

EUROPEAN U.S. TAX DESK NEWSLETTER

December 2016



IN THIS ISSUE!

Welcome to the second issue of the Mazars European U.S. Tax Desk Newsletter!

This is our new series of regular European tax newsletters. These will provide you with insights on current topical tax issues and discuss how they will affect you.

In this edition, our contributors from 5 European countries discuss:

- the increasing transparency of the European tax regimes;
- initiatives to tackle hybrid mismatches;
- knowledge development IP regime;
- draft new legislative provisions to be introduced by the UK in April 2017;
- tackling of double dip structures;
- proposed amendments to German real estate structures;
- new anti-avoidance legislation and increased exchange of information; and
- draft German legislation proposes greater flexibility in the utilisation of trading tax losses.

On behalf of the Mazars European U.S. Tax Desk, we hope you find our newsletter useful. If there are any issues you would like to discuss further, please do not hesitate to contact us.

HERE TO HELP YOU!

International firms with a competitive advantage have real time access to insightful foreign tax knowledge. The right advisor helps to identify opportunities and to manage risk profiles. Given the far reaching effects of the OECD BEPS project, awareness of legislative and regulatory changes has never been more important.

The Mazars European US Tax Desk was created to help US companies successfully manage these challenges. We can help you to ask the right questions, set priorities and define the action plans needed to succeed in the fast moving landscape of international tax.

The Mazars European US Tax Desk is a platform for companies with existing European operations and those looking to enter Europe.

In working with the Desk, companies will be able to access a wealth of multifaceted, cross border experience in areas such as:

- International tax structuring
- Transfer pricing
- Inbound and outbound investment
- Intellectual property planning
- Financing structuring
- Treaties – interpretation and maximisation of benefits
- Research and development tax credits
- Cross border financing, leasing and licensing
- Corporate acquisitions and divestments

We are here to help you! As part of our programme to keep you up to date on what is happening in Europe, we will publish regular newsletters. These will discuss important tax legislative changes, provide on the ground insight, but most importantly, identify how this news is of relevance to you.

We hope you enjoy our first newsletter. Please do not hesitate to contact any of the Desk members if you have a particular issue you would like to discuss further.

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THE NETHERLANDS

1. PROPOSED CHANGES TO DUTCH DIVIDEND WITHHOLDING TAX RULES

On September, 20th 2016, the Dutch Minister of Finance sent a letter to the Dutch parliament to announce changes to Dutch dividend tax rules. The government intends to align the dividend tax treatment of holding cooperatives (“Coops”) and to introduce a broad dividend tax exemption for business structures.

COOPS

Currently, distributions by Coops are not subject to dividend tax, with the exception of abusive situations. Dividend distributions by Dutch BVs/NVs are typically subject to 15% withholding tax.

Under the new proposal, a Coop which acts as an (intermediate) holding company is obliged to withhold dividend tax on dividend distributions to its members, but only when the member has an interest of 5% or more in the Coop. Under the new rules, the dividend tax treatment of holding Coops will therefore be aligned with the position of BVs/NVs.

EXEMPTION

To avoid dividend tax in genuine business structures, the Dutch government proposes to extend the scope of the existing withholding exemption for participation dividends in business structures.

Currently, in general, this withholding exemption applies only to parent companies within the EU/EEA with an interest of 5% or more and certain other conditions are met.

Under the new proposal, the scope of the withholding exemption will be extended to dividends in business structures to parent companies outside the EU with which the Netherlands has concluded a tax treaty.

Anti-avoidance provisions will be introduced in order to prevent and combat untaxed routing of dividends from the Netherlands to non-treaty countries or tax havens.

GOING FORWARD

The September letter is an announcement of new rules and the legislative proposal is still to be prepared. The government aims to bring the new rules into force as from 1 January 2018.



THE NETHERLANDS

2. PROPOSAL AGAINST HYBRID MISMATCHES

On October, 25th 2016, the European Commission (EC) published a proposal for a directive which lays down rules against hybrid mismatches involving third (non-EU) countries. The rules, amongst others, are expected to have an impact on Dutch CV-BV structures used by US multinationals. This directive forces US multinationals to reconsider their Dutch CV/BV structures.

DIRECTIVE

The EC's proposal is an amendment to the agreed upon Anti-Tax Avoidance Directive on June, 20th 2016, which includes rules against hybrid mismatches within the EU. The proposal extends the scope of the rules to mismatches between EU and third countries, such as the US.

A hybrid mismatch generally arises if a taxpayer exploits a difference in classification of an entity or instrument by two countries to achieve (double) non-taxation. The proposed rules prevent such mismatch by either denying a deduction of the payment or including such payment in the taxpayer's tax basis.

For the proposal to come into effect, all 28 EU Member States will have to unanimously approve after which the EU Member States will implement these rules into their domestic legislation by December 31st, 2018.

EFFECT ON DUTCH CV/BV STRUCTURES

A hybrid mismatch-structure frequently used by US multinationals is a CV/BV structure. The CV/BV structure typically involves a Dutch limited partnership (CV) that owns the group's non-US IP and shares in a Dutch holding company (usually a BV or cooperative). The Dutch holding company, in turn, holds the group's non-US operating subsidiaries. Royalties and/or other fees are paid by the subsidiaries, via the Dutch holding company, to the CV. The CV is set-up as a pass-through for Dutch tax purposes (and therefore not subject to Dutch corporate income tax). On the other hand, checking the box treats the CV as a corporation for US tax purposes, blocking the income from being taxable in the US. Accordingly, the payment of royalty/fee would effectively be tax deductible, without a corresponding inclusion of taxable income at CV-level.

