BEPS and international tax newsletter

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Introduction

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

Our thirty-first edition deals with the new measures published in August 2023 by the European Union and in 16 countries: Brazil, Canada, Chile, Egypt, France, Germany, Hong Kong, Israel, Italy, Korea, Luxembourg, Poland, Russia, South Africa, Spain, and the United States.

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

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European Union

The European Commission adopts final Implementing Regulation for transitional phase of CBAM.

Brazil

Brazil's Complementary Law number 199 simplifies tax obligations.

Brazil Senate considers VAT reform plan.

Canada

On 4 August 2023, the federal government released for public comment revised legislative proposals on the proposed excessive interest and financing limitation rules (the EIFEL rules) to take into account various comments received since their initial release on 4 February 2022 and their subsequent revision through draft legislative proposals released on 3 November 2022 (the 4 February 2022 and 3 November 2022 draft legislative proposals are referred to herein as the "Initial EIFEL Proposals" and the 4 August 2023 draft legislative proposals are referred to herein as the "Revised EIFEL Proposals"). Interested parties are invited to provide comments in respect of the Revised EIFEL Proposals by 8 September 2023. The stated objective of the EIFEL rules is to address base erosion and profit shifting (BEPS) concerns arising from taxpayers deducting excessive interest and other financing costs, principally in the context of multinational enterprises and cross-border investments, as raised by the Organisation for Economic Co-operation and Development (OECD) / G20 in its BEPS Action 4 report. However, the EIFEL rules can also apply to purely Canadian businesses, subject to certain exceptions. The EIFEL rules have two separate sets of provisions, which are primarily set out in proposed sections 18.2 and 18.21 of the Income Tax Act (Canada) (the Act) and are used to determine the amount by which net interest and financing expense deductions are restricted – specifically, the amount by which "interest and financing expenses" (IFE) exceed "interest and financing revenues" (IFR). Very generally, under the "Fixed Ratio Rules", net interest and financing expenses may be deducted in an amount that does not exceed a fixed percentage of the taxpayer's "adjusted taxable income" (ATI, which approximates tax-adjusted earnings before interest, taxes, depreciation, and amortization (EBITDA)) for the year. Alternatively, where certain conditions are met and a group of corporations and/or trusts so elects, a higher "group ratio" may be applied in lieu of the Fixed Ratio Rules (the Group Ratio Rules).

Chile

Chilean Government announces content of "Fiscal Pact".

Egypt

Egypt introduces further tax incentives to stimulate foreign direct investments.

In his speech on 24 August 2023, the Minister of the Economy promised to implement during fall the "Plan de lutte contre les fraudes fiscales, sociales et douanières" (Plan to combat tax, social security, and customs fraud) presented before the summer. This plan includes lowering the threshold for transfer pricing documentation from EUR 400 million to EUR 150 million in sales or gross assets, making transfer pricing documentation enforceable against the authorities, and increasing penalties for non-compliance. The plan also provides for an extension of the statute of limitation for the hard-to-value intangibles, and an intensification of tax audits.

France

France postpones electronic invoicing initially scheduled for 1 July 2024.

Germany

On 4 August 2023, the Federal Executive published in the Official Gazette of the Federation the "Decree enacting the Protocol Amending the Agreement dated 9 July 2008, between the United Mexican States and the Federal Republic of Germany for the Avoidance of Double Taxation and Tax Evasion with respect to Taxes on Income and Capital, executed at Mexico City on the eighth day of October, two thousand twenty-one". The recent Official Gazette publication specifies that the notifications of the completion of the procedures required by the legislation of each of the Contracting States for the entry into force of the aforementioned Protocol, were received in Berlin on 31 October 2022, and 7 July 2023, and therefore the Protocol entered into force as of 6 August 2023. In addition, the Protocol shall apply as follows:

- In the case of withholding taxes at source, with respect to amounts paid on or after the first day of January of the calendar year immediately following the date of entry into force of the Protocol;
- In the case of other taxes, with respect to taxes levied for periods beginning on or after the first day of January of the calendar year immediately following the year in which the Protocol enters into force.

Based on the foregoing, the Protocol amending the Agreement between Mexico and Germany to Avoid Double Taxation and Prevent Tax Evasion related to Income Tax Matters will be applicable as of 1 January 2024.

Hong Kong

Hong Kong-Mauritius Double Taxation Avoidance Agreement entered into force in Mauritius from 23 June 2023.

Israel

Israeli Parliament approves measures to boost investment in high-tech sector.

Italy

Italy announces proposed one-time windfall tax for banks.

Korea

Korea's Ministry of Economy and Finance announced the 2023 tax reform proposals (the 2023 Proposals). Unless otherwise specified, the 2023 Proposals will generally become effective for fiscal years beginning on or after 1 January 2024. Significantly, the supplementary rules for income inclusion (known as Undertaxed Profit Rule (UTPR)) are proposed to have a 12-month delay, extending the effective date to 1 January 2025.

