BEPS and international tax newsletter

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mazars

Introduction

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

Our thirty-fifth edition deals with the new measures published in December 2023 by the Court of justice of the European Union and in 12 countries: Australia, Belgium, Canada, Denmark, Ecuador, France, Hong Kong, Hungary, New Zealand, Saudi Arabia, USA, and Vietnam.

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

Europe

On 5 December 2023, the Court of Justice of the European Union (ECJ) issued its judgment in joined cases C-451/21 (Luxembourg v Commission) and C-454/21 (Engie Global LNG Holding and Others v Commission) against the European Commission (EC)'s decision of 20 June 2018 which had stated Luxembourg's granting of state aid to the Engie Group in connection with tax rulings on intra-group financing transactions. The EC decision had been upheld by the General Court. According to the ECJ, the EC nevertheless erred in determining the reference system constituting the starting point for the comparative examination to be carried out in the assessment of the selectivity of those tax measures and thus of their classification as prohibited State aid. Moreover, the EC was not required to consider the administrative practice of the Luxembourg tax authorities relating to a national provision on abuse of law, as the Luxembourg tax authorities had deviated from their established practice in dealing with transactions similar to the one at issue. Those errors vitiated the whole of the selectivity analysis and the EC's decision has been therefore annulled.

On 14 December 2023, the Court of Justice of the European Union (CJEU) sided with Amazon and Luxembourg and dismissed the European Commission's appeal against a May 2021 judgment of the General Court that had found Amazon did not receive unlawful state aid from Luxembourg. The CJEU judgment is final.

Estonia, Latvia, Lithuania, Malta, and Slovakia have postponed the application of the income inclusion rule and the undertaxed payment rule (UTPR). They can do this because twelve or fewer ultimate parent entities of multinational groups in the scope of Pillar 2, are situated in these countries. The Pillar 2 Directive then allows the countries to postpone Pillar 2 for six consecutive years, starting from 31 December 2023. The EU member states have to notify the European Commission of the decision to postpone the IIR and the UTPR on or before 31 December 2023. The five countries have done so on 12 December 2023.

Australia

The Australian Government has proposed amendments to the thin capitalization and debt deduction creation rules, which have been referred to a Senate committee to report by 5 February 2024, thereby delaying the enactment of the measures. The thin capitalization measures are still expected to apply to income years starting on or after 1 July 2023. The amendments include a proposal to defer the debt deduction creation measures to apply to income years starting on or after 1 July 2024; however they may apply to transactions that occurred before this date. Requirements to disclose subsidiary information, including tax residency, would apply from financial years starting on or after 1 July 2023.

Belgium

On 14 December 2023, the Belgian parliament approved the draft bill to introduce into Belgian law the Pillar Two minimum effective tax rate of 15% for multinational enterprises and large-scale domestic groups with consolidated annual revenues exceeding €750m. The Memorandum of Understanding confirms that the new legislation is aligned with the Organisation for Economic Co-operation and Development (OECD) Pillar Two model rules and implements the European Union Pillar Two Directive (EU Directive 2022/2523). Interaction with and consequences of (updated) Agreed Administrative Guidance should be closely monitored. Effective for Fiscal Years starting on or after 31 December 2023, a Qualified Domestic Minimum Top-up Tax (QDMTT) and an Income Inclusion Rule (IIR) is introduced. An Undertaxed Profits Rule (UTPR) will apply for Fiscal Years starting on or after 31 December 2024. The bill also includes a Transitional Country-by-Country Reporting Safe Harbor as well as a transitional UTPR Safe Harbor for MNE Groups in the initial phase of their international activities. Furthermore, the bill includes noteworthy amendments to certain existing provisions, in particular an amendment to the research and development (R&D) tax credit regime to meet the definition of a "Qualified Refundable Tax Credit."

New compliance and filing requirements are included, as well as a system of advance tax payments to collect the Top-up Tax under the QDMTT and IIR. The bill includes in the interaction between the (current) system of advance tax payments for the corporate income tax liability and the advance tax payment system for the QDMTT.

