017 was statistically low and only applied by a very specific group of large taxpayers. According to official data, from the time this became the norm until the beginning of 2018, only nine APAs have been made and only 34 special audits have been conducted.

(b) However, tax authorities actively apply the TP rules for casual fiscal checks, even though the law provides neither APAs, nor corresponding adjustments. For example, all transactions with a foreign-affiliated person ("parent" holding) or non-affiliated person from an offshore jurisdiction (there are currently 41 countries and territories in the Russian "offshore black list" of jurisdictions) fall under TP rules. In practice, the application of transfer TP rules to such transactions is more common than the "general order". By the end of 2017, taxpayers reported more than 124 million controlled transactions (i.e. transactions falling under Russian TP regulations) executed in 2016. Therefore, currently the Russian TP rules are being formed as the instrument for regulating relations in cross-border transactions and as the regulatory instrument for capital migration to other jurisdictions.

The key event in 2017 was that, on 26 January, the Russian Federation signed the Multilateral Competent Authority Agreement on Country-by-Country Reporting (CBC reporting). According to the new requirements, the largest Russian holdings whose consolidated revenue for the fiscal year is more than 50 billion rubles (about €700m or $800m) have to submit a special report containing the financial and tax performance of their foreign-affiliated entities. Having adopted the rules in 2017, Russia has provided its residents with the right to submit a CBC report for 2016. This decision was made to avoid foreign tax authorities' claims that the corresponding rules could have been introduced earlier and could require the reporting of subsidiaries located in their jurisdictions if the Russian head company had not reported on them within the Multilateral Competent Authority Agreement. However, submission of reports for 2016 is voluntary for Russian holdings. Determining the jurisdictions that require reporting will need to be done before 30 June 2018, when the Russian tax authorities will end the voluntary reporting period.

Controlled foreign corporations (CFCs)

The first CFC declaration campaign in Russia's history ended in April 2017. During this campaign, the Russian owners and beneficiaries of foreign companies had to submit tax declarations on revenues of their foreign companies for 2015. Russian CFC is largely similar to the American model and has probably been "inspired" by it. CFC rules apply to tax resident individuals and entities (tax rate of 13% and 20% respectively). Though the relevant Section of the Russia Federation Tax Code has been applied only to two declaration campaigns (2017 and 2018), essential amendments to it have been made more than six times, the latest significant ones being adopted in December 2017.

It is difficult to say whether the campaign in 2017 was unambiguously successful. According to the available data, information about 6,000 controlled companies was voluntarily submitted, with total profits of 20 billion rubles (approximately €285m or $330m). According to various estimates, the undeclared assets of Russian residents exceed the available data by multiples of ten. It is obvious that, in Russian tax law, the CFC is now one of the most complex and problematic tax institutes, with a multitude of ambiguous nuances and technical gaps, the application of which raises questions not only to taxpayers but also, in some cases, to territorial tax authorities.

Tax amnesty – "the first and second wave"

Upon the beginning of automatic exchange of information and also bearing in mind the low success of the CFC declaration campaign, the Russian tax authorities are offering residents the preferential voluntary declaration of foreign capital. The last easements of the first wave tax amnesty ceased to be in force in December 2017, and even though it was initially supposed that amnesty would not be prolonged, in March 2018 a similar round of tax amnesty was announced.

Until the end of 2019, tax residents of the Russian Federation have an opportunity to declare income gained previously and undeclared foreign bank accounts (in the Russian Federation, tax residents are obliged to report to tax authorities possession of foreign accounts), or to liquidate the offshore company with distribution of its assets without tax consequences. It is obvious that the second wave amnesty will be more effective than the first wave, since a part of the capital is actively returning to Russia as a result of expectations of AEOI and the effect of the anti-Russian economic sanctions (in particular, the American CAATSA and its European analogues).

Foreign internet company VAT

Starting from 1 January 2017, foreign companies that provide electronic services and content in Russia are obliged to be registered with the Russian tax authorities for calculation and payment of VAT. For payment of VAT in Russia, it is necessary to be registered separately, since Russian law does not provide separate accounts for VAT such as in, for example, Europe. Until last year, only companies that were registered by calculation of income tax were obliged to pay VAT independently.

Amendments to the Tax Code of the Russian Federation were introduced by Federal law No. 244-FZ, informally named the "Google tax law", since it stipulates for the taxation of services of mobile phone app stores (such as Google Play and Apple's App Store). The law refers to: electronic services levied with VAT, including those relating to e-books, music, video and others; services granting rights to use computer programs on the internet, including games and databases; internet advertising services; services for placement of announcements; and the maintenance of electronic resources. Since the beginning of 2017, 155 foreign companies have been tax registered in Russia. Among them are several Amazon holdings, Apple Distribution, Bloomberg Finance, Facebook Payments, Google Commerce, Netflix International, Samsung Electronics, several of Uber's operating companies and others.

Moreover, the future taxation of foreign shops and platforms that sell goods to Russian natural persons (iHerb, Aliexpress, eBay and similar) is being actively discussed and considered at the moment. For now, foreign trade shops do not fall under current VAT regulation. Perhaps in the future, their taxation will be settled by means of simply raising customs duties for natural persons.

Essential transactions and highlights illustrating corporate tax

A series of tax disputes related to non-taxation under double tax agreements (DTAs) was a key aspect of 2017, as well as previous years in general. However, the majority of these disputes affected taxpayers negatively. The tax authorities consistently assessed companies that could not confirm the status of the beneficial owner of income of foreign persons receiving interest, dividends or royalties from Russian companies, with additional taxes that had been underpaid in previous periods. Generally, the main issue was that the Russian daughter companies lacked adequate information about sufficient presence in the jurisdiction of domicile of the recipient of such income (in particular, the existence of an office in the jurisdiction of receipt, vigorous activity by the recipient company in the jurisdiction, and payment of local taxes were tested).

The enjoyment of easements by banking and financial groups when structuring cross-border client products is an important feature in the application of DTAs. There are several very similar situations that concern additional accruals by Russian financial companies that traditionally offered their clients products that were realised outside of Russia:

intermediary services by affiliated brokers; and activities of investment banks and financial intermediaries in Switzerland, Luxembourg and other world financial centres. The courts regard payments in favour of investment intermediaries as not having the right not to be taxed under a DTA, and toughening of jurisprudence has led to additional accruals receiving the same treatment. Among the parties to the disputes are not only Russian financial groups, but also international holdings (for example, the financial group FABI, an Intesa Sanpaolo subsidiary).

The fact that Russia joined the MLI on 7 June 2017 also demonstrates that the practice of DTA application will become increasingly complicated and that it requires close attention of all participants in their cross-border relations.

Key developments affecting corporate tax law and practice

Russia is following all of the modern trends in tax law and transparency. During 2017–2018, there has been a number of measures undertaken, allowing (a) state bodies to establish the structure of property of Russian companies, and (b) other persons to carry out Know Your Customer (KYC) procedures for Russian contractors successfully, making their relationships safer.

Russia does not use a centralised state register for companies' beneficiaries, and currently this question is not on the agenda. Nevertheless, in 2017, new requirements were introduced with regard to Russian companies: under the threat of a fine, they must keep internal registers in order to record information about beneficiaries, and must update it from time to time. In practice, beneficiaries are defined as natural persons – ultimate owners who, regardless of the complexity of intermediate structure, own at least 25% of the Russian legal entity, directly or indirectly. The tax authorities will conduct the first audits concerning compliance with this rule in 2018. It is supposed that this requirement may cause difficulties, in particular in branched groups of foreign persons with a large number of owners, family possession, foundations and trusts, or other features within its structure. Nevertheless, it should be noted that the legislation currently stipulates the issue softly, and prescribes that Russian subsidiaries must develop a reasonable system of data exchange with its parent structure, assuming that, if the beneficiary cannot be identified, it is possible to provide a reasoned refusal to identify such.

Since 2012, Russia has been consistently implementing the FATF regulation in relation to KYC and has been exercising counteractions to tax offences by banking businesses. At the end of 2017, during the centralisation of this process, Russian banks have received their first significant instructions from the Central Bank of the Russian Federation about control techniques for clients' tax obligations. The indicators that must be tracked by banks include the tax efficiency of the client's company, the level of salary paid to employees, transit operations with low margins and the economic nature of the relations with the client's contractors. In many respects, trends in banking control coincide with Europe's, although they remain less regulated, allowing some banks to operate their internal controls freely. All of that mentioned above makes Russian practice regarding KYC vary from bank to bank.

It is also planned that, in 2018, the financial statements of Russian companies will become publicly available in order to improve the transparency of relations. The reports of all companies that have a tax number will become available to anyone on FTS' website for free for previous years. It should be noted that the project for the publication of accounting reports was postponed for over a year because of technical reasons; however, it will be completed in summer 2018. Precautionary messages can currently be published, indicating

if a Russian company has not submitted reports and tax payments for over a year, does not have a credible registered address, if the company has a licence and various other information which is deemed to increase the level of credibility and transparency in relations with Russian persons.

Tax climate

Noted below are a few facts about the tax climate in Russia:

- Russia continues to have relatively similar level of corporate taxation in comparison to Europe, wherein corporate income tax is 20%, the VAT rate is variably 10%, 15%, 25% or 18% (for different cases), and there is also a very low taxation of natural persons (13%).
- One of the fundamental features in the Russian budgetary system is the specialised tax on income from minerals and oil and gas production (23%–25% of tax budget revenues for 2017). Moreover, tax on the corporate profit of legal entities (19%–20% of tax budget revenues), VAT and income tax (18%–19% of tax budget revenues) are almost equally important in the breakdown of the budget.
- One of the features of the Russian tax administration is the fact that 80% of the tax total is collected by 10 tax authorities: six specialised tax authorities for the largest taxpayers, working with large business and specific branches of economy (communication, transport, banks, insurance companies); and four territorial internal revenue services (capital regions – Moscow and the Moscow region, St. Petersburg and Khanty-Mansi Autonomous District – the centre of mining).

Tax administration practice in 2017 did not develop ambiguously – the Russian tax authorities started checking businesses much less, which, in return, facilitated business within the country.

The number of field/site tax audits has been reduced by two thirds in the last five years. At the same time, the amount of underpayments revealed has statistically grown a lot. The average additional accrual of taxes to legal entities is 16.5m rubles ($265,000 or €230,000), while the amount is higher for businesses in the largest financial centre, Moscow, amounting to 42m rubles ($700,000/€600,000). Thus, the Russian tax authorities have consistently introduced "the focused risk approach", which is based on conducting tax audits in relation to taxpayers whose tax payments are suspiciously lower than those generally levied on similar activity.

At the same time, the level of loyalty of the courts has decreased because of the actions, appeal and decisions of the tax authorities. The number of rulings in favour of the taxpayer, which used to be nearly 70%, now has turned the opposite way – only 20% of decisions made by courts are in favour of the taxpayer. Therefore, the taxpayer to whom the tax has been additionally accrued has few chances to appeal the decision of the tax authority in court.

Thus, it can be noted that there is currently a preventive practice of taxpayers "self-checking", where the taxpayer himself is keen to ensure that his activity is not seen as risky from the point of view of the tax authorities. This practice has formed recently and in particular is rather new for Russia. Hence, the general principles of risk identification in the activity of taxpayers are applicable. Ultimately, this a positive tendency that allows the taxpayer to plan its activity more responsibly.

Developments affecting attractiveness of Russia for holding companies

Russia is similar to the European jurisdictions as far as tax burdens for businesses are concerned (with a 20% rate for corporate income tax). In general, foreign investors

usually use Russia as a jurisdiction for the creation of regional companies in the production and trade sectors; traditionally there is a lot of foreign capital in auto and mechanical manufacture. Additionally, production of the equipment used in industries such as telecoms, IT and agriculture is becoming popular. In recent years, the attractiveness of the tax system for foreign investments has been maintained by creating special tax clusters, which offer investors the opportunity to reduce taxation on condition of capital investment in a particular region. One of the most famous and popular regions is Moscow Skolkovo – a centre for innovative technologies in a wide range of activities (with a possible tax rate of 0%). Dubna is another region near Moscow for companies in the technical sphere (with a possible tax rate of 2%). Alabuga, Tatarstan is popular for production companies and manufacturers (with a possible tax rate of 2%). The enclave of Kaliningrad, which is almost in EU territory, is intended for medical and IT companies (with a possible tax rate of 0%).

Among the financial complexities when conducting global business is the Russian currency law. Russia strictly regulates cross-border operations "outside" of the banking system. Currency and banking regulation is becoming increasingly relevant in connection with external economic sanctions, which have exerted an impact on cross-border operations with Russian participation. Currently, currency restrictions are often a more crucial issue when planning transactions than corporate taxation.

Russian law strictly regulates monetary transfers from Russia to other countries; thus penalties can be up to 100% of the transaction, and in some cases there may be a criminal penalty. A few years ago, the administration of currency relations was transferred to the jurisdiction of the tax authorities, which is why the guidelines for such administration now include the control of such violations. According to statistics, in 2017, compared to 2016, in the international payments sphere offences grew by 50%, while total penalties increased by 16 times in the same period.

The following are the most relevant violations of foreign companies that are often neglected when planning cross-border relations, as they feature in Russian law with no equivalent in other countries, which causes difficulties when trying to make comparisons:

- Attempting to carry out non-monetary offsets for previously rendered services/ the delivered goods (in relation to foreign contractors, such offset is almost always forbidden).
- Unreasonable arrears in foreign trade contracts or credit contracts with foreign money which are not stipulated in the contract.
- Opening of accounts in a foreign bank by the Russian resident (including the Russian subsidiary of foreign group) without notifying the Russian tax authorities.

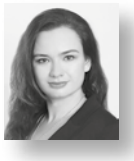
These points certainly make the activity of international holdings in Russia more difficult. Meanwhile, transactions to and out of Russia are not forbidden and remain in frequent practice. In 2017–2018, the Russian Government announced it would be making steps towards liberalising the currency law, and relevant laws were adopted. However, in practice, the measures had no basic positive influence on the relations between Russian companies and their foreign contractors/foreign parent companies.

The year ahead

Possible tax reform will be the most discussed question of 2018–19. The cornerstone measure for tax reform, discussed publicly in 2017, was the so-called "22/22 model", proposing a reduction in the amount of the mandatory fees for medical and pension insurance collected from salaries (from 30–32% to 22%), with an increase in the standard VAT rate from 18%

to 22%. The reasons for the measure are obvious: VAT is calculated on the whole turnover of the company, while contributions only on salaries. VAT is also administered much better than insurance fee contributions. At the same time, it is obvious that it can significantly complicate the position of businesses: the VAT rate of 21–22% is, frankly speaking, very high, and may also be an obstacle for free turnover of services. As another option, the Government is also discussing a smaller increase in VAT – only to 20% – but without a relevant reduction of other taxes and charges.

