BEPS and international tax newsletter

Edition 19 – August 2022

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Introduction

This newsletter provides regular updates and insights on the OECD's BEPS initiative and ongoing international tax reforms.

Our nineteenth edition deals with the new measures published in August 2022 by the OECD, the EU, and in 21 countries: Argentina, Australia, Brazil, Canada, Chile, Colombia, Egypt, Ethiopia, Germany, Hong Kong, India, Ireland, Italy, Luxembourg, The Netherlands, South Korea, Spain, Switzerland, Thailand, Uruguay, and the USA.

If you have any questions, please don't hesitate to get in touch with a member of our team.

Gertrud Bergmann,
Partner, Transfer Pricing
Mazars in Germany
gertrud.bergmann@mazars.de

Frédéric Barat,
Partner, Transfer Pricing
Mazars in France
frederic.barat@avocats-mazars.com

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OECD

The Organization for Economic Co-operation and Development (OECD) released an update on the results of the peer reviews of jurisdictions' domestic laws under Action 5 (harmful tax practices) of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project. The results were approved on 7 June 2022 by the Inclusive Framework on BEPS. The updated results cover new decisions on 12 preferential tax regimes. According to the press release, the total number of tax regimes that have been reviewed, or are under review, is 319. The reviews were undertaken by the Forum on Harmful Tax Practices (FHTP). Two regimes of Armenia and one of Pakistan were classified as "potentially harmful" and will be subject to further evaluation by the FHTP. The remaining nine regimes on which new decisions were announced have been abolished, are being amended, are under review, or are considered to be "not harmful." The FHTP will continue its reviews and will provide periodic updates. Additionally, the Inclusive Framework concluded its first annual monitoring process for the effectiveness of the substantial activities requirements in previously identified no or only nominal tax jurisdictions. Concerning 8 out of 12 jurisdictions, issues have been identified and recommendations provided.

European Union

Further to the request of the European Parliament for concerted EU action, the European Commission issued on 22 December 2021 a proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU (hereafter referred to as "ATAD III proposal" or simply "directive"). More recently, the Committee on Economic and Monetary Affairs has issued a draft report on the said ATAD III proposal (simply the "Draft Report"). This is not yet the final version of the directive but given the importance of this preliminary step in the legislative process, the amendments suggested therein are significant indicators to the market on the direction being taken.

ATAD III proposal was born at the request of the European Parliament for EU coordinated action on the misuse of shell entities for tax purposes and, more broadly, from civil society and several member states further to media revelations. As such, the ATAD III proposal aims to address this subject as the leading example on the matter. Broadly speaking, the term "shell entity" refers to entities lacking minimum economic substance, that do not perform any actual economic activity, and that can be misused for tax avoidance or evasion purposes. The aim of the ATAD III proposal is thus clear on a rather intricate matter - to lay down a common framework to tackle the misuse of shell entities for tax purposes. In essence, the ATAD III proposal lays down conditions known as "gateways" that are intended to identify entities that may be considered empty shells. The first two gateways are met if:

- The threshold for relevant income (mobile and passive income or from insurance or banking activities) is reached; and
- The entity is engaged in cross-border activity.
- The latter is measured again by reference to precise thresholds concerning the book value of specific assets located abroad and relevant income arising from cross-border transactions.

The third gateway is the one involving more discretion in its interpretation as it refers to the outsourcing of the administration of day-to-day operations and decision-making on significant functions without precise references or thresholds.

Should all three gateways be met, the entity should declare in its tax return whether they meet the minimum substance indicators and provide documentary evidence in this respect (e.g., office space, bank account, details on board composition, qualifications, tax residence, as well as their employees). The undertaking will be presumed to have the minimum substance for that tax year if the minimum substance indicators are met and adequate evidence is provided. The undertaking can also apply for an exemption from these obligations by proving that its interposition does not reduce the tax liability of its beneficial owner or the group, as the case may be. If not, and if no additional information is provided to evidence the undertaking's substance and economic activity, the entity may ultimately be denied access to treaty relief and EU directives and trigger withholding tax on payments and taxation of its shareholder on a look-through basis. It is important to note that the directive provides a carve-out for entities considered low-risk, as they are already under significant scrutiny (this is the case, for example, of companies listed in regulated markets and regulated financial undertakings). Non-compliance with the obligations set out in the directive will give rise to penalties of at least 5% of the entity's turnover in the relevant tax year.