Canada

Canada is one step closer to enacting the Digital Services Tax Act (DSTA), which was included in Bill C-59, Fall Economic Statement Implementation Act, 2023, tabled in the House of Commons on 30 November 2023. This latest draft of the DSTA is a follow-up to the Department of Finance's revised draft legislative proposals released for public consultation on 4 August 2023. The DSTA continues to impact large Canadian domestic and foreign businesses that have a corporate group global consolidated revenues of at least €750m and that earn in excess of CA$10m in Canadian digital services revenue from providing online marketplace services, online advertising, social media services and the monetizing of user data.

The most notable changes to the DSTA since its iteration in August are:

- The thresholds for global revenue (i.e., €750m or more), in-scope revenue (i.e., CA$20m), and registration (i.e., CA$10m) have been moved from the DSTA to the Digital Services Tax Regulations under "Prescribed Thresholds." This relocation of the thresholds allows the federal government the flexibility to lower the thresholds for taxation or registration without requiring any legislative amendments to be passed in Parliament, thereby giving the cabinet the ability to increase tax revenues from the digital services tax without needing to seek parliamentary approval.

- The provision dealing with security (section 44 of the DSTA) has been removed; thus, a taxpayer will not be required to maintain security for the purposes of payment.

- Section 96 has been added, which allows for a due diligence defense for offenses under section 91 (failure to file or comply) or section 95 (general offense).

The earliest that the DSTA may come into force is 1 January 2024. However, the date of enactment will now be based on a date fixed by order of the Governor in Council. While Canada's Deputy Prime Minister and Minister of Finance, Chrystia Freeland, continues to give every indication that the legislation will be declared in force on 1 January 2024, by having the legislation come into effect on a date set by the federal cabinet, the government retains the flexibility to change or delay the implementation depending upon measures that other governments may take (most notably the United States) in reaction to Canada's passage of the DSTA.

Implications

With the tabling of Bill C-59, businesses and consolidated groups (both Canadian and foreign) that satisfy the €750m threshold are well advised to closely review the draft legislation and determine whether each revenue stream earned by the group is within the scope of the digital services tax. Certain provisions are broadly worded, and even businesses with a primary focus that is not digital or online services may find themselves within scope.

Key points to keep in mind include:

- Registration: A taxpayer or an affected member of a consolidated group is required to register under the DSTA if it earns Canadian digital services revenue, it meets the €750m threshold, and it earns more than CA$10m of Canadian digital services revenue. Notably, the threshold required to register (CA$10m) is lower than the threshold required for taxation (CA$20m). If a taxpayer or an affected member of a consolidated group is required to be registered, the taxpayer must apply to register by 31 January of the following calendar year.

- Returns: Returns are due annually on or before 30 June of the following calendar year.

- Payments: Payments must be made on or before 30 June of the following calendar year. Any payments of CA$10k or more must be paid electronically unless the taxpayer cannot reasonably pay that amount electronically.

Denmark

On 7 December 2023, the Danish Parliament passed Bill No. L 5 implementing Pillar Two into Danish law. The global minimum tax rules are incorporated into a new law, the Minimum Taxation Act (Minimumsbeskatningsloven). The law closely follows the structure of Council Directive (EU) 2022/2523 of 14 December 2022 and includes clarifications and interpretations published by the OECD in 2022 and 2023. Among other things, taxpayers can elect to apply a temporary safe harbor based on country-by-country reporting. The law also introduces a qualified domestic minimum top-up tax. The Income Inclusion Rule (IIR) is applicable for financial years beginning on 31 December 2023 or thereafter, whereas the Undertaxed Payment Rule (UTPR) is applicable for financial years beginning on 31 December 2024 or thereafter. However, the UTPR is applicable from 31 December 2023 in relation to a low-tax constituent entity that is resident in a country that has elected to not to apply the IIR and the UTPR for six consecutive fiscal years beginning from 31 December 2023.