Unfortunately, this is very probable outcome. The Russian budget needs additional payments. The budget is currently insufficient and there are two options to solve this issue: gradually increase the collection of taxes; or increase the rate of taxes. The international automatic exchange of information (AEOI), the automated VAT system (the tax authorities automated the tracking of VAT payments for entire transaction chains) and active control of banks in the taxation of clients have been made a bid to increase the collection of tax. The question is what effect these measures will have and, even more importantly, how soon. If within the next year the collection of tax has not significantly increased, an increase in tax rates is very likely to happen.



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Head of the tax practice and Deputy Head of the International Tax Planning Department of Cliff Legal Services, Natalia Kordyukova has more than 10 years' experience in tax law.

Natalya's main practice expertise lies in the areas of international tax planning, tax risk assessment, currency regulation, banking and corporate law, currency control, CFC legislation, protection of trusts and funds, financing and capitalisation of business.

She has profound experience in advising large holding structures on tax planning issues, optimising risks, as well as building the structure of asset protection and structuring of M&A transactions.

Ms. Kordyukova has shown exceptional expertise and flexibility in the resolution of complex legal cases, both for Russian and international business. Among her clients are large international construction, petrochemical and power engineering companies, jewellery trading houses, as well as banks and cross-border investment companies.

Closed projects:

- Structuring Russian investments in more than 60 countries, including Switzerland, Cyprus, Liechtenstein, the USA, the BVI and Belize.
- Advising a leading development company on the creation of its own mutual investment fund with the financing of projects by a well-known Swiss bank.
- Restructuring a world-leading producer of chemical products in order to build trade relations with Russia, the European Union and the African region.
- Legal accompaniment of a unique cross-border project for the creation of innovative solar cells (Hong Kong, China and Russia).

In addition, Ms. Kordyukova has broad expertise in the areas of asset protection by using special structures (trusts, foundations) and in the structuring of private investments.

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Overview of corporate tax work over last year

The tax practice in WongPartnership LLP is one of the leading tax practices in Singapore. We collaborate with the firm's other practices to holistically provide advice to clients through the entire spectrum of tax-related issues, including tax planning and advice, corporate and international tax, stamp duties, goods and services tax and property tax. We also advise on tax issues arising in debt financing, restructuring, swaps, funds, securitisations and real estate deals. Quite often, these transactions involve novel structures and issues.

Over the past year, we were involved in various significant commercial deals, such as the issuance of US$500 million senior perpetual securities by Parkway Pantai, one of Asia's largest integrated private healthcare groups, as well as the inaugural issuance of women's Livelihood Bonds by Impact Investment Exchange, which is the first "social welfare" bond which can be traded like any other bonds. We have also been active in advising on the nascent area of initial coin offerings and the tax implications arising therefrom.

Key developments affecting corporate tax law and practice

AXY and others v. Comptroller of Income Tax [2018] SGCA 23

This is a May 2018 Singapore Court of Appeal decision which discusses the obligations of the Singapore Comptroller of Income Tax ("Comptroller") under Singapore's exchange of information ("EOI") regime in dealing with requests by foreign tax authorities for protected information from financial institutions. In the High Court, the applicants in *AXY* had applied to commence judicial review of the Comptroller's decision to issue notices to various banks seeking protected information after receiving such a request from a foreign tax authority. The High Court had to determine whether or not the applicants could establish an arguable case of reasonable suspicion that the Comptroller's decision was either illegal or irrational. The High Court Judge held that the applicants had not established an arguable case and dismissed the application to commence judicial review. The applicants then appealed to the Court of Appeal.

The Court of Appeal dismissed the appeal. More crucially, the Court of Appeal also held that in order for the EOI regime to run effectively, the Comptroller must be able to assume the correctness of the information laid before him by the foreign tax authority, and that it is not part of the Comptroller's function, when deciding to accede to an EOI request, to resolve contentious issues of foreign law or reach definitive conclusions as to whether the person of interest is or is not liable to tax in the Requesting State. To hold otherwise would not only render the EOI regime inoperable and impractical but also would run counter to its purpose, which is to facilitate the exchange of information as much as possible.

Transfer pricing

The Inland Revenue Authority of Singapore ("IRAS") endorses the arm's length principle as the standard to determine transfer prices between related parties. Under the arm's length principle, prices between related parties should be equivalent to prices that unrelated parties would have charged in similar circumstances. Methods which are used to determine the appropriate transfer price include the comparable uncontrolled price method, the resale price method, cost plus method, and transactional profit methods such as the transactional profit split method and the transactional net margin method. Taxpayers should prepare and keep contemporaneous transfer pricing documentation to show that their related party transactions are indeed conducted at arm's length. The purpose of preparing transfer pricing documentation is also to provide evidence to IRAS that taxpayers have conducted a thorough evaluation of their compliance with transfer pricing rules and can defend their transfer prices in the event of a transfer pricing audit by the tax authorities.

With effect from Year of Assessment 2019, it is mandatory for certain taxpayers to prepare transfer pricing documentation. Taxpayers who are not required to do so on a mandatory basis are still encouraged to do so to better manage their transfer pricing risks.

Taxpayers who are required under the law to prepare transfer pricing documentation are (a) taxpayers where the gross revenue derived from their trade or business is more than S$10 million for the basis period concerned, or (b) taxpayers where transfer pricing documentation was required to be prepared for the basis period immediately before the basis period concerned. Transfer pricing documentation would include documents providing an overview of the businesses of the group in which the taxpayer is a member and which is relevant to its business operations in Singapore, as well as details of the taxpayer's transactions with its related parties, including functional and transfer pricing analysis. While there is no requirement for taxpayers to submit the transfer pricing documentation when they file their tax returns, they are required to submit them within 30 days upon receipt of a request for such documentation by IRAS. Taxpayers are also required to retain such documentation for a period of at least five years. It should also be noted that if transfer pricing adjustments are made by IRAS following a transfer pricing review or audit, the adjustments are subject to a surcharge of 5%, regardless of whether there is tax payable on the adjustments.

There are notable transactions that are exempt from transfer pricing documentation. For example, taxpayers are exempt from preparing such documentation in the following scenarios:

(a) related party domestic transactions subject to the same tax rate;
(b) related party domestic loans;
(c) routine support services on which a 5% cost mark-up is applied; and
(d) related party transactions not exceeding certain prescribed threshold values.

Carbon tax

Singapore has joined more than 130 countries, including China, Japan and South Korea, in ratifying the Paris Agreement, re-affirming its commitment to address climate change and reduce emissions. With effect from 2019, a carbon tax will be imposed on large direct emitters of greenhouse gases such as power stations. These emitters will be charged S$5 per tonne of greenhouse gas emissions from 2019, and this tax rate will be reviewed by 2023. Such emitters are required under the Carbon Pricing Act to register themselves and prepare emissions reports. The policy objective behind the introduction of a carbon tax is to incentivise companies to improve energy and carbon efficiency. Affected emitters will pay

the carbon tax by buying and surrendering carbon credits corresponding to their greenhouse gas emissions. These carbon credits are bought from the National Environment Agency.

Taxation of virtual currency

The rise in the popularity and use of virtual currency as a medium of exchange is a recent evolution, and tax rules have not been specifically amended or revised to take into account their use and the manner in which virtual currency should be taxed. However, the IRAS has issued guidance on the use of virtual currency. According to the guidance provided by IRAS, businesses that accept virtual currencies as payment of goods and services should record the sale based on the market value of the goods or services; the same applies for businesses which pay for goods or services using virtual currencies. If the market value of such goods and services cannot be determined, the virtual currency exchange rate at the point of the transaction may be used. Tax deductions can also be allowed to businesses that use virtual currency as a medium of exchange.

Additionally, businesses that buy and sell virtual currencies in the ordinary course of business will be taxed on the profit derived from trading in virtual currency. Profits derived by businesses which mine and trade virtual currencies in exchange for money are also subject to tax. Businesses that buy virtual currencies for long-term investment purposes enjoying capital gains from the disposal of these virtual currencies will not be subject to tax as there is no capital gains tax in Singapore. Whether a business is buying virtual currencies in the ordinary course of business or for long-term investment purposes is a question of fact, and IRAS uses the "Badges of Trade" test to determine whether or not a trade exists. These "Badges of Trade" include:

(a) The length of ownership of the asset
The longer the asset is held, the more likely it is regarded as being held for long-term purposes and therefore not with a view to trade.
(b) The frequency of transactions
The higher the frequency of similar transactions, the more likely it is to be found that there is the existence of a trade.
(c) The motive
If the intention is to quickly dispose of the asset at the time of acquisition for a quick profit, it is more likely that there is a trade.
(d) Mode of financing
Significant and/or short-term financing are indicators that there is a trade and that the company does not have the financial ability to hold the asset for a long term.
(e) Nature of the asset being bought/sold
Assets such as immovable property would generally be regarded as being held for a long term, while other types of assets such as commodities would more likely be regarded as the subject of trading.

Adjustments to income tax exemptions applicable to corporates

Singapore has a start-up tax exemption scheme, pursuant to which qualifying start-up corporates can enjoy a 100% exemption on the first S$100,000 of normal chargeable income and a 50% exemption on the next S$200,000 of normal chargeable income. With effect from Year of Assessment 2020, this tax exemption will be adjusted to a 75% exemption on the first S$100,000 of normal chargeable income, and a 50% exemption on the next S$100,000 of normal chargeable income.

In addition, all companies and bodies of persons can qualify for partial tax exemption on 75% of the first S$10,000 of normal chargeable income and 50% of the next S$290,000 of normal chargeable income. With effect from Year of Assessment 2020, this will be adjusted

to 75% of the first S$10,000 of normal chargeable income and 50% of the next S$190,000 of normal chargeable income.

Introduction of a new tax framework for funds which are Singapore Variable Capital Companies ("S-VACCs")

The S-VACC is a new vehicle which is typically used for collective investment schemes and intended to accommodate a variety of traditional and alternative asset classes and investment strategies. Such vehicles are typically used by funds and the Monetary Authority of Singapore is studying the regulatory framework for S-VACCs to further develop and strengthen Singapore's position as a hub for fund management and fund domiciliation. A tax framework for S-VACCs will be introduced. Under this new framework, an S-VACC will be treated as a company and a single entity for tax purposes, and the tax exemptions under sections 13R and 13X of the Singapore Income Tax Act, which are typically utilised by funds structured as companies, trusts or limited partnerships, will also be extended to S-VACCs.

Rationalisation of withholding tax exemptions for the financial sector

Under Singaporean tax law, withholding tax is imposed on interest and certain other payments made by a tax resident or a Singapore permanent establishment. To promote Singapore as a financial hub, there is a range of withholding tax exemptions that apply to financial institutions for certain types of payments.

It was announced in the Singapore Budget Statement 2018 that the withholding tax exemptions for the following types of payments will be reviewed by 31 December 2022:

(a) payments made under cross-currency swap transactions made by Singapore swap counterparties to issuers of Singapore dollar debt securities;
(b) payments made under interest rate or currency swap transactions by financial institutions;
(c) payments made under interest rate or currency swap transactions by the Monetary Authority of Singapore;
(d) specified payments made under securities lending or repurchase agreements by specified institutions;
(e) interest on margin deposits paid by members of approved exchanges for transactions in futures; and
(f) interest on margin deposits paid by members of approved exchanges for spot foreign exchange transactions (other than those involving Singapore dollars).

The year ahead

The implementation of mandatory transfer pricing documentation is consistent with Singapore's approach in aligning its practices with international tax practices, such as those based on the OECD's Base Erosion and Profit Shifting ("BEPS") initiative. The imposition of a 5% surcharge where transfer pricing adjustments arise will certainly encourage taxpayers to take transfer pricing issues seriously and maintain detailed transfer pricing documentation. We would also expect more rules and regulations consistent with the BEPS initiative to be implemented in Singapore in due course.

The announcement by the Government to review the various withholding tax exemptions is not surprising, given the Government's policy in reviewing Singapore's numerous tax incentives from time-to-time, as some incentives become less relevant with changes in the economy (whether domestic or global) or objectives for implementing those incentives become less compelling or are met. As these incentives are reviewed and revised on a frequent basis, it would certainly be useful to keep abreast of announcements on the validity of these incentives before finalising any business structure.

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Spain

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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.

In our opinion, the most relevant developments of Corporate Income Tax in Spain, to be further analysed, 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 (Spanish real estate investment funds).
(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.

New participation exemption regime on dividends and capital gains

The new participation exemption regime was introduced in Spain with effect from 1 January 2015 and amended on 3 December 2016, 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.

Therefore, Spanish companies will be 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 abovementioned 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 abovementioned 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 Permanent Establishments – 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.

New 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 with another Spanish entity were allowed to form part of a tax unity in Spain.

This amendment has enabled multinationals 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 with 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 rate different than that of the parent company, etc.

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 when the SOCIMIs started to be attractive for foreign investors.

SOCIMIs (also known as Spanish 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 €5m, 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.

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.

With effect from 1 January 2015, 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 passed in 2015 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

On 3 December 2016, Spain passed an urgent Royal Decree to introduce an important number of measures directed at reducing the public deficit and adjusting imbalances in the Spanish economy.

Measures contained in the Royal Decree have been 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 operation losses and double taxation credits.

The main tax measures are summarised below:

- Limits on the use of tax loss carry forwards. New limits to offset operating losses have been established depending on the net revenue of the taxpayer. In that sense, for large companies with net revenues equal to or above €20m 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 beginning date of the taxable period, the company's net revenues are equal to or above €20m but below €60m; and (ii) up to 25%, wherein the same 12-month period the company's net revenues are equal or to above €60m.
  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 €20m 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.
- The change in control rules for entities with a net operating loss was modified. 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 as of 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 and other tax credits

Several tax credits have been abolished (including the environmental investment credit, the reinvestment credit and the profit investment credit) and will be replaced by a capitalisation reserve.

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.

The capitalisation reserve will allow 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) and must book a non-distributable reserve for the same amount. 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, with effect from 1 January 2015, Spain has created a new tax allowance consisting of a tax levelling reserve.

Thus, small and medium-sized companies (companies with a turnover in the previous tax year of below €10m) 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 €1m.

BEPS

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, applicable with effect from 1 January 2015. In this sense, the most important amendments to Spanish domestic legislation are the following:

- Tax planning disclosure. Spain has not passed any specific regulation with regards to disclosure of tax planning strategies. However, Spanish-based companies are progressively winding down tax planning structures through low-tax jurisdictions mainly because of the negative publicity.
- 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 EBITDA with the company.
- Permanent establishments (PEs). Spain has not passed or amended any current law in this regard. However, the Spanish tax authorities have been applying a more economic approach to the PE definition.

Within the BEPS environment, the Spanish Government introduced for Spanish corporations 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 permanent establishments 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 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.

Tax climate

In 2014, the Spanish economy started a period of continued growth, leaving behind numerous years of austerity. In 2017, Spain has continued consolidating the economic recovery, shown by approximately 3% of GDP growth. It means that, from 2014 to 2017, Spain has achieved a continued growth of approximately 3% per year, for an accumulated growth of 9.8% during the 2015–2017 period. After the Corporate Income Tax rate was decreased from 30% to 25% in 2015, the Tax Authorities have recently 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.