The rapporteur set out three main objectives for the Draft Report:

- Guarantee privacy and data protection;
- Safeguard a level playing field for EU companies; and
- Avoid the excessive administrative burden and compliance costs for operators.

In its explanatory statement, the rapporteur acknowledges the importance of differentiating between the legitimate use of specific legal structures for investments, compliance, and cross-border operations from the misuse of tax avoidance and aggressive tax planning. One positive sign in this direction is already given in the amendments to the recital. While defining shell entities as companies with minimal economic substance, the rapporteur acknowledges their use for legitimate business purposes. It is further conceded that to preserve the competitiveness of the European undertakings, the obligations under the directive should be proportionate, effective, and neutral from a tax point of view, which demonstrates a better understanding of certain industries such as the investment fund industry. With regards to the core measures, the amendments are also welcomed. The scope of the reporting obligation is mostly reduced by increasing (or reducing, as the case may be) the gateway thresholds a shell entity would need to meet to trigger the reporting obligation. The scope of the third gateway is also further reduced as now the outsourcing of the administration of day-to-day operations and decision making on significant functions is only met if it is to an entity that is not an associated enterprise within the same jurisdiction as the reporting undertaking. And more importantly, entities owned by regulated financial undertakings and which have as their objective the holding of assets or investment of funds are now also clearly mentioned in the carve-out provision. One other key amendment was the postponement of the entry into effect of the directive by one year (i.e., to 1st January 2025). This is most welcomed given that the previous timeline with the "look-back" period of two years was creating a retroactive application of the measures. Finally, the penalty threshold for non-compliance was reduced to at least 2.5% of the undertaking's turnover (instead of the 5% previously prescribed).

ATAD III proposal is currently under consultation procedure and awaits the committee's decision. The vote is scheduled for 17 November 2022 and the plenary session is for 12 December 2022. The proposed amendments in the Draft Report are an important step toward a more realistic approach to minimum substance and we hope that further steps in this direction will be taken during the legislative procedure before the final adoption of the directive.

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Argentina

Argentine Tax Authority establishes one-time windfall corporate income tax prepayment.

Australia

The Australian Treasury has released a discussion paper on Multinational Tax Integrity and Tax Transparency on the Labor Government's election proposals made as part of their multinational enterprises (MNEs) tax integrity package to address tax avoidance practices of MNEs and improve transparency through better public reporting of MNEs' tax information. This discussion paper confirms that the many technical questions raised following the election announcements are open for discussion. It does not contain references to potential application dates (expected from 1 July 2023 or the 2023/24 year). The discussion paper seeks to consult on the implementation of proposals to:

- Amend Australia's existing thin capitalization (thin cap) rules to limit interest deductions for MNEs in line with the OECD recommended approach under Action 4 of the Base Erosion and Profit Shifting (BEPS) program
- Introduce a new rule limiting MNEs' ability to claim tax deductions for payments relating to intangibles and royalties that lead to insufficient tax paid
- Ensure enhanced tax transparency by MNEs, through measures such as:
    - Public reporting of certain tax information on a country-by-country basis
    - Mandatory reporting of material tax risks to shareholders
    - Requiring tenderers for Australian government contracts to disclose their country of tax domicile.

Responses to this consultation must be submitted by 2 September 2022. The discussion paper containing 53 questions, some of them of complex issues, together with the aspiration to get the draft law out sooner rather than later, makes the opportunity to influence decision look limited but should nevertheless be used to prevent outcomes that would put Australia out of step with global best practices. Following consideration of responses to the discussion paper, the Australian Government will issue and consult further on exposure draft legislation before introducing any legislation into Parliament.

Brazil

Brazilian tax authorities may use information from transfer pricing studies in customs valuations.

Brazilian Internal Revenue Service Issues New Regulation on Tax Settlement.

Canada

Canada's Department of Finance releases General Anti-Avoidance Rule consultation and paper.

Chile

Chile's Congress to discuss tax reform proposal. The tax reform bill would prohibit certain domestic shareholders from claiming credits for taxes paid by companies and would require them to apply a 22% corporate tax rate to profits distributed by the company. The bill would decrease the corporate income tax rate from 27% to 25% while increasing the 10% tax rate on gains from stock sales to 22% and introducing a 1.8% tax on the retained earnings of certain companies. Other changes would include limits on certain tax benefits, limits on the use of foreign tax credits and loss deductibility, benefits for small and medium-sized businesses, and the introduction of a wealth tax for Chilean individuals.