Luxembourg

Luxembourg enacts new reporting regime to combat VAT fraud.

Luxembourg publishes draft legislation on implementation of the EU Minimum Tax Directive. The proposed measures in the Bill are largely in line with the provisions of the Pillar 2 Directive.

General application

The proposed measures will apply to constituent entities located in Luxembourg that are members of an MNE group or a large-scale domestic group which had an annual revenue equal to or above EUR 750 million, including the revenue of excluded entities, in its ultimate parent entity's (UPE) consolidated financial statements for at least two of the four fiscal years immediately preceding the tested fiscal year.

In-scope MNE groups and large-scale domestic groups will pay a top-up tax whenever the effective tax rate (ETR) of constituent entities determined on a jurisdictional basis is below the minimum rate of 15% ("low-taxed constituent entities").

The top-up tax will take the form of an income inclusion rule (IIR) and an undertaxed profit rule (UTPR).

The (Luxembourg) parent entity of an MNE group will apply the IIR in relation to a top-up tax that has been determined for the low-taxed constituent entities of the MNE group. The UTPR is a back-up mechanism, the purpose of which is to ensure that any residual amount of top-up tax that has not been subject to the application of an IIR is reallocated to the relevant jurisdiction(s) on the basis of a specific formula. The UTPR may, for example, apply in Luxembourg when the UPE is located in a jurisdiction that does not have a qualified IIR, or when the UPE is an excluded entity.

Introduction of a QDMTT

Furthermore, Luxembourg has opted to include a qualified domestic minimum top-up tax (QDMTT), according to which a domestic top-up tax will apply with priority over the IIR and the UTPR to all low-taxed constituent entities located in Luxembourg (this also includes Luxembourg joint ventures within the meaning of Pillar 2 and their Luxembourg affiliates). The amount of any top-up tax due by a foreign UPE will be reduced to zero by the amount of Luxembourg QDMTT due from the Luxembourg constituent entities of the MNE group. The QDMTT will be determined and administered in accordance with the Pillar 2 rules detailed in the Bill, in particular for the determination of the ETR and of the top-up tax amount.

Calculation of ETR

The ETR will be calculated by dividing the amount of adjusted covered taxes of the constituent entities in the jurisdiction by their net qualifying income or loss, as reported in the financial accounts used for consolidation purposes, with certain adjustments. Those adjustments are largely in line with the Pillar 2 Directive, with a small exception. The financial accounting net income or loss of a constituent entity may be adjusted by the amount of a debt waiver (which is normally recorded as an exceptional profit by the debtor) in certain circumstances (for example in the context of insolvency proceedings, or in certain cases involving third-party creditors). The Bill clarifies that Luxembourg covered taxes include *inter alia* corporate income tax, municipal business tax, and net worth tax. The commentary to the Bill clarifies that filing a tax return will normally be considered as triggering an expectation on the part of the taxpayer that the corresponding taxes are due to be paid within three years.

The Bill confirms in line with Recital 24 of the Pillar 2 Directive that taxpayers should use the GloBE Rules, the Pillar 2 Commentary, and the GloBE administrative guidance of February 2023 as sources of illustration or interpretation. The bill does not include any reference *inter alia* to the OECD's detailed guidance on QDMTT or to the QDMTT safe harbour rules, both of which were included in the GloBE administrative guidance of July 2023. They may have been omitted due to time constraints.

Safe harbour rules

The Bill implements a transitional country-by-country report (CbCR) safe harbour, which aims to provide transitional relief (with a top-up equal to zero) for MNE groups operating in low-risk jurisdictions in the initial years during which the rules come into effect (the transition period). In line with the GloBE Safe Harbours and Penalty Relief released in December 2022, the safe harbour will apply in three cases:

- Where the MNE group (or the large-scale domestic group) reports total revenue of less than EUR 10 million and profit before income tax of less than EUR 1 million in the jurisdiction on its qualified CbCR for the fiscal year (*de minimis test*), or
- The MNE group has a simplified ETR that is equal to or greater than the transition rate (15% for financial years starting in 2023 and 2024, 16% for financial years starting in 2025, 17% for financial years starting in 2026) in the jurisdiction for the fiscal year (*simplified ETR test*), or
- The MNE group's profit before income tax in such jurisdiction is equal to or less than the substance-based income exclusion amount for constituent entities resident in that jurisdiction under the CbCR, as calculated under the proposed rules.

If an MNE group has not applied the transitional CbCR safe harbour with respect to a jurisdiction in a fiscal year in which the MNE group was subject to the above rules, the MNE group will not qualify for that safe harbour for that jurisdiction in a subsequent year. The proposed rules include specific rules that apply *inter alia* to joint ventures and their affiliates, UPEs that are tax transparent entities, and investment entities, as well as certain exclusions.