In 2017, Spain remained active at an international level, negotiating or renegotiating Double Tax Agreements with Belarus, Cape Verde, Romania and Ukraine.

During 2017, 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, the fraud of the digital economy and the tax elusion 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.

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 €20m. 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.

Finally, Royal Decree 2/2016, of 30 September, has introduced an amendment on the calculation of Corporate Income Tax instalments (or advanced payments) for companies with a turnover equal to or greater than €10m.

These advanced payments will be calculated in accordance with the profit and loss account of the company, which includes qualified dividends and capital gains. However, the company will be entitled to a refund of these payments when filing the Corporate Income Tax return.

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 2017, following the trend of the last few years.

In line with this, in 2016 the Spanish Supreme Court ruled against the local Tax Authorities which subjected the transfer of urban real estate to Land Value Increased Tax even when the transferor did not obtain a capital gain from the transfer. The Spanish Constitutional Court confirmed the position of the Supreme Court in May 2017.

Tourism and leisure. As per its weight in the Spanish GDP, tourism and leisure remains one of the main economic sectors in Spain. In this regard, several regions in Spain are applying a tax on stays in tourist establishments, which has increased every year since its implementation. In addition, the Tax Authorities launched a specific plan to widen control over the taxation of online housing platforms.

Automotive, pharmaceuticals, 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 production is growing every year in a very consistent manner, reaching, in 2017, the highest values ever recorded.

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 €5m, several multinational groups have decided to locate their R&D activities in Spain. The pharmaceuticals, life & science and engineering industries are also amongst the most benefitting sectors from the R&D incentives.

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Overview of corporate tax work over last year

Types of corporate tax work

M&A

Private equity activities with Swiss involvement reached a record high in 2017. In total, 395 transactions across all sectors and industries have been recorded, which is an increase of 9% compared to the previous year. However, the values of those transactions went down from USD 119.1 billion in 2016 to USD 101.5 billion in 2017. One key transaction was Johnson & Johnson's acquisition of the Swiss biopharmaceutical company Actelion with a value of almost USD 30 billion. This is in addition to the acquisition for USD 2.6 billion of General Electric Industrial Solutions by ABB, which belongs to the top 10 Swiss M&A transactions in 2017.[1] For the current year, it is assumed that the M&A activity will remain strong, partly as a result of the US tax reform.

Tax litigation

A stunning number of cases regarding international requests for administrative assistance have been judged by the Swiss Federal Supreme Court during 2017. Also, various decisions in connection with the refund of Swiss withholding taxes (WHT) in structured transactions have been published.

IPOs

During 2017, six companies (poenina holding ag, Landis+Gyr Group AG, Zur Rose Group AG, Idorsia Ltd., Galenica AG and Rapid Nutrition PLC) were listed on the Swiss stock exchange. With a placement volume of CHF 2,295m and an implied total market capitalisation of CHF 2,317m, Landis+Gyr Group AG, a leading global provider of integrated energy management solutions for the utility sector, was the largest among the six companies. It is expected that 2018 will also be an interesting IPO year with three IPOs in the first quarter already.

Significant deals and themes

M&A

The following deals stood out in 2017 and 2018, all requiring tailored corporate tax advice for the transaction itself, the integration or the debt financing:

- **Johnson & Johnson's $30bn acquisition of Actelion**: On 25 January 2017, Johnson & Johnson launched an all-cash tender offer in Switzerland to acquire all of the outstanding shares of Actelion (see previous edition).
- **HNA's $1.449bn acquisition of Dufry**: On 26 April 2017, Chinese conglomerate HNA Group completed the acquisition of a 16.2% stake in Swiss airport retailer Dufry. With

this transaction, HNA's total stake in the Swiss group rose to 20.9%, which means that the Chinese group became the largest stakeholder after this transaction.

- **CVC Capital Partners' $871m acquisition of Breitling**: On 28 April 2017, CVC Capital Partners Fund VI agreed to acquire a majority stake of 80% in Breitling, a leading, independent, family-owned manufacturer of Swiss luxury watches.
- **Nestlé's $0.5bn acquisition of Blue Bottle Coffee**: On 14 September 2017, the world's largest coffee producer Nestlé announced that it has acquired a majority stake (68%) in Blue Bottle Coffee, a high-end speciality coffee roaster and retailer based in Oakland, California. During 2017, Nestlé also acquired the Canada-based vitamins producer Atrium Innovations ($2.3bn), which shows the existing trend that the food and healthcare sectors are moving closer together.
- **ABB's $2.6bn acquisition of General Electric Industrial Solutions**: On 25 September 2017, ABB announced its acquisition of General Electric Industrial Solutions. With this acquisition, ABB intends to strengthen its number 2 position in electrification globally and to expand its access to the attractive North American market. ABB sees potential for annual cost benefits of $200m.
- **Novartis' $3.696bn acquisition of Advanced Accelerator Application (AAA)**: On 30 October 2017, Novartis announced that it had entered a memorandum of understanding with the radiopharmaceutical French company AAA, under which Novartis intends to commence a tender offer for 100% of the share capital of AAA. The tender offer was completed on 22 January 2018.
- **Bell Food Group's $443.8m acquisition of Hügli Holding**: On 15 January 2018, the Bell Food Group AG announced the launch of a takeover bid for all publicly listed bearer shares of Hügli Holding. Hügli is an internationally operating food manufacturing company producing soups, sauces, bouillons and convenience food. Bell is one of the leading meat processors and convenience food producers in Europe.

Reorganisations

- **Shared services transfer from UBS to UBS Business Solutions AG**: Through a series of transactions which were completed for the most part in early June 2017, UBS AG and other UBS group companies transferred group shared services functions, which are mainly based in Switzerland, the UK and the US, to UBS Business Solutions AG and other related service companies. UBS Business Solutions AG now operates as the group service company of UBS and is a wholly owned subsidiary of UBS Group AG. The implementation of UBS Business Solutions AG enables UBS to maintain operational continuity of critical services should a recovery or resolution occur. It represents an important step towards improved resolvability, and is in line with global guidance defined by the Financial Stability Board.

Financing

- On 30 June 2017, Banque Cantonale de Genève successfully completed the placement of CHF 90 million perpetual additional tier 1 subordinated bonds and CHF 110 million tier 2 subordinated bonds, due 2027. Both bonds have been provisionally admitted to trading at the SIX Swiss Exchange and are expected to be listed there as well.
- On 9 March 2018, Orior AG successfully placed 592,499 new shares by way of an accelerated bookbuilding in a private placement with institutional investors. The placed shares are sourced from the company's existing authorised share capital and the pre-emptive rights of the existing shareholders have been excluded.
- On 15 February 2018, Novartis Finance S.A. completed the placement of EUR 750,000,000 Guaranteed Notes due 2023, EUR 750,000,000 Guaranteed Notes due

2030 and EUR 750,000,000 Guaranteed Notes due 2038. The Notes are guaranteed by Novartis AG. They have been provisionally admitted to trading at the SIX Swiss Exchange and are expected to be listed there as well.

Key developments affecting corporate tax law and practice

Domestic legislation

Tax Proposal 17 (TP 17)

In light of international developments and upon pressure from the EU, in July 2014, Switzerland committed to abolishing its cantonal (holding, domicile and mixed companies) as well as federal tax regimes (finance branch and principal companies). Consequently, the Swiss government launched the Corporate Tax Reform (CTR III), which aims to modify the corporate taxation system and to substitute the abolished tax regimes by internationally accepted measures. On 5 June 2015, the Swiss Federal Council published its draft legislative proposal for further parliamentary discussion. On 12 February 2017, however, the CTR III was submitted to a referendum and rejected by a majority of 59.1%. Opponents of the rejected reform proposal were primarily concerned with the potential losses in cantonal tax revenues, and their criticism was broadly aimed at limiting the fiscal effects of the new measures.[2] As a consequence of the rejection, the current corporate tax laws remain in force. This, however, also means that the pressure from the OECD and EU for abolishing the tax-privileged regimes continues.

To avoid unilateral tax repercussions from the EU, the OECD or any other individual countries, the Swiss Federal Department of Finance stated on 2 March 2017 that it is forging ahead with work on a new corporate taxation proposal entitled Tax Proposal 17 (TP 17).[3] Since that time, the project for a new corporate tax reform has progressed considerably. During its meeting on 21 March 2018, the Federal Council adopted the dispatch on TP 17. Not surprisingly, the starting point for the reform is the abolition of the cantonal status companies and federal practice regarding finance branches and principal companies. TP 17 and the cantonal implementation plans shall ensure that Switzerland remains an attractive business location. For that reason, one aim of the new corporate tax reform is to introduce a mandatory patent box for all cantons and additional deductions for R&D expenditure on an optional basis. These measures will be accompanied by a relief restriction, which includes a binding provision for the cantons whereby at least 30% of companies' profits must remain taxable even if these measures are applied. In order to enable the cantons to lower their corporate income tax rates, their share in the federal income tax revenue will be increased. The proposal also foresees that Swiss resident individuals will be subject to a higher taxation of dividends from qualified participations at 70% by the Confederation and at least 70% in the cantons.[4] This measure shall help to finance the reform but also reflects that the taxation on the company level will be reduced upon the reform, mainly because many cantons will lower their corporate income tax rates. As expected, the new proposal is less far-reaching and tries to find a solution without triggering a referendum. In particular, the Notional Interest Deduction is currently not part of the Federal Council's proposal.

At best, the Swiss Parliament can adopt TP 17 in the autumn session 2018. If a referendum is not called, the first measures could come into force at the beginning of 2019 and most of them could come into force from 2020.[5]

Automatic Exchange of Information (AEOI)

On 1 January 2017, Swiss AEOI implementation legislation (the Administrative Assistance Convention, the Multilateral Competent Authority Agreement, the Federal Act on the

AEOI, the Ordinance on the International Automatic Exchange of Information in Tax Matters as well as the final version of the AEOI Guideline) entered into force. From this date, the AEOI was activated with 38 states and territories (including the agreement with the EU which applies for all 28 EU Member States). Since then, Swiss financial institutions subject to the reporting duty or persons/entities who are deemed a controlling person of a passive Non-Financial Entity (NFE) (e.g. trust, foundation or domiciliary company) in the form of beneficiary, settlor, protector or similar have been collecting account information concerning persons resident in these partner states for tax purposes. The collected data will be exchanged for the first time in autumn 2018. Parliament adopted the federal decrees concerning the introduction of the AEOI with further partner states from 2018/2019 in December 2017. This means that Swiss financial institutions have been collecting data with a further 40 partner states (including Hong Kong and Singapore) since 1 January 2018. This information will be exchanged for the first time in autumn 2019.[6] As more than 100 states have already committed to implementing AEOI, it is expected that Switzerland's list of partner states will further increase during the coming months.

The AEOI reporting does not require approval from the person who is subject to the reporting. Since tax transparency has reached a new level, it will be risky to try to avoid reporting under the AEOI (especially as such persons may be included in group requests as described in the last edition).[7] Persons who have not yet done so should therefore consider legalising these assets by filing a penalty-free voluntary disclosure. It has to be noted, however, that the key requirements for the exemption from penalty through a voluntary disclosure are (i) that the application is filed for the first time in Switzerland, (ii) it is deemed voluntary, as well as (iii) that the authorities have no knowledge of the undeclared assets. The FTA now presumes that a non-punishable voluntary disclosure will no longer be possible after September 2018, i.e. when the AEOI will be performed. As of this date, data of all tax subjects are automatically provided to the respective tax authorities in the respective countries. This implies that, as of this date, voluntary disclosure is no longer permitted. The FTA's opinion, however, is not undisputed in Switzerland.

Global Forum's recommendations

On 17 January 2018, the Federal Council launched the consultation on the recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes. The bill proposes the conversion of bearer shares into registered shares as well as a system of sanctions to be applied should shareholders not comply with their duty to report beneficial owners or if companies breach their obligation to keep a register of shareholders and beneficial owners. In addition, the bill contains provisions on the confidentiality of administrative assistance requests and the capacity to be a party during the administrative assistance proceedings. The consultation will last until 24 April 2018. The dispatch, which will be based on the results of the consultation procedure, will also regulate the handling of stolen data. The proposed text is due to be discussed by Parliament in winter 2018. The next peer review of Switzerland by the Global Forum will start in the second half of 2018.[8]

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. As of 29 January 2018, Switzerland has signed more than 90 double taxation agreements (DTAs), of which 58 contain a provision on the exchange of information according to international standards. Fifty-one of these 58 agreements are in force. In addition, Switzerland has signed 10 tax information exchange agreements, of which nine are in force.

Revised double tax treaties, which entered into force or whose dispatch was submitted to Parliament for approval during March 2017 to March 2018 include treaties with Ecuador, Belgium, Zambia, Pakistan, Latvia and Kosovo.

Partial revision of the Value Added Tax Act

As of 1 January 2018, a partial revision of the Value Added Tax Act came into force. Based on the new provisions, a company's global turnover will now be decisive for mandatory tax liability, and no longer just its turnover in Switzerland. Companies whose global turnover is at least CHF 100,000 are now liable to value-added tax (VAT). Previously, foreign companies could provide their services in Switzerland without VAT up to a turnover level of CHF 100,000.[9] The new provision intends to achieve an equal treatment for foreign and Swiss businesses. The Federal Council estimates that at least 20,000 foreign businesses will have to register for Swiss VAT for the first time during 2018.

In addition, amendments of the VAT rates have been determined. There is a standard tax rate of 7.7%, a special rate of 3.7% (for accommodation services) and a reduced rate of 2.5% (for food, books, newspapers, medicines and other everyday consumer goods).

Dividend withholding tax – changes to the notification procedure

In 2011, the Swiss Federal Supreme Court held that the 30-day filing deadline for the notification of the dividend withholding tax (instead of payment based on a reduction at source with respect to corporate shareholders) is a forfeiture and not a pure administrative deadline. Consequently, missing the deadline resulted in withholding tax payments of 35% (temporary cash out due to the refund possibility) and 5% p.a. late payment interest. In the 2016 fall session of the Swiss Parliament, the Council of States and the National Council reconciled their differences and agreed on an amendment to the Swiss Withholding Tax Ordinance in connection with the application of the dividend notification procedure. Under the revised Swiss Withholding Tax Ordinance, which came into force on 15 February 2017, the 30-day filing period constitutes a mere administrative deadline and, thus, the dividend notification procedure is applicable even if the 30-day filing period has been missed as long as the substantive requirements for the notification procedure are met. Thus, late filing of forms does not result in withholding tax payment and late interest consequences, but can be sanctioned by means of an administrative fine of up to CHF 5,000. According to these rules, late interest can also be reclaimed for past cases, provided they are not time-barred or finally assessed before 1 January 2011. On 18 August 2017, the Swiss Federal Supreme Court published seven cases in which the new legal rules have been applied and confirmed the repayment claim of the taxpayer for the late interest.