Colombia

Colombia and Brazil sign a double tax treaty. The treaty includes reduced withholding tax rates for certain passive income and permanent establishment provisions. Taxpayers in the technology/software industry should be aware of the technical services/technical assistance and royalty provisions as they might benefit from a reduced withholding tax rate of 10%. Both Colombia and Brazil must complete their internal ratification processes for the treaty to enter into force.

The Colombia-Japan double tax treaty will be effective on 1 January 2023. The permanent establishment rules follow the guidelines of the Base Erosion and Profit Shifting (BEPS) plan of the Organization for Economic Co-operation and Development (OECD). The treaty has reduced withholding tax rates for certain passive income. The treaty also reduced tax rates for certain capital gains.

The new Colombian Government submitted to the Colombian Congress a tax reform bill that is expected to bring in COP25 trillion in revenue for 2023 (approx. US$6.2 billion) (1.72% of the GDP), and COP50 trillion (approx. US$12.4 billion) in revenue by 2026, by reducing tax evasion. The bill would eliminate the reduced corporate income tax rates for certain activities. The bill would increase taxes on nonresident entities. Additionally, the bill would increase taxes on individuals.

Egypt

Egypt provides relief from delayed interest, additional taxes, and duties.

Ethiopia

A new Investment Incentive Regulation Number 517/2022 was approved by Ethiopia's Council of Ministers on 21 May 2022 and published in the Negarit Gazette on 12 July 2022. The new investment incentives regulation aims to expand the coverage of investment incentives and hence boost investment in Ethiopia.

Germany

The German Federal Ministry of Finance (MoF) issued guidance on the withholding tax treatment of remuneration paid to nonresidents for software development services. The withholding tax treatment of remuneration in connection with software purchases or software development - even after a basic classification of the payments was made by the MoF guidance dated 27 October 2017 - repeatedly gives rise to discussions between remuneration creditors and remuneration debtors regarding the obligation to withhold tax under Section 50a (1) No. 3 German Income Tax Act (ITA). The discussions center around whether transactions should be viewed as a final transfer of a right or as a (temporary) license to use a right for a limited period, as only the latter gives rise to withholding tax under domestic law.

Hong Kong

Hong Kong delays implementation of OECD Pillar Two rules. It was previously announced in the 2022/23 Hong Kong Budget that the Global Anti-Base Erosion Rules (GloBE Rules) under Pillar Two of the OECD BEPS 2.0 project were intended to be implemented from 2023. In line with the delay of the GloBE Rules implementation in other jurisdictions, it is now confirmed that Hong Kong will also delay the implementation timeline to 2024 at the earliest.

India

The Indian Supreme Court recently held that an arrangement involving the secondment of employees constitutes manpower supply services or taxable service. Overseas entities seconding employees to Indian group entities will need to carefully review the impact of this ruling not only from an indirect tax perspective but also from Indian income-tax perspective.

Ireland

The Irish Revenue Commissioners published guidance confirming that certain Digital Services Taxes (DSTs) incurred wholly and exclusively for trade are deductible in computing income of that trade for Irish corporation tax purposes. The guidance applies to:

- France’s Digital Services Tax
- Italy’s Digital Services Tax
- Turkey’s Digital Services Tax
- United Kingdom’s Digital Services Tax
- India’s Equalization Levy

This list may be updated as required in the future.

Italy

According to Supreme Court Decision No. 13123 of 27 April 2022, if a taxpayer elects to apply the "fiscal unit" regime as a consolidating entity and it is considered a "shell company", the losses of consolidated companies may not be used to reduce the entity's income below the minimum deemed return. The issue under analysis concerned a group of companies that had elected to use the fiscal unit regime provided by article 117 and the following articles of the Income Tax Code, which allows group taxable income to be determined as the sum of all the incomes and losses of the consolidated companies, as a result of choosing to apply the "fiscal unit" regime. In this context, the consolidating company was a shell company that had reported the minimum deemed income (according to the provisions under article 30 paragraph 3 of Law No. 724/1994) in its tax return. After having reported this, the consolidating company applied the criteria of the tax consolidation regime by offsetting its income (i.e., minimum deemed income) against the operating losses of the other consolidated companies, so that it did not result in any groupwide taxable amounts for the fiscal years under dispute. The Tax Authority questioned the offsetting of the consolidating company's minimum income against the tax losses of the other companies within the scope of the fiscal unit regime and when assessing a tax base equal to such minimum income, which would require the payment of the related taxes, in addition to interest and penalties. The Supreme Court confirmed the Tax Authority's position and denied the group's behavior, stating that it was not consistent with the rationale of the provisions regarding "shell companies". In particular, the Court argued that under no circumstances the non-operative entity can tax an amount that is lower than the minimum income threshold. In other words, a "shell company" can only use the tax losses of the other consolidated companies to offset the income that exceeds this threshold.