Ecuador

The Ecuador Tax Authority has issued the Technical Sheet (version 8) for the Standardization of Transfer Pricing Analysis, applicable as of fiscal year 2023. The Technical Sheet makes substantial modifications to filing procedures, the content of the Comprehensive Transfer Pricing Report (Local File), formulas for applying working capital adjustments and comparability factors required for selecting comparable companies in Ecuador.

The recently elected Ecuadorian President has introduced a tax reform bill with implications for international taxation and foreign investment. The bill aims to promote foreign investment by making certain tax changes. The legislature will debate, approve, modify or deny the bill by the end of December; it will became effective once it is summited to the Official Public Registry. The bill is expected to be in force this month (December 2023) such that the new tax regime will begin in 2024.

France

Following the publication of the 2023 edition of the Transfer Pricing Guide for SMEs, the French tax authorities have updated their comments in the BOFiP on transfer pricing principles (see BOI-BIC-BASE-80-10-10, 22/11/2023).

1. Clarification about the group concept

As a reminder, and in accordance with OECD principles, transfer prices are "the prices of transactions between companies belonging to the same group and established in different countries". The BOFiP clarifies the notion of group, which presupposes the existence of links of dependence between the various companies that make up the group. Thus, two companies belong to the same group if one of them participates directly or indirectly in the management, control or capital of the other, or if both companies are owned or influenced by the same company or group. It is also specified that the relationship of dependence may be legal or de facto.

2. Intra-group services specificities

The BOFiP adds further details concerning administrative, financial, commercial or technical services provided by companies in the same group. Thus, for the expense relating to the remuneration of this service to be deductible and for the payment not to constitute an abnormal act of management, the service rendered must meet a real need of the beneficiary company, and the service rendered must not duplicate services that already exist in the subsidiary. Administrative doctrine now specifies that it is necessary to ascertain whether the activity is of economic or commercial interest to a group member, enabling it to strengthen or maintain its commercial position. To do this, it is necessary to ask whether an independent company would have been prepared to pay another independent company to carry out this activity in comparable circumstances, or whether it would have carried it out itself internally. If this is not the case, the activity should generally not be considered as an intra-group service in line with the arm's length principle.

3. Specificity of intangible assets that are difficult to value

The BOFiP provides clarification on intangible assets that are difficult to value. These assets are defined as those for which, on the one hand, there are no reliable transactions or comparables at the time of transfer, and on the other hand, at the time of the transaction, forecasts of future cash flows or revenues, or the possibilities of using the intangible asset, are highly uncertain, making it difficult to forecast its ultimate profitability and value at the time of transfer. Administrative doctrine now specifies that, in the case of such assets, the tax authorities may rely, in the context of an audit, on information and results occurring after the asset transfer date. This will enable the tax authorities to establish a presumption that the assumptions made by the company in setting the price at the time the asset was transferred were well-founded. If the actual results observed differ significantly from the forecasts, the tax authorities may review and question the transfer price used. The taxpayer can rebut the presumption of profit transfer by demonstrating:

- the reliability of the information used to support the calculation method adopted at the time the transaction was carried out; or
- that the difference between projections and actual results can only be attributed to the occurrence of events that could not have been anticipated.

4. Intercompany financial transactions

The BOFiP clarifies that intra-group loans, centralized cash management agreements and financial guarantees between associated companies must comply with the arm's length principle. With regard to intra-group loans, the BOFiP specifies that compliance with the arm's length principle is assessed by characterizing the risks borne by the lender and the borrower. This requires a precise delimitation of the transaction, identifying the commercial and financial relationships involved, but also taking into account the effect of belonging to the group, the presence or absence of restrictive financial clauses and the determination of an arm's length interest rate. As far as centralized cash management agreements are concerned, in assessing compliance with the arm's length principle, account must be taken not only of the facts and circumstances specific to the balances transferred, but also of the more general context set by the terms of these agreements. In addition, if the entity responsible for centralized cash management merely performs coordination or agent functions, only limited remuneration may be granted, while higher remuneration may be awarded if it performs other functions. On the subject of guarantees, the BOFiP specifies that the methods that can be used to assess their arm's length price are: the comparable open market price method, the yield-based method, the cost method, the expected loss method or the capital support method.