Amended rules for the refund of Swiss WHT

Based on Swiss domestic law, a Swiss resident taxpayer may only request the full refund of withholding taxes if the declaration duties have been fulfilled. According to circular letter no 40, published by the FTA on 11 March 2014, a negligent failure of the declaration duties leads to the rejection of the refund claim.

In a dispatch to the Swiss Parliament, the Federal Council proposed amended rules for the refund of Swiss withholding taxes on 28 March 2018. According to the Federal Council, the Federal Act on Withholding Tax is to be amended in such a way that a declaration which has been negligently omitted in the tax return shall not generally lead to a forfeiture of the refund claim. Therefore, the taxpayer shall be entitled to subsequently declare the relevant income until the appeal period of the tax assessment ends. The purpose of the bill is to limit a double burden of withholding and income tax to cases where there is an attempted

tax evasion. With the bill, the Federal Council wants to respond to the criticism on the reimbursement practice based on circular letter no 40.[10]

Domestic case law

BGer 2C_69/2017: Capital contribution principle

Based on Swiss domestic law, the repayment of (qualifying) capital contributions is generally exempt from Swiss income tax for Swiss resident individuals holding the shares as private assets and exempt from Swiss withholding tax. Only capital contributions by the direct shareholder which have been made after 31 December 1996 qualify for the above tax exemption. With respect to capital contributions into Swiss entities, such contributions are assessed and confirmed by the Swiss Federal Tax Administration (FTA) and strict *forma* rules apply, e.g. the booking into a separate account in the statutory balance sheet (so-called capital contribution reserves or "*Reserven aus Kapitaleinlagen*") and the notification of all changes to the tax authorities. In the present case, from 17 July 2017 the Swiss Federal Supreme Court had to assess distributions made by a German company to its Swiss shareholder with respect to the income tax exemption. First it decided that, in general, the capital contribution principle is also applicable to foreign companies. However, the application of the capital contribution principle must be proved by the Swiss taxpayer. In the present case, the distributions were made from a tax-specific capital contribution account (so-called "*steuerliches Einlagekonto*"). The court held that, since the German tax-specific capital contribution account as well as the Swiss capital contributions reserves account pursue different objectives, both accounts are not comparable to each other. From a Swiss law perspective, the capital contributions principle is only applicable if the contributions, premiums and subsidies are openly declared in the balance sheet. In contrast to the German law, the repayment of hidden capital contributions are not exempt from taxation. As a result, the payments were qualified as taxable dividends.

BGer 2C_1168/2016: Qualification of accruals

Based on Swiss tax law, provisions shall be released and added to taxable income to the extent that such provisions are no longer justified. In this recent decision (1 March 2017), the Federal Supreme Court decided that there is no right to retain a provision even if the tax authorities did not undertake any profit adjustments during the previous years. In particular, there is no breach of the principle of trust when the tax authority proceeds to examine whether the provisions are still justified. This applies even if the tax authority decided to forego any profit adjustments, although the possibility of such a procedure already existed at that time.

In case 2C_1082/2014, dated 29 September 2016, the Swiss Federal Supreme Court already decided that the tax authorities' task in the assessment procedure is limited to adding back value adjustments to the taxable profit, in case the respective value adjustment is either qualified as contrary to Swiss commercial law or not commercially justified. The tax authorities, however, are not obliged to review whether a commercially justified value adjustment is final or provisional at the time of the assessment (as this question has no influence on the tax factors of the respective assessment). The Swiss Federal Supreme Court stated that the determination of whether a value adjustment has final or provisional character (qualification as depreciation or provision from a tax point of view) can only be made in the tax period, in which the qualification impacts the taxable factors.

BGE 142 II 283: Tax neutral restructuring and the requirement of the existence of a business or part of a business

The present case concerns the restructuring of a partnership into a legal entity. Based on domestic law, a transfer of a business or part of a business to a legal entity is tax neutral,

insofar as the tax liability in Switzerland continues, the transfer happens at tax book value and the shares are not sold at a price above the transferred taxable equity within five years following the restructuring. The term "business" is characterised by a high degree of independence and represents an organisation which can independently exist. According to the court, no self-employed activity can be regarded as a business in that sense, since the term "self-employment" has a broader meaning than the term "business". Moreover, it is justified that the requirements for a tax neutral restructuring of a partnership into a legal entity should be interpreted strictly because such transactions are regularly accompanied by the transfer of business assets (membership in the partnership) into private assets (shares in the legal entity). This is important because gains from the sale of private assets are not taxable (in contrast to the gains from sale of business assets).

The court came to the conclusion that the management of real estate fulfils only under exceptional circumstances the requirements of a business. For the case at hand it stated that the general partnership did not own a large number of properties. The management activity was limited to administrative functions without further services. Therefore, the requirement of a business or part of a business for a tax neutral restructuring was not met.

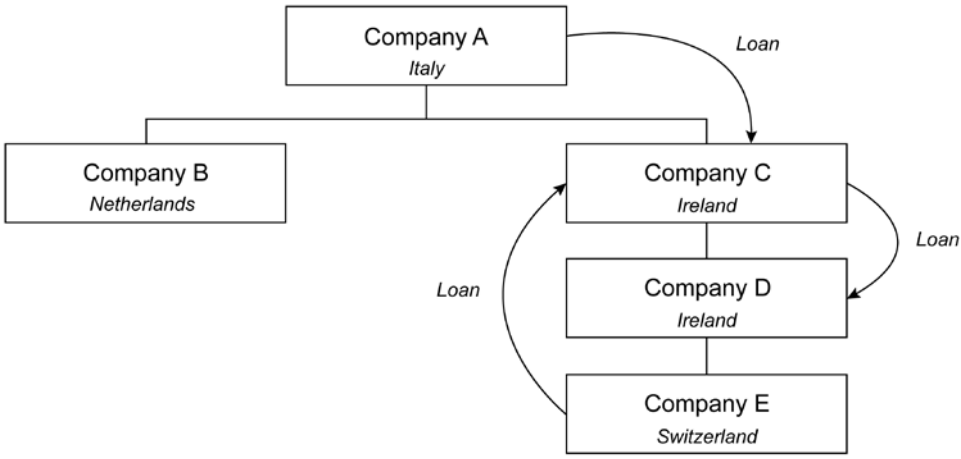
BGE 143 II 185: Exchange of information in the area of transfer pricing

This case from 13 February 2017 concerned a change made by a multinational group to its transfer pricing policy, notably an alleged transfer of functions and risks into Switzerland. Following this restructuring process, French tax authorities sent a request for information to the FTA on the basis of the information exchange procedure foreseen in the applicable double tax treaty. The French tax authorities were asking for various documents to assess the transfer prices between Swiss and French group entities. The requested information referred, *inter alia*, to the nature of the activities, substance in Switzerland, tax charge and tax status including the tax rulings of the Swiss taxpayer. The taxpayer argued that the information requested was not foreseeably relevant, as a transfer pricing study had already been provided to the French tax authorities. Despite the objections of the taxpayer, the Swiss Supreme Court considered the majority of the information to be (i) foreseeably relevant, (ii) well founded and in line with the principle of good faith, as well as (iii) not constituting a fishing expedition. The court discussed the criteria of "foreseeable relevance" in detail, referring to the OECD Model Tax Convention and its commentaries. It ruled that "foreseeably relevant" requires presence of a reasonable possibility that the requested information is relevant at the time of the request.

The decision follows the trend with regard to increasing transparency both at international and national levels.

A-7299/2016: Beneficial ownership (subject to appeal to the Federal Supreme Court)

On 28 February 2018, the Federal Administrative Court denied for withholding tax purposes the beneficial ownership of a parent company based in Ireland which received dividends from its Swiss subsidiary. The Irish company (hereinafter referred to as company D) is the sole shareholder of the Swiss subsidiary (hereinafter referred to as company E). The shares have been acquired from the sister company (hereinafter referred to as company B) and the purchase price was financed by a loan granted by the grandparent company also based in Ireland (hereinafter referred to as company C). For its part, the grandparent company was largely financed by loans granted by its parent company based in Italy (hereinafter referred to as company A). The structure can be depicted as follows:



In 2007, a dividend distribution from company E to company D was decided and (after the notification procedure was rejected[11]) 35% withholding tax was paid by company E and company D applied for the refund of the withholding taxes based on the (then applicable) Interest Savings Agreement with the EU.

According to the Federal Administrative Court, the beneficial owner of a dividend is the person who is entitled to dispose of the dividend. Thus, the recipient of a dividend must have the right to use it without being restricted by any legal or contractual obligations. Ownership structures within a group may lead to a factual obligation to pass the income. In such a case, the right to use may be denied, where there is evidence that the (indirect) shareholders have the sole power to decide on the use of the income without taking the interest of the controlled company (direct shareholder) into account. However, not every obligation to pass the income leads to the denial of the right to use. The denial of the beneficial ownership provides that there is a close connection or interdependency between the income and the obligation to pass it on.

For the present case, the Federal Administrative Court took into account that, at the time the dividend distribution was decided, company C and company D had an identical board of directors. Therefore, company D was *de facto* under the control of company C. The court adopted an economic perspective and argued that, because of the existence of the loan agreements between the group companies, the shares in company E had not been acquired by company D but rather by company C. The position of company C as lender was reinforced by the fact that it was the legal owner of the borrower. Based on this, the Federal Administrative Court qualified company D as a dependent intermediate company only and denied the beneficial ownership and thus, the refund of the withholding taxes. Not part of the decision was the question whether, e.g. company C as the beneficial owner would be entitled to a full (or partial) withholding tax refund.

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 new bill of the TP 17 will implement appropriate measures to replace favourable cantonal and federal tax regimes.

Action	Topic	Method of Implementation in Switzerland
5	Requiring substantial activity for preferential regimes.	A patent box, if implemented in the TP 17, 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 double tax treaties 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 double tax treaties are in line with the OECD minimum standard (see below).
15	Multilateral instrument.	Switzerland signed the BEPS convention and announced the adjustment of its double tax treaties according to 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 (see also above). The regulations on the spontaneous exchange of tax rulings are included in the revised 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 have been granted after 1 January 2010 and are still in force at 1 January 2018, i.e. the time when the actual exchange of tax rulings will start in Switzerland. In line with BEPS Action 5, only a summary, but not the whole ruling, will be spontaneously exchanged. The spontaneous exchange is *per se* not restricted to rulings; any information which might be of importance for the other state can be subject to a spontaneous exchange of information. However, for the latter the Ordinance does not yet contain specific cases as the practice still needs to be developed in congruence with international standards and practice applied by other countries. As regards the procedural rights, the person concerned by the spontaneous exchange of information will be informed about the intended exchange in advance, except in cases where the purposes of the administrative assistance would be defeated and the success of the investigation would be endangered by a prior notification. The persons concerned have participation rights and rights to appeal, similar to other cases of exchange of information. The new transparency should not change the Swiss ruling practice *per se,* except that in cases subject to exchange, the tax authorities now request that the template for the exchange is completed and submitted in addition to 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. According to the State Secretariat for International Finance (SIF), the SIF, the FTA and the cantons are working together to ensure the uniform implementation of spontaneous administrative assistance throughout Switzerland.[12] During the course of 2017, the cantonal and federal tax authorities examined which existing tax rulings fall under the spontaneous exchange of information and contacted the taxpayer in order to verify whether the tax ruling shall be applicable after the end of December 2017, and if so, request that the BEPS template is completed electronically and forwarded to the FTA.

According to the OECD's annual review report relating to compliance with the minimum standards on Action 5, Switzerland has undertaken administrative and organisational preparations to be ready to exchange information pursuant to the new legal framework. Therefore, no recommendations on the implementation of the transparency framework have been made in the report.[13]

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). Therefore, MNEs in Switzerland are obliged to start drawing up a country-by-country report from fiscal year 2018 onwards. Switzerland will thus exchange country-by-country reports with 52 partner states from 2020 (status as at 21 December 2017).[14] Non-compliance with the country-by-country reporting obligation may be subject to a penalty of up to CHF 100,000. In case of non-cooperation with the FTA, additional penalties up to CHF 10,000 could be due during an examination process. The CbCR obligations already applied in many OECD states for fiscal year 2016 with the first filing obligations per end of 2017. Due to the implementation of the ALBA Act in December 2017, Swiss multinationals had the possibility to file these CbCRs via the parent surrogate filing procedure in Switzerland with the FTA.

BEPS Action No. 14: Making Dispute Resolution Mechanism More Effective

On 26 September 2017, the OECD released Switzerland's peer review report on the implementation of the BEPS Action 14 minimum standard. The report concludes that Switzerland meets most of the elements of the Action 14 minimum standard; more specifically, the prevention of disputes by allowing taxpayers to request bilateral Advance Pricing Agreement (APAs), granting access to the mutual agreement procedure (MAP) in all eligible cases, and using a pragmatic approach to resolve MAP cases in an efficient manner with sufficient resources for an effective MAP function. The peer review report shows that Switzerland has an extensive treaty network, with all treaties including a provision relating to MAP.[15]

BEPS Action No. 15: Developing a Multilateral Instrument (MLI) to Modify Tax Treaties

Switzerland has played an active role in the development of the MLI. Therefore, when the first signing ceremony took place on 7 June 2017 in Paris, Switzerland was one of the 68 states and territories which signed the BEPS convention. At the time of signing, Switzerland initially announced the adjustment of the double tax treaties with Argentina, Austria, Chile, the Czech Republic, India, Iceland, Italy, Liechtenstein, Lithuania, Luxembourg, Poland, Portugal, South Africa and Turkey. These states are prepared to agree with Switzerland on the precise wording of the double tax agreements to be adapted via the BEPS convention, which is a formal requirement from the Swiss legal perspective.

Switzerland has decided on the following adoptions:

- Adoption of the new preamble on treaty abuse.
- Adoption of the mandatory provisions related to treaty abuse.
- Opting in for the mandatory and binding arbitration clause.

- Opting out of all other options.
- Adoption of the Principal Purpose Test (PPT) and not the simplified limitation of benefits clause.[16]

On 20 December 2017, the Federal Council initiated the consultation on the MLI agreement. Since the BEPS minimum standards can also be agreed through bilateral amendments to double tax treaties, the consultation proposal also covers, in addition to the MLI, respective changes to the double tax treaty between Switzerland and the UK. The consultation process lasted until 9 April 2018.[17] The proposal has to be approved by the Federal Assembly and is subject to an optional referendum.

Tax climate in Switzerland

Increasing tax transparency

Increasing tax transparency, which especially results from the implementation of the automatic exchange of information, has led to a flood of non-punishable voluntary disclosures during the last few months. 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.

TP 17

Despite the rejection of CTR III by the Swiss voting population, the reform of the current corporate tax system remains an important and urgent issue for both taxpayers and tax authorities. Switzerland is under increasing pressure from the EU as well as the OECD to change its "harmful" tax practices. Instead of only abolishing these regimes, the reforms aim to find solutions to maintain the fiscal attractiveness of Switzerland 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 would be abolished with the TP 17, at the earliest from 2020. The attractive participation deduction provisions for dividends and capital gains will remain unchanged. Switzerland currently has no plan to introduce CFC rules and generally remains a beneficial holding location.