Luxembourg

Luxembourg Tax Authority issues guidance on the application of controlled foreign company rules in Luxembourg.

The Netherlands

The Dutch Parliament adopted the bill to amend the tax regime for stock options.

South Korea

South Korea announces 2022 tax reform proposals including several significant changes. These proposals include new global minimum tax rules to align with OECD BEPS 2.0 Pillar Two.

Spain

The High Court of Justice (Tribunal Superior de Justicia) of Catalonia, confirmed that the dividends received by a Spanish tax resident individual from a Brazilian company are entitled to a full tax exemption as set forth by the Brazil-Spain Double Tax Treaty (DTT). While the referred decision deals with the rules applicable to Spanish tax resident individuals, the reasoning followed by the Court on the prevalence of the DTT over the domestic provisions may also be relevant to sustain the application of a full tax exemption on dividends derived by a Spanish tax resident company from a Brazilian subsidiary.

Switzerland

The Swiss Federal Council opened the public consultation on the ordinance that will temporarily regulate the material aspects of the OECD Pillar Two minimum corporate tax in Switzerland during a transition phase. The ordinance includes a Swiss top-up tax (qualified domestic minimum top-up, “QDMTT”) and an international top-up tax (income inclusion rule, “IIR,” and undertaxed payments rule, “UTPR”) in line with the GloBE Model Rules. The draft wording of the ordinance mainly refers to the GloBE Model Rules for the determination of the respective taxes and includes only very limited additional Swiss regulations.

Thailand

The Royal Decree No. 750 (B.E. 2565) issued under the Revenue Code regarding income tax exemption on investment in Thai startups (the “Royal Decree”) was recently published in the Government Gazette, in cases where the funding for the startups is provided directly or indirectly through Venture Capital (VC), Corporate Venture Capital (CVC), or private equity trust (PE Trust). This Royal Decree aims to unlock capital gains tax on investment in startups under Royal Decree No. 597 (B.E. 2559) and No. 636 (B.E. 2560). These tax benefits are effective for ten accounting periods until 30 June 2032. The cabinet anticipates that these tax privileges will facilitate Thai startups to raise more funds from both Thai and foreign investors, leading to faster growth in GDP in Thailand, and an increase in the number of workers employed in Thailand.

Uruguay

Uruguay's Tax Authority clarifies the tax treatment of profit repatriations paid by a permanent establishment under a double tax treaty.

Uruguay intends to change its traditional source criteria for corporate income tax purposes to comply with EU requirements.

USA

United States President Joe Biden signed into law the Inflation Reduction Act (the Act). For companies that report over US$1 billion in profits to shareholders, the Act includes a 15% corporate alternative minimum tax (Minimum Tax) based on book income. The Minimum Tax was originally introduced in the House Ways and Means Committee's Build Back Better Act (BBBA) proposal in November 2021. It was then modified by the Senate Finance Committee in its December 2021 BBBA proposal. As was its purpose in both House and Senate BBBA proposals, the Minimum Tax is primarily a revenue raiser in the Act. The CAMT will apply to tax years beginning after 31 December 2022.

The US Inflation Reduction allocates nearly US$80 billion in new funding for the Internal Revenue Service (IRS). Of that $80 billion, more than $45 billion is for enforcement (including the determination and collection of "owed taxes"), more than $25 billion is for operations, nearly $5 billion is for systems modernization, and over $3 billion is for customer service, among other expenses. The Congressional Budget Office estimates the enforcement-related funding will raise $204 billion in additional revenue, offsetting the cost of the Act's incentives for energy transition and renewable energy, as well as its extension of the expiration date for expanded premium tax credits under the Affordable Care Act. The increased funding for IRS enforcement will likely shift the current audit landscape and significantly increase the IRS's scrutiny of transfer pricing cases. Accordingly, taxpayers should consider enhancing their transfer pricing documentation so they can support their intercompany tax positions.

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Contacts

Gertrud Bergmann,
Partner, Transfer Pricing
Mazars in Germany
gertrud.bergmann@mazars.de

Frédéric Barat,
Partner, Transfer Pricing
Mazars in France
frederic.barat@avocats-mazars.com

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