Hong Kong

Two bills making additional revisions to the foreign-sourced income exemption (FSIE) regime regarding asset disposal gains and providing safe harbor rules for onshore equity disposal gains1 have now been passed in the current form. The FSIE ordinance was gazetted on 8 December and the safe harbor ordinance will be gazetted on 15 December; both will come into effect starting from 1 January 2024. This Alert highlights the key features of the new rules.

Hong Kong introduces bill to enhance aircraft leasing preferential tax regime.

Hungary

President of Hungary signed the legislation on BEPS 2.0 Pillar Two on 24 November 2023. The legislation was published in the Official Gazette on 30 November 2023. The final legislation does not include significant modifications comparing to the draft legislation introduced to the Parliament on 31 October 2023. Most of the changes were legal technical clarifications but some also included actual changes. Based on the final legislation, an Income Inclusion Rule (IIR) and a Qualified Domestic Minimum Top-up Tax (QDMTT) will be introduced from 1 January 2024, and an Undertaxed Profits Rule (UTPR) will apply from 1 January 2025. A transitional Country-by-Country Reporting (CBcR) Safe Harbor and QDMTT Safe Harbor will be available. Covered taxes will include not only corporate income tax but also local business tax, innovation contribution and energy suppliers' tax. A Substance-Based Income Exclusion will be available, and a deferred taxation/tax accounting concept will be introduced for Pillar Two purposes.A Hungarian holding regime (providing full exemption for dividends and capital gains) will remain in place. Hungary will not introduce domestic withholding taxes; thus, no withholding tax will apply to any kind of payments that Hungarian entities make to foreign corporate entities. A new R&D tax incentive regime will be introduced as a qualifying refundable tax credit, potentially resulting in a cash refund.

New Zealand

When the New Zealand Parliament resumed sitting on 6 December, the new Government chose to reinstate a bill that introduces the OECD's GloBE Pillar Two Rules into domestic law. Although the Government has not yet made any amendments to the Bill, amendments are possible in response to public submissions received to date. The bill is likely to progress to enactment by 31 March 2024.

New Zealand Government reinstates Digital Services Tax Bill, following General Election.

Saudi Arabia

On 5 December 2023, the Ministry of Investment of Saudi Arabia (MISA), in conjunction with the Ministry of Finance, and the Zakat, Tax and Customs Authority (ZATCA), announced a 30-year tax incentive package for multinational companies with regional headquarters (RHQ) activities in Saudi Arabia, according to the Saudi Press Agency. The comprehensive tax incentive package offers a 0% corporate tax and withholding tax rate for three decades on approved regional headquarter activities, applicable from the date companies obtain their RHQ license. The new tax exemption is expected to further boost the appeal of Saudi Arabia to multinational companies and help the country achieve its goal of becoming one of the world's 10 largest city economies by 2030. Formal regulations on the proposed tax incentive scheme are still awaited.

The ZATCA has issued the Guidelines to clarify the related-party transactions concept for zakat payers and its impact on the zakat.

Highlights of the Guidelines

The Guidelines provide extensive details and classify related-party transactions under the following categories:

1. Commercial transactions (e.g., sale of goods and provision of services): For zakat computation, if the transaction is not based on the "arm's length" principle, adjustment for the excess amount is required.

2. Indirect financing (e.g., payments of any cost or invoice by a related party on behalf of the zakat payer): This will not necessarily require an adjustment for zakat purposes.

3. Direct financing (e.g., loan financing): This may include working capital financing, long-term shareholders' financing, related-party or shareholder's cash asset financing and related-party or shareholder's in-kind financing. Loans from related parties are generally treated as debts and equivalents for zakat purposes; however, based on their nature and terms, these may be reclassified as equity and treated accordingly.

The Guidelines clarify the cases in which credit balances of the above transactions should be treated as liabilities, and, as such, added to the zakat base as per Article 4(3) of the Zakat Bylaws. The ZATCA also clarifies the cases in which such credit balances are treated as equity elements and added to the zakat base in full. The guidelines also address certain related-party transactions, related credit balances and their zakat treatment as follows:

- If an amount due to a shareholder or a related party is classified as part of equity, it will be treated accordingly for zakat purposes based on Article (4)1 of the Zakat Bylaws.