Industry sector focus

Technology industry

Switzerland sees enormous innovative potential in blockchain technology. On 18 January 2018, the SIF announced that it has established a blockchain/initial coin offering (ICO) working group, which will review the legal framework and identify any need for action with

the involvement of the Federal Office of Justice, the Swiss Financial Market Supervisory Authority (FINMA) and in close consultation with the sector. The aim of this work is to increase legal certainty, maintain the integrity of the financial centre and ensure technology-neutral regulation. This clarification of the regulatory framework should help to ensure that Switzerland remains an attractive location in this area. The working group will report to the Federal Council by the end of 2018.[18]

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

The reform of the corporate tax regime, especially the TP 17, will continue to be at the centre of attention during the year ahead. The challenge for Switzerland will be to bring its tax regime into conformity with the international standards and still offer an attractive tax environment. The political consensus for a balanced proposal will be essential.

Furthermore, Switzerland actively took a position on the issue of taxation of the digital economy. According to a press release, Switzerland takes the view that the digital economy should be appropriately taxed. The existing taxation rules and possible new options should be discussed. To guarantee legal certainty, avoid over- and double taxation and combat the high administrative burden, especially in the case of start-ups and smaller companies, short-term measures should not be introduced.[19] It remains to be seen which concrete long-term measures will be proposed and implemented.

* * *

Endnotes

1. *See* KPMG, Clarity on Mergers & Acquisitions, The growing appetite of Swiss dealmakers, January 2018, https://home.kpmg.com/ch/en/home/insights/2018/01/clarity-on-mergers-and-acquisitions.html (last visited on 15 April 2018).
2. *See* Susanne Schreiber / Cyrill Diefenbacher, tax bill rejected, in: *IFLR International Briefings*, March 2017; http://www.baerkarrer.ch/publications/BK_Briefing_Corporate_Tax_Reform_III_rejected_by_referendum.pdf (last visited on 11 April 2018).
3. *See* https://www.efd.admin.ch/efd/en/home/dokumentation/nsb-news_list.msg-id-65885.html (last visited on 11 April 2018).
4. *See* https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-70181.html (last visited on 11 April 2018).
5. *See* https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-70181.html (last visited on 11 April 2018).
6. *See* http://de.baerkarrer.ch/publications/BK_Briefing_Automatic_Exchange_of_Information.pdf (last visited on 11 April 2018).
7. *See* Susanne Schreiber / Corinna Seiler, *Global Legal Insights – Corporate Tax 2017, 5th ed.,* p. 171 *et seqq*.
8. *See* https://www.efd.admin.ch/efd/en/home/dokumentation/nsb-news_list.msg-id-69518.html (last visited on 11 April 2018).
9. *See* https://www.efd.admin.ch/efd/en/home/dokumentation/nsb-news_list.msg-id-66940.html (last visited on 11 April 2018).

10. *See* https://www.admin.ch/gov/de/start/dokumentation/medienmitteilungen.msg-id-70256.html (last visited on 11 April 2018).
11. Decision of the Swiss Federal Supreme Court 2C_756/2010 from 19 January 2011.
12. *See* https://www.sif.admin.ch/sif/en/home/themen/informationsaustausch/spontane-amtshilfe.html (last visited on 11 April 2018).
13. *See OECD/G20 Base Erosion and Profit Shifting Project, Harmful Tax Practices – Peer Review Reports on the Exchange of Information on Tax Rulings*, p. 273 *et seqq*.
14. *See* https://www.sif.admin.ch/sif/en/home/themen/informationsaustausch/automatischer-informationsaustausch/cbcr.html (last visited on 11 April 2018).
15. *See OECD/G20 Base Erosion and Profit Shifting Project, Making Dispute Resolution More Effective – MAP Peer Review Report, Switzerland (Stage 1)*, p. 9 *et seqq.* and 53 *et seqq*.
16. *See* https://www.sif.admin.ch/sif/en/home/dokumentation/medienmitteilungen/medienmitteilungen.msg-id-66981.html (last visited on 11 April 2018).
17. *See* https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-69304.html (last visited on 11 April 2018).
18. *See* https://www.efd.admin.ch/efd/en/home/dokumentation/nsb-news_list.msg-id-69539.html (last visited on 11 April 2018).
19. *See* https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-70165.html (last visited on 11 April 2018).

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Overview of corporate tax work over last year

Significant deals and themes

The following statistics are accurate as of September 2017.

M&A

The value of outward M&A activity increased to £76.6bn in 2017 compared to £17.3bn in 2016. This is in contrast to a significant fall in the value of inward M&A from £190bn in 2016 to £35.3bn in 2017.

The number of outward M&A deals increased in 2017, but it was the value of such deals that led to an increase in outward M&A. The average value per deal increased from £122.6m per deal in 2016 to £510.7m in 2017.

The average deal value in 2017 was primarily as a result of two high-value transactions; namely, the acquisition of (a) Mead Johnson Inc. by Reckitt Benckiser, and (b) Reynolds American Inc. by British American Tobacco. These deals accounted for over 75% of the total value of outward M&A activity.

The significant fall in the value of inward M&A in 2017 follows the high level reached in 2016, which was dominated by a small number of very high-value transactions (each above £10bn). There were no inward M&A transactions worth over £10bn in 2017. The value of domestic M&A fell from £24.7bn in 2016 to £18.6bn in 2017.[1]

Looking forward, the direction of UK M&A has shifted in the past six months. UK deals have refocused on Europe with Ireland (4) and the Netherlands (5) replacing the US and India in the top five target destinations, alongside France (2) and Germany (3). This is in contrast to 2017, where approximately 93% of the value of UK companies' outward acquisitions was in the Americas.[2]

Financing

In 2017, there were 78 IPOs in the UK (across the Main Market and AIM), with total proceeds of US$14.8bn, representing 4.6% of global IPOs and 7.7% of global IPO proceeds.[3] The two largest IPOs in 2017 were Allied Irish Bank Plc's listing in Q2 2017 at €12bn[4] and EN+ Group Plc's listing in Q4 2017 at US$8bn.[5]

The most active sectors for IPO activity in the UK for Q1 2018 were technology, energy and financials. The UK exchanges saw eight IPOs raising US$1.2bn in Q1 2018, a decline of 38% by IPOs and an increase of 6% by proceeds over Q1 2017. Europe had a significantly higher number of IPOs in Q1 2018 (39) and IPO proceeds (US$14.7bn) in comparison to the UK.

Real estate transactions

Real estate transactions were particularly active throughout 2017 in the UK, raising £5,477m via 42 deals, of which 10 were IPOs raising £1,715m.[6]

UK investment volume in 2017 was approximately £65.4bn and this represents a 26% increase in the 2016 total. The office and industrial sectors led the way to meet investors' appetite for UK commercial real estate.

Nearly half of the total UK investment volume in 2017 was accounted for by overseas investors and a fifth of all investment was Far East, by origin.[7]

Transfer pricing and Diverted Profits Tax (DPT)

HMRC continued the trend of launching transfer pricing investigations in 2017. Two hundred and fifty investigations commenced in the 12 months to 31 March 2017. This represented a 31% drop in investigations launched in 2015/2016, but the amount of tax under dispute rose from £3.8bn to £5.8bn.[8]

HMRC approximated that the annual amount of additional actual tax secured from transfer pricing challenges doubled from £853m in 2015/2016 to £1,618m in 2016/17.[9]

In addition, the Diverted Profits Tax yield figures published by HMRC have increased significantly from 2015/2016 (£31m) to 2016/2017 (£281m). HMRC stated that the figures of DPT yield 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*". Interestingly, HMRC state that they have noted 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.[10]

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

The below section on UK tax law developments reflects a summary of the key developments in 2017, but it is not a comprehensive or detailed discussion of all tax measures in the past year.

Corporate criminal offenses

The UK Criminal Finances Act 2017 (the CFA) became law on 27 April 2017. Part 3 of the CFA, which creates two new corporate criminal offences, came into force on 30 September 2017. The two new offences are:

- *Section 45* – failure of a relevant body to prevent facilitation of UK tax evasion (the UK Offence); and
- *Section 46* – failure of a relevant body to prevent facilitation of foreign tax evasion (the Foreign Offence).

The Corporate Criminal Offences (CCOs) are similar in design to the "corporate" failure to prevent bribery offence under section 7 of the Bribery Act 2010. A key similarity is that the only available defence is to have in place reasonable prevention procedures designed to prevent the facilitation. The CCOs represent a very significant development in corporate criminal law in the UK and are aimed at companies that fail to prevent the criminal facilitation of tax evasion by a person "associated" with the company.

The main elements of the CCOs are:

- *Stage 1* (tax evasion): a taxpayer (either an individual or company) criminally evades tax under existing law. This must be deliberate, but there does not need to be a conviction.

- *Stage 2* (facilitation): an "associated person" of the relevant body criminally facilitates this tax evasion by the taxpayer when acting in that capacity. This also must be deliberate.
- *Stage 3* (failure to prevent facilitation): strict liability of the relevant body failing to prevent the associated person from committing the criminal facilitation.

In order to commit either of the CCOs, there must be an underlying tax evasion offence committed by a taxpayer (*Stage 1*), and the associated person of the "relevant body" must have facilitated that evasion (*Stage 2*). A relevant body commits one of the CCOs where a person associated with it, acting in that capacity, criminally facilitates an act of fraudulent tax evasion by another person, and that relevant body does not have reasonable prevention procedures in place (*Stage 3*).

As the offence is one of strict liability, once the base offences (Stage 1 and Stage 2) are made out, the only defence is one of having reasonable prevention procedures in place. This defence is made out where a relevant body shows that, at the time the tax evasion facilitation offence was committed, it had in place such "prevention procedures" as it was reasonable in all the circumstances to expect it to have in place.

HMRC published guidance on 1 September 2017 on the CFA, which covers amongst other things the six guiding principles that should inform the prevention procedures put in place by corporate persons.

These include:
(i) Risk assessment.
(ii) Proportionality of risk-based prevention procedures.
(iii) Top-level commitment.
(iv) Due diligence.
(v) Communication (including training).
(vi) Monitoring and review.

These principles will be useful in the preparation of an outline of an organisation's formal anti-tax evasion policies.

If a corporation is found guilty of either of the CCOs, it faces unlimited financial penalties. Companies should be aware that failure to put in place prevention procedures leading to tax evasion, particularly when coupled with a failure to report such failings to the authorities, may result in prosecution.

Employment taxes

The Finance (No. 2) Act 2017 enacted changes to the taxation of termination payments, which will apply where an employment terminates on or after 6 April 2018. Further changes will be made by the Finance Bill 2018 and by a new NICs (national insurance contributions) Bill to be published later in 2018.

On 6 April 2017, the government introduced a new tax regime for workers who supply their services to the public sector through personal service companies (PSCs). The new regime provides that the public sector entity must determine the employment status of a worker who provides his/her services through PSCs and, if there is deemed employment, must account for tax and NICs on the payments that such worker makes to the PSC. The government intends to consult on extending this tax regime to the private sector.

The Taylor Review of Modern Working Practices was published in July 2017. It did not deal directly with the tax issues, but a consultation on the reform of employment status of workers and the employment/self-employment divide is expected in 2018.

Taxation of investment in UK real estate

In the 2017 Autumn Budget, the government announced its intention to extend capital gains tax (CGT) to non-resident investors in UK real estate. The UK traditionally had not taxed international investors on capital gains derived from investment in UK land and buildings. As such, the UK has long been a favoured destination for international real estate investors who have, year after year, consistently invested billions of dollars, euros, and pounds into both commercial and residential schemes.

Rental income has always been taxed and, since 2013, the UK has imposed taxation on international investors on gains derived from some residential UK property.

The new proposals mean that tax will now be charged on gains made by international investors on disposals of all types of UK land and buildings – residential and commercial and owned either directly or indirectly. The proposed changes extend the existing rules that apply to residential property and are due to come into effect from April 2019.

The proposed rules are intended to apply to direct disposals of UK immovable property, as well as to indirect disposals – i.e., the sale of interests in entities whose value is derived from UK land and buildings. Disposals of significant interests in entities that own (directly or indirectly) interests in UK real estate will also be brought within the scope of UK tax if: (a) the entity being disposed is "property rich" (i.e., 75% or more of entity's gross asset value is derived from UK immovable property); and (b) the non-resident must hold a 25% or greater interest in the entity or has held 25% or more at some point in the five years ending on the date of disposal.

The rules will apply to disposals from April 2019. Non-residential property already owned as at April 2019 will be re-based to its April 2019 value (i.e. the charge to tax will only be in respect of any increase in value post-April 2019). The re-basing point for residential property will remain at April 2015 as such disposals are already within the scope of UK tax. Different re-basing points will be used on mixed-use properties with an appropriate allocation of the gain between both elements.

Anti-forestalling measures will be introduced with effect from 22 November 2017 (being the day on which the announcement was made), to prevent circumvention of the tax through "treaty shopping".

The Finance (No 2) Act 2017 introduced changes to the substantial shareholder exemption (SSE) to extend the exemption to qualifying institutional investors. SSE will apply to disposals of property-rich companies (or groups) by such investors, and remains subject to a consultation with stakeholders at the time of writing.

Extension of corporation tax to non-resident landlords

In March 2017, the UK government consulted and set out proposals to bring non-resident corporate landlords into the charge to corporation tax (CT) in respect of their UK property income and gains (previously chargeable to income tax and CGT).

At the Autumn Budget 2017, the UK government announced that it will make this change in April 2020. The reform is expected to bring more parity in treatment for UK and non-resident companies, but further consultation will be required regarding implementing the new regime.

Corporate interest restriction

The corporate interest restriction was introduced in the Finance Act (FA) (No. 2) 2017.

The aim of the 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 account of how much the group borrows from third parties.

Following the BEPS project and domestic consultation, the UK corporate interest restriction (CIR) rules were introduced for periods of account commencing on or after 1 April 2017 with straddling periods divided around this date.

The Corporate Interest Restriction (Consequential Amendments) Regulations, SI 2017/1227, aim to prevent the new corporate interest restriction rules having unintended consequences for collective investment vehicles and securitisation companies. The generally applicable tax policy for such vehicles is to move the point of taxation on the funds' income to investors and to tax investors in a broadly similar manner as would apply if they held the underlying investments directly, instead of through the investment vehicle. Absent specific rules, the operation of the CIR could operate so as to restrict the amount of deemed interest expense taken into account for taxation purposes for collective investment vehicles.

The regulations came into force on 29 December 2017 and have effect for accounting periods beginning on or after 1 April 2017.

Corporate loss relief reform

The changes announced in 2016 relating to the rules governing corporate losses were enacted in Finance (No. 2) Act 2017 (Sch 4) and had effect for accounting periods beginning on or after 1 April 2017.