Administrative domestic provisions and penalties

Each Luxembourg constituent entity (as well as joint ventures within the meaning of Pillar 2) of the MNE group or large-scale domestic group will, in addition to their filing obligations, be required to register with the Luxembourg direct tax authorities within 15 months after the last day of the reporting fiscal year (or 18 months for the transition year) and provide information on the UPE and the filing constituent entities. Filing obligations are generally in line with the Pillar 2 Directive, but any Luxembourg tax due on the basis of either the IIR, UTPR, or the QDMTT is payable within one month after the filing of the Pillar 2 returns. None of those taxes will be creditable or deductible against any other tax.

In addition, the Bill includes penalties for constituent entities that do not meet their registration and filing obligations. In particular, a fine of up to EUR 250,000 may apply for late filing and filing incomplete or inaccurate information. The information file will be subject to an automatic exchange of information with jurisdictions that have signed an agreement with Luxembourg (list to be provided in a Grand Ducal regulation).

The Bill also introduces joint and several liability for the payment of any Luxembourg top-up tax due between the Luxembourg members of the MNE group or large-scale domestic group.

The provisions will apply from the 2024 tax year, except for the provisions on UTPR, which will apply from the 2025 tax year (unless the UPE is located in a jurisdiction that has opted for the deferred application of the IIR and UTPR rules).

Conclusion and next steps

As expected, the proposed measures are very similar to the Pillar 2 Directive. It is confirmed that the solutions identified at OECD level in relation to the OECD model rules will likely remain relevant for the application of the Luxembourg Pillar 2 rules. As the proposed rules (including a QDMTT) will apply from the 2024 tax year, taxpayers are advised to promptly assess whether they fall within the scope of the proposed rules and/or whether there will be any practical impact on their operations. The application of any safe harbour or transition rule will need to be monitored. The Bill now follow the usual legislative process through Parliament.

Luxembourg ratifies amendments to UK-Luxembourg tax treaty.

Poland

Polish Government seeks annulment of CBAM regulation in the European Court of Justice.

Mandatory e-invoicing law (KSeF) signed by President.

Russia

Russia suspends the majority of articles of the double tax treaty between Switzerland and Russia with immediate effect.

South Africa

2023 Draft TLAB

Tax proposals contained in the 2023 Draft TLAB include:

- Tax incentive proposals relating to renewable energy, research and development, and the Urban Development Zone;
- Adjusting the minimum royalty rate for oil and gas companies;
- Codifying the interest deductibility principles contained in Practice Note 31 of 1994;
- Clarifying anti-avoidance rules dealing with third party-backed shares;
- Refining the provisions applicable to unbundling transactions;
- Clarifying the foreign business establishment (FBE) exemption for controlled foreign companies (CFCs);
- Refining the participation exemption for the sale of shares in foreign companies; and,
- Two value-added tax (VAT) provisions, namely reviewing the VAT treatment of specific supplies in the short-term insurance industry and clarifying the VAT treatment of prepaid vouchers in the telecommunications industry.

The draft legislation clarifying the FBE exemption proposes that the FBE definition be amended to read that all the important functions of the business for which the CFC is compensated must effectively be in-sourced and performed in-country. Essentially, this means that companies relying on outsourced operating models where primary functions are outsourced and performed in other countries will not be able to access an FBE exemption. If implemented in its current form, the legislation could have a significant impact on the cost of doing business when expanding offshore, because certain functions cannot be centralized.

2023 Draft TALAB

Key tax proposals contained in the 2023 Draft TALAB include:

- Advance Pricing Agreement (APA) program;
- Employee’s tax registration requirement for non-resident employers;
- Variation of employees’ tax withholding in respect of remuneration;
- Expanding the general disclosure provisions for section 18A approved organizations; and,
- Alignment with anti-money laundering and combatting terrorism developments.

Other notable proposals

Other notable proposals include:

- Draft Regulations in terms of paragraph (d) of the definition of “Research and Development” in section 11D(1) of the Income Tax Act on additional criteria for multisource pharmaceutical products;
- Draft Regulations in terms of paragraph (e) of the definition of “Research and Development” in section 11D(1) of the Income Tax Act on criteria for clinical trials in

respect of deductions for research and development;

- Draft Regulations on domestic reverse charge relating to valuable metal in terms of section 74(2) of the VAT Act, 1991; and,
- Draft Carbon Offset Regulations.

Spain

Spanish Supreme Court issues taxpayer-favorable decision on domestic dividend withholding exemption with respect to EU holding structures.

The United States

Termination of the US-Hungary double tax treaty effective on 31 December 2023.

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About Mazars

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