- Outstanding liabilities that arise from related-party transactions and classified as long-term, will be treated as such for zakat purposes based on Article (4)3 of the Zakat Bylaws, unless the substance of the transaction is of a capital nature.

- If any liability resulting from related-party transactions is classified as short term, and the nature of such transaction is commercial, such liability should not be treated as capital.

- Shareholder's loans in listed companies should be treated as equity or liabilities for zakat purposes, based on their classification in the financial statements.

- Owners' and shareholder's loans in individual establishments and one-person companies are treated as equity (irrespective of their classification in the financial statements) and should be added to the zakat base without applying the capping rule.

- Shareholders' loans in other capital companies will be treated as liabilities if the following conditions are met:

  o Financial statements audited by a licensed accountant in Saudi Arabia are available.

  o The shareholders' loans are classified under liabilities in the financial statements.

  o Debt financing agreement is available, including agreed terms of repayment and return/interest.

  o Where the debtor treats the due-to-related-party loans as "equity," the creditor will be able to deduct the loan receivable from the zakat base.

o No offset is allowed between shareholders'/related parties' debit and credit balances that resulted from different commercial or financing transactions unless this is performed for accounting purposes.

Zakat payers' assets that are in the name of shareholders may be deducted from the zakat base even if the title is still with the shareholders, based on the following conditions:

- There is a restriction or justifiable delay in transferring the title to the zakat payer.
- The assets are used for the company's activities.
- The assets represent in-kind capital contribution.
- Shareholders' salaries and allowances are fully deductible expenses for zakat purposes if:
- A legal employment contract is in place.
- Registration with the General Organization for Social Insurance (GOSI) is completed.
- The provisions of the Wages Protection System apply.

Implications

Taxpayers, zakat payers and businesses should assess the nature of their transactions with related party to determine the appropriate zakat treatment, adhering to the guidance provided in the Guidelines.

USA

In Notice 2023-80 (Notice), issued December 11, 2023, the United States (US) Treasury Department (Treasury) and the Internal Revenue Service (IRS) outlined guidance on the interaction of the foreign tax credit (FTC) rules and dual consolidated loss (DCL) rules with top-up taxes imposed via the Income Inclusion Rule (IIR) or a Qualified Domestic Minimum Top-Up Tax (QDMTT) under the OECD's Global Anti-Base Erosion Model Rules (GloBE Rules). Treasury also announced its intent to issue proposed regulations that will align with this new guidance. The Notice generally does not provide guidance on the FTC implications of the UTPR (commonly referred to as the "Undertaxed Profits Rule"); however, Treasury and the IRS are analyzing these issues and plan to release additional guidance. The Notice also extends, through tax years "ending before the date that a notice or other guidance withdrawing or modifying the temporary relief is issued (or any later date specified in such notice or other guidance)," the temporary relief from the application of regulations under IRC Sections 901 and 903, which identify foreign taxes for which taxpayers may claim a credit (FTC Creditability Regulations) described in Notice 2023-55.

Vietnam

The National Assembly passed a Resolution on the application of top-up corporate income tax (CIT) in accordance with the global anti-base erosion (GloBE) Model Rules. The Resolution takes effect from 1 January 2024, applying from fiscal year 2024. Taxpayers subject to this tax are constituent entities (CE) of multinational enterprise (MNE) with revenue in the consolidated financial statements of the ultimate parent entity equivalent to €750m or more for at least two of the four years preceding the fiscal year, except for certain regulated exclusions.

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

About Mazars

Mazars is an internationally integrated partnership, specialising in audit, accountancy, advisory, tax, and legal services*. Operating in over 90 countries and territories around the world, we draw on the expertise of more than 42,000 professionals – 26,000+ in Mazars' integrated partnership and 16,000+ via the Mazars North America Alliance – to assist clients of all sizes at every stage in their development.

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