The loss relief reform has two aspects. Firstly, it provides more flexibility in how losses arising on or after 1 April 2017 can be relieved when they are carried forward; and secondly, it limits the amounts against which all carried-forward losses (whenever they arise) can be relieved to 50% of profits, subject to an annual allowance. In addition, anti-avoidance rules have been enacted to counteract arrangements designed to obtain more relief than intended by the new legislation.

The new rules are beneficial to groups who will not be affected by the 50% restriction but some larger groups will be adversely affected as the rules will restrict the amount of losses they can carry forward and result in a real cost to the group. In addition, the new rules add complexity to the loss relief legislation as pre-April 2017 losses will be governed by the old regime, and as such two systems will be operated simultaneously until pre-2017 losses have been utilised.

Taxation of the digital economy: UK consultation documents

The UK government published two consultation papers in November 2017 and March 2018 on the taxation of the digital economy, which concluded that the preferred way to tax current and emerging digital business models is to reflect the value of user participation.

The UK consultation papers are to be read in the context of an international framework. The OECD recently published its interim report on the Tax Challenges arising from Digitalisation (March 2018) and set out possible approaches for international tax reform. However, no consensus has been reached internationally regarding the taxation of digital businesses and several jurisdictions, such as the UK, are proposing national measures.

The proposed UK measures focus on the participation and engagement of users as an important aspect of value creation for digital business models. The March 2018 consultation paper considered how user value could be measured and allocated in a multinational corporation and essentially proposes to attribute value in supply chains to the market in which products are sold or services are provided.

The UK proposed measures also include extending withholding tax on royalties with effect from April 2019 to payments made within licensing chains that derive their value from UK sales.

The OECD is working towards a consensus-based solution to the taxation of digital businesses by 2020. However, the UK government has stated that it will act unilaterally if sufficient progress is not made internationally.

Royalties withholding tax

On 1 December 2017, the UK government published a consultation setting out the circumstances in which it considers that the payment of royalties will have a liability to income withholding tax.

The government will introduce legislation in Finance Bill 2018–19 that broadens the circumstances in which certain payments made to non-UK residents have a liability to income tax. These measures will mean that payments for the exploitation of certain property or rights in the UK that are made to connected parties in low- or no-tax jurisdictions will be subject to tax. The consultation document states that the measures are targeted at intra-group arrangements that achieve artificially low effective rates of taxation and adds that digital businesses will be predominately affected. These changes will take effect in April 2019.

The proposed legislation builds on changes introduced in Finance Act 2016 to ensure that all royalties arising in the UK will be subject to the deduction of income tax at source unless the UK has explicitly given up its taxing rights under a double tax agreement (DTA).

The purpose of the proposed legislation is to extend the withholding tax regime to situations where the royalties may not obviously have a UK source, and as such the concept of "UK source" is being expanded. This has the effect of widening the UK tax net as where there is a UK source, the payer of a royalty payment will be obligated to withhold tax.

The impact of the proposals remains to be seen, but it is worth noting that the consultation document makes clear that the withholding tax liability will only arise if the royalty payment is made to a jurisdiction with which the UK (a) does not have a DTA, or (b) has a DTA that does not contain a non-discrimination article. As most DTAs have such articles, the proposed legislation may have a restricted impact.

Intangibles consultation

The UK government underwent a consultation in early 2018 on the corporate intangible fixed assets (IFA) regime. The scope of the consultation was to review the IFA regime and to consider potential reforms.

The UK government is keen to reform the fragmented IFA regime by ensuring alignment between tax and accounting treatment of IFAs and goodwill, and making the regime more competitive internationally. The specific areas the UK government sought views on included: (a) the impact of the commencement rule (pre-FA 2002 rule); (b) the impact of the restriction on goodwill and customer-related intangibles on the complexity and competitiveness of the regime; (c) the use and competitiveness of the election for a 4% per annum fixed rate of relief; and (d) the impact of the regime's de-grouping rules on mergers and acquisitions.

The IFA regime was introduced in April 2002 and part of its complexity emanates from the fact that it does not apply to assets in existence pre-April 2002. This inconsistency causes unnecessary convolution and means that the regime is uncompetitive internationally.

Gains arising from assets that existed prior to 1 April 2002 (pre-FA 2002 intangibles) are subject to tax on capital gains (unless they have been acquired from an unrelated party since

that date). The primary contention with the inconsistency of treatment is that similar assets are treated in a different way without any apparent commercial justification.

The consultation seeks to understand the types of assets that are affected by the pre-FA 2002 rule and importantly, what the potential impact would be of bringing pre-FA 2002 intangibles within the IFA regime. There would be a number of transitional issues, such as how to value pre-FA 2002 intangibles and how to ensure that companies would still be able to benefit from capital losses in the event of a disposal.

The consultation also sought opinion from stakeholders on the restrictions introduced in the Finance Act 2015, whereby relief was denied for "relevant assets", which included goodwill. As a result of the changes, instead of giving a deduction for expenditure on relevant assets when the cost is recognised for accounting purposes as amortisation or impairment losses, the IFA regime only gives a deduction at the time of disposal. This is considered as out of line with current international practice.

The de-grouping rules are also being considered in the context of the IFA regime. The Finance Act 2011 provided that a capital gains de-grouping charge is generally exempt from tax in cases where the Substantial Shareholding Exemption applies to the disposal of the asset-owning company. However, this does not apply to assets within the IFA regime. The consultation is considering whether post-IFA intangibles should receive the same treatment as other kinds of assets (including pre-FA 2002 intangibles).

In summary, there are many areas for potential reform, and a simplification process is undoubtedly required. However, the impact of these changes for businesses would need to be carefully considered (particularly those with pre-FA 2002 intangibles) and the cost implications for the UK government will be high.

Domestic case law in 2017

HMRC have been increasingly aggressive in investigating taxpayers for non-payment of taxes and this has resulted in a continuing trend in the adjudication of tax avoidance cases in 2017. The below cases are a sample of anti-avoidance cases and show the courts taking action where the tax practices are technically legal but the court disagreed with the principle behind such practices (*RFC v Advocate General*). Furthermore, the relationship between seeking judicial review and the tax appeal mechanism available in the tax tribunal process was highlighted in *Glencore* and the *Aozora* case emphasised the requirement of clarity regarding the circumstances in which taxpayers can rely on the interpretation of legislation contained in HMRC manuals.

- *RFC 2012 Plc (formerly The Rangers Football Club Plc) v Advocate General for Scotland [2017] UKSC 45*

  The Supreme Court ruled on a tax-avoidance scheme by which employers paid remuneration to their employees through an employees' remuneration trust in the hope that the scheme would avoid liability to income tax and Class 1 national insurance contributions. The principal question was whether an employee's remuneration is taxable as earnings when it is paid to a third party in circumstances in which the employee had no prior entitlement to receive it himself or herself.

  After examination of the relevant employment legislation, the court stated that there is nothing in the wider purpose of the legislation, which taxes remuneration from employment, which excludes from the tax charge or the PAYE regime remuneration, which the employee is entitled to have paid to a third party.

  The Supreme Court was clear that the elements of the transaction were all genuine and had legal effect. However, the judgment represented a change in practice of taxing

remuneration paid from third parties. This is the general rule, but the court noted a few constraints; namely (i) the taxation of perquisites, (ii) where the employer uses the money to give a benefit in kind, which is not earnings or emoluments, and (iii) an arrangement by which the employer's payment does not give the intended recipient an immediate vested beneficial interest but only a contingent interest.

- *The Queen on the application of Glencore Energy UK Ltd v HMRC [2017] EWCA Civ 1716*
  In this case, HMRC made an assessment that the appellant was liable to pay diverted profit tax in relation to profits arising from its oil-trading business, which HMRC maintained had been diverted to its parent company in Switzerland, Glencore International AG, so as to constitute "taxable diverted profits" within the meaning of the relevant legislation. One of the principal issues in this case was the relationship between the judicial review in the High Court and the tax appeal system involving the First-Tier Tribunal. The High Court had refused Glencore's application for judicial review on the ground that it had suitable alternative remedies. The court noted that judicial review is a remedy of last resort and that to allow it to intrude alongside the appeal regime risked disrupting "*the smooth operation of statutory procedures which may be adequate to meet the justice of the case*". Furthermore, the Court of Appeal's analysis of whether the effective tax mismatch outcome condition had been met did not strictly follow the relevant legislation. This brings into focus that there is a risk of legislation by HMRC guidance and practice because of the lack of judicial precedence and the complexity of the diverted profits tax legislation.
- *The Queen on the application of Aozora GMAC Investment v HMRC [2017] EWHC 2881*
  The principal issue that arose in this case was whether the relevant HMRC manual gave rise to a legitimate expectation on the part of a taxpayer to rely on the contents of such manual as an interpretation of the relevant legislation. Aozora UK was the wholly owned subsidiary of a Japanese company, Aozora Japan. Aozora UK owned a subsidiary in the USA, Aozora US. Aozora UK had made loans to Aozora US, and received interest payments. The US had imposed a 30% withholding tax on the interest received and Aozora UK was liable to corporation tax in the UK on interest. It was denied relief under the relevant legislation.
  Aozora UK argued that HMRC's international manual contained a representation by HMRC that gave rise to a legitimate expectation that it would be taxed in accordance with the manual, whether or not the terms of the manual were accurate.
  The court observed that in order for such a representation by HMRC to give rise to legitimate expectation, the taxpayer must demonstrate that the representation is "*clear, unambiguous and devoid of relevant qualification*".
  The court stated that a statement of the law, or an interpretation of the law, contained in a particular guidance, can in principle constitute a relevant representation, but it must be examined on a case-by-case basis. The court concluded that the relevant HMRC guidance was a representation that may give rise to legitimate expectation. However, the court examined whether the taxpayer relied on the relevant representation and concluded that Aozora Japan's tax adviser relied on their own analysis and Aozora UK were unable to demonstrate that it had suffered substantial detriment by means of "putative reliance" on the relevant representation.

<u>European – EU law developments</u>

Brexit update

The UK and the EU have started drafting the withdrawal agreement reflecting the

commitments agreed on 8 December 2017 in their joint report on progress in the first phase of Article 50 negotiations.

2018 will see the continuation of negotiations on withdrawal issues, including those not yet addressed in the first phase of negotiations. The aim is for the UK and the EU to conclude Article 50 negotiations by October 2018 in order to allow time for the Council of the European Union, the European Parliament and the UK to approve the agreement by 29 March 2019.

The Common Consolidated Corporate Tax Base

The European Parliament, on 15 March 2018, consented to the proposed Common Consolidated Corporate Tax Base (CCCTB) Council Directive and Common Corporate Tax Base (CCTB) Council Directive with suggested amendments.

The two Council Directives aim to establish a common base for the taxation in the EU of certain companies and lay down rules for the calculation of that base, including rules on measures to prevent tax avoidance and on measures relating to the international dimension of the proposed tax system. The proposals concern only the corporate tax base and are not intended to harmonise national corporate tax rates.

The proposal is that a common tax base would only be mandatory for companies with a total consolidated group revenue of €750m and above. The aim is to reduce this threshold to zero over a period of seven years.

Calculation of a common tax base will be based on four factors, namely (i) sales, (ii) assets, (iii) labour, and (iv) personal data collection and its exploitation for commercial purposes. The fourth factor has recently been introduced and its purpose is to ensure that the CCCTB also applies to digital activities.

The Council Directives will have to be unanimously approved by the EU Council.

UK Statement of Practice on Mutual Agreement Procedure

The Statement of Practice describing the UK's practice in relation to methods for reducing or preventing double taxation was published on 20 February 2018. It sets out the mutual agreement procedure (MAP) process and use of the MAP under the relevant UK DTAs. The legal framework for the MAP in the UK is governed by the Taxation of International and Other Provisions Act 2010 (TIOPA 2010).

Following the OECD's BEPS Action 14 Report (Making Dispute Resolution more Effective), the UK has made efforts to strengthen the efficiency and effectiveness of the dispute resolution process and minimise incidences of unintended double taxation.

The UK has committed to implementing the minimum standard proposed in respect of (i) preventing disputes, (ii) availability and access to MAP, (iii) resolution of MAP cases, and (iv) implementation of MAP agreements.

The multilateral instrument

On 7 June 2017, 68 countries (including the UK) signed the multilateral instrument (MLI). The MLI, a product of the BEPS project, Action 15, is the mechanism by which modifications are made to the network of existing DTAs to which its signatories are party to give effect to the recommendations under various other actions of the BEPS project.

On 28 March 2018, the UK issued a draft order (The Double Taxation Relief (Base Erosion and Profit Shifting) Order 2018) to implement the MLI into UK domestic law.

The UK has indicated it will:

- largely apply the provisions on hybrid mismatches;

- apply the minimum standard provisions on treaty abuse, and thus adopt the principal purpose test in full;
- not adopt the PE recommendations except for the anti-fragmentation rules; and
- apply the arbitration provisions with the "baseball arbitration" option. The UK has stated that it will also apply arbitration with countries that have opted for "reasoned opinion" arbitration.

BEPS update

In 2017, the UK continued its implementation of the BEPS measures. Most significantly, the UK signed the MLI (discussed above), which will enable parties to implement recommendations contained in the relevant BEPS actions to double tax treaties. HMRC will make available consolidated texts of its double tax treaties and explain how the MLI will affect each one in accordance with the positions taken by the UK and the other jurisdiction.

The implementation status of key BEPS measures in 2017 is considered below:

- *Action 1: Addressing the Tax Challenges of the Digital Economy*
  - Withholding tax on royalty payments made in connection with UK sales to low-or no-tax jurisdictions to be introduced from April 2019.
  - Consultation papers on taxation of digital economy published by the UK government on November 2017 and March 2018.
- *Action 2: Hybrid mismatch arrangements*
  The new UK rules are now in force and apply to payments made on or after 1 January 2017. The UK rules closely follow the OECD's recommendations.
- *Action 4: Deductibility of corporate interest expense*
  The restriction on tax deductibility of corporate interest expense consistent with OECD recommendations was introduced on 1 April 2017.
- *Action 5: Countering harmful tax practices*
  The UK introduced a reformed patent box regime, effective 1 July 2016, compliant with OECD recommendations.
- *Action 13: Transfer pricing documentation and country-by-country reporting*
  The UK has implemented the BEPS Action 13 proposals on country-by-country reporting and the rules came into force on 1 January 2016. The UK is party to the automatic exchange of country-by-country reports, and as of June 2017, has activated 39 exchange relationships.

Digital economy

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.

The report highlights three prevalent features of highly digitalised businesses:

- cross-jurisdictional scale without mass – the ability to have a significant economic presence in a country without a major physical presence;
- reliance on movable intangible assets; and
- new business models based on data, user participation, network effects and user-generated content.

The main contention is whether and to what extent customer data and user-generated content contributes to value creation. The report does not reach any conclusions because there is a divergence of opinion amongst the 113 inclusive framework members as to whether digital businesses require a separate tax regime.

The report considered the implementation and impact of the package of BEPS measures released in October 2015 with a focus on those BEPS Actions that are most relevant to digitalisation (in particular, Action 7: artificial avoidance of permanent establishment status and Actions 8–10: transfer pricing). It was noted that as the implementation of the BEPS measures is still in its early stages, data on the impact of the measures remains limited. The final OECD report on taxing the digital economy is expected by 2020. This will allow time for a deeper analysis on the impact of the BEPS measures and perhaps more unity amongst the member states on the best approach for long-term reform.

Whilst the OECD was considering the challenges of taxing the digital economy, the European Parliament's Committee for Economic and Monetary Affairs voted in favour of the concept that a permanent establishment (PE) could be based on a company having a digital platform for a commercial purpose active in a jurisdiction. On 21 March 2018, the European Commission published draft Directives, which proposed the introduction of an interim revenue tax and, in the longer term, a new Directive on digital PEs. As with the OECD report, Member States are not unanimously in favour of the proposals, and if the usual procedure is followed, any decision to introduce the proposals into European law must be made unanimously.

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. Brexit aside, the UK government has refocused on aggressive tax collection. This is evident from the increase in DPT investigations and the changes in the tax code to widen the UK tax net; for example, the changes to real estate taxes. Furthermore, it is clear that the UK government is not resting on its laurels to act on global tax issues. The position papers published on the digital economy indicate a willingness to legislate on an international tax matter if consensus is not reached on how to tax revenue from *in situ* and emerging digital businesses.

In addition, there is a trend of legislation by guidance. The courts have opined on what constitutes reliance on representations in HMRC manuals as summarised in the *Aozora* case above. The difficulty is that even though a taxpayer can have a legitimate expectation on representations made by HMRC, it is not clear as to when a taxpayer can rely on such representation. This is particularly risky in new areas of tax where there is not a wealth of judicial precedence such as DPT, and, perhaps in the future, digital business tax.

Developments affecting attractiveness of the UK for holding companies

Despite the uncertainty around Brexit, the UK government continues to state that the UK is "open for business", and has proposed or implemented a number of positive changes in 2017, including: (i) the enactment of the Corporate Interest Restriction (Consequential Amendments) Regulations, the aim of which is to prevent the new corporate interest restriction rules having unintended consequences for collective investment vehicles and securitisation companies; (ii) implementation of legislation to relax the conditions to be satisfied in order for UK companies to achieve an exemption from tax on chargeable gains accruing as a result of the disposal of a substantial shareholding; (iii) introducing increased

flexibility in the use of carried-forward losses; and (iv) the signing of the MLI, which will allow implementation of the BEPS recommendations in double tax treaties.

Industry sector focus

Overseas property investors

As stated above, in the 2017 Autumn Budget, the government announced its intention to extend capital gains tax (CGT) to non-resident investors in UK real estate. This may have a negative impact on international real estate investors going forward, but the real estate market is still showing signs of growth primarily as a result of overseas investors.

Finance

The banking sector has been targeted to raise revenue ever since the financial crisis. The bank levy is currently imposed on large banks' balance sheets. The UK government confirmed that it would re-scope the bank levy from 2021, and technical changes were introduced in the Finance Act 2018. However, the UK may be less and less attractive for large banks given the application of the bank levy, and this may be intensified with the uncertainty of Brexit. The Bank Corporation Tax surcharge of 8% still applies to the profits of banking companies.

Funds

The Finance Act 2018 included a measure to remove transitional rules that are no longer required for the effective taxation of amounts of carried interest that are charged to capital gains tax under the carried interest rules, which took effect on 8 July 2015. The UK asset management and investment fund sector has had to contend with a number of legislative changes to the taxation of funds in recent years, and it remains to be seen whether these changes will have a negative impact on fund investment activity in the UK.

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. A technical consultation on draft legislation to introduce a TTH for oil and gas companies was announced in the Spring Statement 2018. The UK government hopes that these measures will encourage new investment in UK oil and gas fields, but it is worth noting that they are unlikely to assist in a situation where the seller does not have sufficient tax history to transfer to a buyer.

The year ahead

Brexit negotiations are ongoing, but the actual impact on industry still remains unclear. There are many challenging areas, but the potential loss of derivative benefits in treaties between third countries when the UK is no longer part of the EU will be of concern for international trade. Closer to home, it is worth noting the proposals for the temporary customs arrangement between Northern Ireland and the Irish Republic. The need of such a proposal highlights that the period prior to Brexit may be marked by proposals to limit the unintended consequences of an unprecedented and uncertain era.

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Introduction

The United States is currently in the middle of the most hyper-partisan political atmosphere in generations. Bipartisan solutions to problems have become nearly impossible, as each side refuses to agree to a solution that might place the other side in a positive light. Against that background, Congress enacted a comprehensive tax reform package less than two weeks before the end of 2017. This tax reform legislation has become the single biggest item of focus in the U.S. tax practitioner world.

Public Law No. 115-97 (the "Act") was signed into law by President Donald Trump on December 22, 2017. The Act was signed just 51 days after it was introduced by the House of Representatives on November 2, 2017. Unsurprisingly, the Act is entirely partisan, having received support only from Republican members of Congress. As a measure of just how partisan the Act is, the Act, which was originally named the "Tax Cuts and Jobs Act" (and still is popularly referred to as such), was forced to abandon that short title due entirely to partisan politics.

As described in more detail below, the Act adds, eliminates, or modifies various sections of the Internal Revenue Code of 1986, as amended (the "Code"). The Act represents the most substantial and far-reaching revisions to the Code since 1986. However, unlike the 1986 revisions, which were generally done in a deliberative manner to bring to fruition overriding theories of tax policy, the Act was a rushed piece of legislation affecting a hodge-podge of different Code sections with little overriding theory. In certain cases, the revisions seem to represent contradictory policy decisions.

Both sides of the political divide continue to argue about the effect that tax reform will have on the U.S. economy. The effect of the tax reform legislation on the federal budget deficit is also a matter of dispute. The non-partisan Joint Committee on Taxation estimates that the Act will increase the gross domestic product, resulting in significantly increased tax revenues despite the reduction in tax rates. Others, however, are sceptical that reality will match this prediction, arguing that without significant reductions in expenditures, a reduction in tax rates will simply result in an increase in the federal deficit.

While the complex interaction of many of the changes makes it difficult to determine the exact effect of the tax reform legislation on any specific taxpayer, it generally appears that most taxpayers will see a reduction in tax liability. Interestingly, one class of taxpayers that will likely see an increase in tax liability is upper-middle class and high-net-worth individuals living in states with high state income tax rates (*e.g.*, New York, Massachusetts, New Jersey, and California). This is due to a new $10,000 cap on deductions for individual state income tax payments.

Domestic tax reform

Numerous corporate and business provisions of the Code have been created or amended by the Act. Some of these provisions relate specifically to lowering tax rates and, in certain cases, targeting such lowered tax rates to specific types of structures and industries. Other provisions are a somewhat random assortment of amendments to various Code sections, creating some winners and some losers, often appearing to be due to nothing more than who had the loudest voice at the table.

Reforms relating to tax rates and business structure

The provisions that likely may have the largest effect on the domestic business atmosphere in the United States are those affecting the corporate and individual tax rates on business income.

Tax rates and AMT

Perhaps the most significant changes made by the Act were reductions in the tax rates. The corporate tax rate, which previously had been among the highest in the world at 35%, was permanently reduced to 21%.[1] In addition, the corporate alternative minimum tax (the "AMT"), which had long been criticised as complicated and unnecessary, has been repealed.[2]

For individuals (including individuals who operate businesses through a partnership, limited liability company, or subchapter S corporation), the reduction in tax rates was more modest, with the highest marginal tax rate reduced to 37% (from the previous highest marginal tax rate of 39.6%).[3] The brackets of income for which each level of tax rate is imposed was also increased, allowing for more income to be taxed at lower rates.[4]

Prior to the passing of the Act, it had been hoped that the individual AMT would be repealed entirely. The individual AMT was originally passed in 1969 to ensure that wealthy taxpayers wouldn't be able to avoid paying income taxes through creative use of deductions.[5] However, in the subsequent years, most of those strategies were eliminated. At the same time, more and more middle class taxpayers became subject to the labyrinthine AMT rules.

Unfortunately, the Act did not repeal the individual AMT entirely. However, it did significantly increase the amounts of income exempt from the AMT and, because such amounts have been indexed to inflation, it is hoped that these changes to the individual AMT will prevent the snare of the AMT creeping onto middle class taxpayers.[6]

Unlike the changes to the corporate tax rates and AMT, which are permanent, the reductions to the individual tax rates and changes to the individual AMT are scheduled to expire starting in 2026.[7] Many commentators have noted that this was a particularly shrewd move by the Republican legislators responsible for passing the Act.[8] Because the Act had no support from the Democrats and only a slim majority in the Senate, it had to be passed using a special parliamentary process that is limited by a rule that prevents legislation from being passed if it would significantly increase the federal deficit beyond the 10-year budget window. The only way that Congress could comply with the rule was by making some of the provisions expire before the end of that 10-year budget window. Republicans chose the individual tax provisions to be those that sunset, based on an assumption that even if the Democrats control Congress at the time such provisions are scheduled to expire, they will pass legislation at such time to allow them to continue rather than face the political backlash of allowing such lower tax rates to expire.[9]

Pass-Through Deduction

While individual tax rates weren't reduced as much as corporate tax rates, individuals are able to benefit from a new deduction (the "Pass-Through Deduction") for "qualified business income" recognised from a partnership, S Corporation, or sole proprietorship.[10] This deduction is generally equal to 20% of such taxpayer's qualified business income,[11] effectively reducing the highest tax rate on such income to 29.6%. However, the amount of the deduction is generally limited to the greater of (i) 50% of the compensation paid by the business to employees, or (ii) the sum of 25% of compensation paid to employees plus 2.5% of unadjusted taxable basis of the tangible depreciable property held by the business and used in the production of qualified business income.[12] A "qualified business" generally means an active trade or business carried on by the taxpayer through a sole proprietorship or pass-through entity, but does not include specified service trades or businesses in certain fields such as health, law, accounting, and other services where the principal asset of the trade or business is the reputation or skill of one or more of its employees or owners.[13]

Taxpayers with taxable income below a certain threshold are not subject to either the limitations based on employment compensation and depreciable tangible property or the prohibition on specified services.[14] In addition, dividends received from a real estate investment trust (a "REIT") are generally eligible for the 20% deduction without being subject to the limitations based on employment compensation and depreciable tangible property.[15]

While this new deduction has been well-received by the business and tax practitioner communities, many questions remain relating to this new deduction, including:

- How active does the business need to be in order to be eligible for the deduction? Is a single triple-net lease real estate property sufficient? What about a portfolio of several such properties?
- How does one determine the deduction when a single entity has more than one trade or business? Are the limitations applied to each trade or business separately? What if one trade or business is a specified service business – are the other trades or business tainted by the specified service business? What if a taxpayer engages in a single trade or business through several entities?
- How does one determine whether the reputation or skill of one or more of the employees or owners is the primary asset? Does the greatest bicycle repairman in the neighbourhood lose the deduction because he or she is not merely mediocre?

In order to prevent abuse of this new deduction, the Act provided for a reduced threshold for imposing penalties for improperly claiming the deduction.[16] Therefore, without sufficiently clear answers to these (and many other) questions, many taxpayers will likely be nervous to claim the deduction in cases where there is any doubt regarding their eligibility. Practitioners are therefore hoping to get some clarity regarding these questions sooner rather than later.

Like the other individual tax reform provisions, the Pass-Through Deduction is also scheduled to expire for tax years starting in January 1, 2026.[17]

Effect of tax reform on choice of entity and structuring decisions

The new tax rates and Pass-Through Deductions have provided taxpayers with new structuring opportunities, and are causing many taxpayers to revisit their current structures. For instance, many taxpayers that had previously been structured as either partnerships or S corporations are now considering whether the substantial reduction in corporate tax rates makes it more profitable to be structured as a C corporation. Particularly for a business that (1) is not eligible for the Pass-Through Deduction, and (2) typically retains earnings rather

than distributing them, the 21% corporate tax rate (plus a second level of individual tax at some distant time in the future) may be more attractive than a 37% individual rate on such income currently.

The intricacies of the Pass-Through Deduction also create many other structuring opportunities. Many real estate companies (especially companies with large portfolios of mortgages) are organising, or reorganising, to be structured as REITs in order to ensure that distributions they pay will be eligible for the full 20% deduction without being subject to the limitations based on employment compensation and tangible depreciable properties. Companies with several distinct trades or businesses are considering whether to separate them to avoid tainting a qualified business with a non-qualified one, while others are considering combining entities in order to have sufficient employment compensation or tangible depreciable property associated with a qualified business. Some are also considering reclassifying senior management employees as partners, in order to allow them to receive the benefit of the Pass-Through Deduction.

While taxpayers are analysing whether any such restructuring makes sense, many are hesitant to make significant changes, especially changes that would be hard to undo without triggering tax. One of the primary concerns is the risk that, if the Democrats win a majority of Congress and the presidency in 2020, they may pass legislation to take away many of these tax benefits.

Other domestic tax reform provisions

In addition to the provisions discussed above, the Act also included many other significant changes that affect the way businesses operate.

Business interest deduction

Under a new limitation added by the Act, taxpayers with average annual gross receipts in excess of $25 million, including corporate taxpayers, are subject to a new limitation on the deductibility of business interest.[18] The new limitation is generally equal to 30% of adjustable taxable income.[19] The new limitation generally does not apply to small businesses with average annual gross receipts that do not exceed $25,000,000.[20] This new limitation will likely have a significant effect on how businesses finance their operations, as the benefits to businesses of debt financing as compared to equity financing are now reduced.

This new limitation has an important exception for real estate businesses. An "electing real property trade or business" may make an election to avoid the 30% limitation.[21] An "electing real property trade or business" is any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business that makes the election to avoid the 30% limitation.[22] However, the trade-off for making the election is that the electing real property trade or business is not eligible for the new bonus depreciation provisions (discussed below).

As with the Pass-Through Deduction, there are still numerous outstanding questions regarding the details of this limitation, including how to determine whether a taxpayer is in a real property trade or business in the case of partnerships and multiple tiers of entities. It is anticipated that regulatory guidance will be issued by the end of 2018.

Like-kind exchanges

Under prior law, businesses and investors could dispose of business use or investment property without recognising gain if such property was exchanged for other "like-kind"

property. Such "like-kind exchanges" under Code section 1031 could be achieved either through a simultaneous exchange, or in a structured transaction that was concluded within six months. Many businesses used this non-recognition provision in order to upgrade older machinery and other property without triggering taxable gain.

Under the Act, such like-kind exchanges are generally no longer eligible for non-recognition treatment. However, in another giveaway to the real estate industry, like-kind exchanges of real property still qualify for non-recognition treatment.[23]

Bonus Depreciation

Under prior law, a taxpayer was allowed, subject to certain phase-down rules, to take an additional 50% depreciation deduction for certain "qualified property" ("Bonus Depreciation") in the year that the qualified property was placed in service.[24]

Under the Act, the Bonus Depreciation rate has been increased to 100% for qualified property that is placed in service after September 27, 2017 and before January 1, 2023.[25] The percentage is phased down to 80% for qualified property that is placed in service during 2023, 60% for qualified property that is placed in service during 2024, 40% for qualified property that is placed in service during 2025, and 20% for qualified property that is placed in service during 2026.[26] The Act also changed the definition of qualified property to permit taxpayers to take Bonus Depreciation on qualified property that is not new as long as the taxpayer has not itself used that property (*i.e.*, the property has been used by other taxpayers, but not this taxpayer).[27] The increase in the Bonus Depreciation rate will almost certainly spur investment in new and used qualified property in the United States.

As mentioned above, real property trades or businesses that elect out of the new business interest deduction limitation will not be able to take advantage of the Bonus Deprecation rate increase.

Excess business loss limitation

Under the Act, "excess business losses" of a taxpayer other than a corporation are not allowed for the taxable year.[28] An excess business loss for the taxable year is the excess of aggregate deductions of the taxpayer attributable to trades or businesses of the taxpayer over the sum of aggregate gross income or gain of the taxpayer plus a threshold amount.[29] The threshold amount for 2018 is $500,000 for married filers who file a joint return, and $250,000 for other filers.[30] The threshold amount is indexed for inflation.[31] In the case of a partnership or S corporation, the provision applies at the partner or shareholder level.[32] All disallowed losses are carried forward and treated as part of the taxpayer's net operating loss ("NOL") carryforward in subsequent taxable years.[33]

Miscellaneous domestic tax reform items

The Act also contained the following new provisions:

- The rule providing for a "technical termination" of a partnership upon the transfer of 50% or more of the partnership interests over a 12-month period has been eliminated.[34] While the consequences of such a technical termination used to be substantial, changes instituted over a decade ago vastly reduced the significance of such a technical termination, though there were still compliance requirements. By eliminating the rule entirely, the Act removes this trap for the unwary.
- Recipients of profits interests (so-called "carried interest") in certain service-based partnerships are now subject to a three-year holding period (rather than a one-year holding period) in order to be eligible for long-term capital gains treatment.[35] Prior to the enactment of the Act, practitioners and relevant taxpayers had feared that the tax

reform would eliminate capital gains treatment for carried interest entirely. This new restriction is a welcome compromise.

- New limitations were imposed on deductions for excess executive compensation of publicly-traded companies (capped at $1 million, including for commissions or performance-based remuneration),[36] net operating losses (now limited to 80% of taxable income),[37] and entertainment expenses (generally, no longer deductible).[38]
- As a response to the "Me Too" sexual harassment movement, the Act created a new provision denying a deduction for any payments made pursuant to a settlement agreement relating to sexual harassment or sexual abuse if such payments are subject to a non-disclosure clause.[39]

International tax reform

Some of the most significant and complex changes enacted by the Act were made to the cross-border U.S. tax regime, particularly to taxation of foreign-source income of U.S. persons.

The U.S. taxation regime has always taxed U.S. persons (both corporate and non-corporate) on their worldwide income. While the Code generally provides for credits against U.S. income tax for foreign taxes paid on foreign-source income,[40] there are numerous limitations that could restrict the ability to use the full foreign tax credit.[41] Further, to the extent the U.S. tax rate on such income is greater than the foreign tax rate, the U.S. taxpayer is liable for that difference. (In the case of corporate taxpayers, this scenario will likely become less common due to the substantial reduction in the corporate tax rate.) Undistributed income earned by foreign corporations has generally not been taxable to U.S. shareholders, unless such foreign corporations were "controlled foreign corporations" (generally, 50% or more owned by U.S. shareholders) and the income was of a specific character (generally, passive and other forms of so-called "subpart F" income).[42] Dividends received from such foreign corporations, however, were subject to full U.S. taxation.[43]

The Act made numerous very significant changes to this regime. The changes have been advertised as instituting a territorial taxation regime. However, this is not entirely accurate, because, in the majority of situations, the changes enacted by the Act will have the result of significantly more foreign-source income being subject to U.S. taxation. A more accurate way of describing the changes would be that, in accordance with President Trump's call for "America first", the Act has instituted incentives for repatriating foreign earnings into the United States so they can be invested into domestic capital and operations.

Territorial system

The new territorial system that has been enacted is a participation exemption regime, providing for a 100% dividends received deduction for the foreign-source portion of dividends received from a foreign corporation.[44] However, this deduction is only available to domestic C corporations who own at least 10% of the foreign corporation and have held, or will hold, such percentage of shares for a continuous one-year holding period.[45] Individuals who receive foreign-source dividends are still subject to full U.S. tax. Corporations that operate in foreign jurisdictions in branch, rather than through corporate subsidiaries, also do not benefit from this new territorial system.

As part of the switch to the territorial system, the Act imposes a mandatory deemed repatriation tax on all accumulated post-1986 foreign earnings held by controlled foreign corporations ("CFCs") and certain other foreign corporations with domestic corporate

shareholders.[46] Specifically, the Act treats all deferred post-1986 foreign-source earnings of such corporations as of either November 2, 2017 or December 31, 2017 (whichever is greater) as subpart F income that must be recognised by its U.S. shareholders for the tax year beginning before January 1, 2018.[47] Such deemed repatriated income is subject to a lower tax rate: 15.5% for earnings held by the foreign corporation as cash or cash equivalents, and 8% on all other earnings.[48] Further, U.S. shareholders may elect to spread the tax liability over an eight-year period.[49]

One notable mismatch in this new regime is that, while only corporate taxpayers benefit from the foreign-source dividends received deduction, all U.S. taxpayers who own at least 10% of a CFC are subject to the deemed repatriation tax. Particularly hard-hit are U.S. citizens living abroad, many of whom operate businesses through corporations formed in their resident jurisdictions. As CFCs that may have had little subpart F income prior to enactment of the Act, many of these corporations have significant post-1986 earnings which, while being fully subject to tax in their home jurisdictions, have never been subject to U.S. taxation.

Base erosion prevention

Unlike the deemed repatriation tax, which is a one-time tax, the changes made by the Act with respect to combating base erosion are permanent and, therefore, ultimately more significant. These changes include (1) a new category of subpart F income for global intangible low-taxed income ("GILTI"), (2) a new base erosion and anti-abuse tax ("BEAT"), and (3) a new Code section that denies a deduction for any payments made to related parties pursuant to a hybrid transaction or to/by a hybrid entity.

GILTI inclusion

As described above, U.S. shareholders that earned income through foreign corporations are generally only subject to tax when the income is paid to the shareholder as a dividend. The primary exception is U.S. shareholders that owned 10% or more of a CFC. Those shareholders are subject to the subpart F rules, and are required to include their *pro rata* share of the CFC's subpart F income irrespective of whether the shareholder received a dividend. Under prior law, subpart F income generally only included certain specific types of income, such as interest, dividends, and other passive income.

The Act creates a new Code section pursuant to which each person who is a 10% U.S. shareholder of any CFC must include in gross income its GILTI for the tax year as additional subpart F income.[50] While the term "Global Intangible Low-Taxed Income" implies that the foreign income is directly related to intangible assets (such as patents and trademarks), the method prescribed for calculating the inclusion is much broader. It uses a complicated formula that allows for a specific rate of return on certain tangible property of a company, and treats the remaining income of the company as GILTI.

There are numerous details relating to the calculation of the GILTI inclusion and the taxation of such amounts to 10% U.S. shareholders (including special deductions and rates of tax for 10% U.S. shareholders that are corporations). But at a basic level, this new inclusion represents a fundamental change to the deferral regime for low-taxed income of CFCs operating in foreign jurisdictions that has been inherent in the Code since the beginning. No longer is there a presumption that all such income will be deferred until repatriation. Rather, all such income will be presumed to be includible except to the extent of the allowed return on specific tangible assets. Depending on the types of business operations of the CFC, such amount might be very low, effectively eliminating all deferral.

The BEAT

One of the methods by which multinational companies had been shifting income away from the United States and thus avoiding tax in the United States was by making payments to foreign affiliates that triggered a deduction in the United States. The Organization for Economic Cooperation and Development ("OECD") has been working to design and cause countries to implement measures to combat base erosion strategies like this one.

The Act creates BEAT in an effort to stop companies from stripping earnings out of the United States.[51] The BEAT applies to both U.S. corporations that seek to reduce their U.S. federal income tax liability by making deductible payments to foreign affiliates and foreign corporations that are engaged in a U.S. trade or business that seek to reduce the tax on their effectively connected income ("ECI") by making deductible payments to foreign affiliates. However, the BEAT only applies to corporations with average annual gross receipts of less than $500,000,000 and a "base erosion percentage" of at least 3%, and does not apply to RICs or REITs at all.[52] For foreign corporations that are engaged in a U.S. trade or business, "gross receipts" are only gross receipts that are taken into account in calculating ECI.[53] The average annual gross receipts threshold is a high one, so it will not apply to most companies.

The BEAT is a type of alternative minimum tax. A company subject to the BEAT is required to pay tax equal to its "base erosion minimum tax amount".[54] The "base erosion minimum tax amount" is the amount by which 10% of the company's "modified taxable income" exceeds the company's normal U.S. tax liability (reduced by certain credits).[55] "Modified taxable income" is essentially normal taxable income plus certain deductible payments to foreign affiliates.[56] In other words, if a company reduces its tax liability to an amount that is less than 10% of its "modified taxable income" (which is its taxable income without regards to base-eroding deductible payments to foreign affiliates), then it will need to pay an alternative minimum tax equal to the difference.

Hybrid transactions and entities

Another method by which multinational companies seek to avoid tax in the United States is by taking advantage of differences in the ways that countries classify business entities for tax purposes. For instance, certain entities ("hybrid entities") may be taxed as a corporation in a low-tax jurisdiction, thus subjecting it to tax in that jurisdiction, but may be treated as a pass-through entity in the United States, thus avoiding an entity level tax in the United States. A similar mismatch in tax treatment also exists for certain payments made pursuant to certain transactions ("hybrid transactions") that are treated differently in different countries. For instance, a payment made by a U.S. entity may result in an interest deduction in the U.S., but that same payment may be treated as a dividend that is not subject to tax in the foreign recipient's jurisdiction. The Internal Revenue Service views these hybrid entities and transactions as abusive.

The Act creates a new Code section that denies a deduction for any "disqualified related party amount" that is paid or accrued pursuant to a hybrid transaction or by, or to, a hybrid entity.[57] A "disqualified related party amount" is any interest or royalty that is paid or accrued to a related party if either the amount isn't included in the related party's income in its country, or the related party receives a deduction for the amount in its country.[58] The term "related party" mirrors the definition in Code section 953(d)(3), which focuses on entities that control (more than 50% of vote or value) each other or are controlled by the same person or persons.[59] The new section includes definitions of both hybrid transactions and hybrid entities that focus on payments or entities that are treated differently in the United States and a foreign jurisdiction.[60]

A common investment structure to which this new rule could be relevant is the "leveraged blocker" structure that is often used by foreign investors to invest in U.S. real estate. This structure involves an investor capitalising a domestic entity treated as a C corporation for U.S. tax purposes with part equity and part debt. The interest paid on the debt portion is generally deductible by the domestic corporation. Under the new rule, this deduction would be denied in some situations, depending on the rules of the home jurisdiction of the recipient. For instance, if the home jurisdiction treats the domestic corporation as a disregarded entity, the interest payments may not be treated as income in such jurisdiction. Alternatively, the home jurisdiction may treat the debt as equity (such that the payments are treated as dividends) and allow the recipient a dividends received deduction. Under this new provision, the domestic corporation would be denied a deduction for the interest payments in those situations.

* * *

Endnotes

1. Code section 11(b).
2. Code section 55(a) (applying the AMT to "a taxpayer other than a corporation").
3. Code section 1(j).
4. *Id.*
5. Pub. L. No. 91-172, 83 Stat. 487 (December 30, 1969).
6. Code section 55(d)(4).
7. *Id.*
8. *See, e.g.*, Scott A. Hodge, *The Economics of Permanent Corporate Rate Cuts Must Outweigh the Optics of Sunsetting Individual Tax Cuts*, The Tax Foundation, November 16, 2017, available at https://taxfoundation.org/permanent-corporate-rate-cut-temporary-individual-tax-cut/.
9. *See, e.g.*, Brett Samuels, *Mnuchin: 'I don't know' if individual tax cuts will extend beyond 2025*, The Hill, November 19, 2017, available at http://thehill.com/homenews/sunday-talk-shows/361091-mnuchin-i-dont-know-if-individual-tax-cuts-will-extend-beyond-2025.
10. Code section 199A.
11. Code section 199A(b)(1).
12. Code section 199A(b)(2).
13. Code sections 199A(d)(1)(A) & (2), 1202(e)(3)(A).
14. Code section 199A(b)(3) & (d)(3).
15. Code section 199A(a)(1)(A) & (b)(1)(B).
16. Code section 6662(d)(1)(C).
17. Code section 199A(i).
18. Code section 163(j).
19. Code section 163(j)(1).
20. Code sections 163(j)(3), 448(c).
21. Code section 163(j)(7)(A)(ii) & (B).
22. *Id.* & Code section 469(c)(7)(C).
23. Code section 1031(a)(1) now says: "No gain or loss shall be recognized on the exchange of **real** property held for productive use in a trade or business or for investment if such **real** property is exchanged solely for **real** property of like kind which is to be held either for productive use in a trade or business or for investment." (Emphasis supplied.)

24. Code section 168(k)(8).
25. Code section 168(k)(6)(A)(i).
26. Code section 168(k)(6)(A)(ii) through (v).
27. Code section 168(k)(2)(A)(ii) & (E)(ii).
28. Code section 461(l)(1).
29. Code section 461(l)(3).
30. Code section 461(l)(3)(A)(ii)(II).
31. Code section 461(l)(3)(B).
32. Code section 461(l)(4).
33. Code section 461(l)(2).
34. Previous Code section 708(b)(1)(B) has been eliminated and previous Code section 708(b)(1)(A) is now just Code section 708(b)(1).
35. Code section 1061(a)(2).
36. Code section 162(m).
37. Code section 172(a).
38. Code section 274(a)(1).
39. Code section 162(q)(1).
40. Code sections 901, 902.
41. Code section 904.
42. Code sections 951–965.
43. Treasury Regulations section 1.1-1(b).
44. Code section 245A(a).
45. Code section 245A(b)(1).
46. Code section 965.
47. Code section 965(a)
48. Code section 965(c).
49. Code section 965(h).
50. Code section 951A(a).
51. Code section 59A.
52. Code section 59A(e)(1).
53. Code section 59A(e)(2)(A).
54. Code section 59A(a).
55. Code section 59A(b)(1).
56. Code section 59A(c).
57. Code section 267A(a).
58. Code section 267A(b)(1).
59. Code sections 267A(b)(2), 954(d)(3).
60. Code section 267A(c) & (d).

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