If the rules of the proposal are implemented, the above-mentioned mismatch would be neutralized by denying the deduction of the royalty/fee payment to the CV. As a result hereof, the CV/BV structure would no longer be effective.

GOING FORWARD

By broadening the scope of the current hybrid mismatch rules as mentioned in the Anti-Tax Avoidance Directive, the EC intends to, prevent the use of hybrid mismatch structures with third (non-EU) countries, such as the US. If implemented, these rules are expected to have a substantial impact for currently used CV-BV structures.

The proposal, as drafted by the EC, is to be implemented in domestic laws of the respective EU Member States as of December, 31st 2018.

3. KNOWLEDGE DEVELOPMENT BOX

The introduction of the KDB is one of a number of measures intended to foster innovation in Ireland and will place Ireland in a unique position to offer long-term certainty to innovative industries planning their research and development activities. With this in mind, the KDB is an annual benefit which can apply to both the SME and FDI sectors. However, the KDB will be of particular benefit to Irish based SME's engaging in qualifying research and development activities as the new regime links the 6.25% rate to qualifying R&D activities carried out in Ireland, with some flexibility.

The Irish KDB aims to be the first patent box that meets the standards of the OECD's 'modified nexus' approach to preferential tax regimes and aims to be the 'best in class' KDB regime.

In principle, the KDB is designed to encourage an ethos of creation, utilisation and exploitation of patents, copyrighted software and supplementary protection certificated in Ireland by offering a 50% reduction in the standard corporate tax rate (12.5% to 6.25%) on qualifying profits of a specified trade. It applies to accounting periods commencing on or after 1 January 2016 and before 1 January 2021.

HOW IT WORKS

The amount of profits that can avail of the relief will be determined by the proportion of the Irish company's R&D expenditure bears to the total R&D expenditure incurred to develop a "qualifying asset". Put simply, if an Irish company performs 100% of the R&D which developed the asset in Ireland, then 100% of the income arising to that asset can potentially qualify for the 6.25% rate. All claims must be made within 24 months from the end of the accounting period to which the claim relates. Therefore, businesses that undertake most of their R&D in Ireland, the KDB could be very attractive.

QUALIFYING ASSETS

Qualifying assets are the income generating assets that qualify for the 6.25% rate. A qualifying asset is an intellectual property asset (other than marketing related intellectual property) which is the result of research and development activities.

Qualifying assets include:

- A copyrighted computer program, or
- An invention protected by:
 - A qualifying patent,
 - A medicinal products certificate,
 - A plant machinery certificate, or
 - Plant breeder's rights.

To recognise the fact the above patent definition of qualifying assets is quite restrictive and only rewards companies which legally protect their intellectual property, the KDB legislation offers an additional inclusion basis for qualifying assets for companies with income arising from intellectual property of less than €7,500,000, less than 250 employees and an annual global turnover of less than €50,000,000 (Definition of SME as per OECD).

Intellectual property for small companies means inventions that are certified by the Controller of Patents, Designs and Trade Marks as “novel, non-obvious and useful”. This new certification process should allow Irish SME’s with patentable intellectual property, but who do not patent due to cost or other factors, to benefit from the KDB.

QUALIFYING INCOME & PROFIT

To be eligible for the 6.25% rate the income from each qualifying asset must be separately identifiable, or where it is not practicable to individually identify those assets due to their interlinked nature then a family of qualifying assets may be identified.

INTERACTION BETWEEN KDB AND R&D TAX CREDIT

The KDB will be granted only where the qualifying assets are the result of qualifying R&D activities that have been carried out by the entity claiming the tax benefit. Claiming the KDB should be a natural extension for those companies already claiming the R&D tax credit on an annual basis. The R&D tax credit already provides a 25% tax credit on qualifying R&D expenditure.

Relief under the KDB and the R&D tax credit target fundamentally different stages of activity in the business cycle of an innovation-rich company. The aim of the KDB is to provide taxpayer relief once successful R&D activity has resulted in qualifying income arising to the company from completed R&D activity. In contrast, the R&D tax credit relief is designed to afford cash tax savings to companies engaged in R&D activities.



LUXEMBOURG

4. TAX REFORM FOR LUXEMBOURG CORPORATIONS

The 2017 Luxembourg tax reform foresees the decrease of the corporate income tax rate, the strengthening of the tax transparency and the promotion of non-harmful tax practices.

The text, presented on the 10 August, 2016 at the Deputies Chamber, has been examined by the State Council on the 15 November, 2016 where it issued its opinions on the proposals. Most of these measures will enter into force in 2017.

The progressive reductions of the corporate income tax (“CIT”) rate and the specific advantages envisaged are designed to improve the attractiveness of Luxembourg. Nevertheless, this new framework also includes a specific focus on tax transparency through the development of the transfer pricing rules and the introduction of new obligations in respect to the country-by-country reporting (“CbCr”).

Specific attention should also be paid on the amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries (“ATAD II”) because of the significant impact it may have on the “CPECs” and “Finance Branch” structures with the US (III).

REDUCTION IN THE CORPORATE INCOME TAX

The tax reform aims to improve the tax situation of companies in order to make Luxembourg more competitive.

The gradual reduction from 21% to 19% in 2017 and, then, to 18% in 2018 of the Corporate Income Tax (“CIT”) rate will be applied, leading to an overall corporate tax rate for companies located in Luxembourg city (including municipal business tax and solidarity surtax) of 27.08% for FY 2017 and 26.01% for FY 2018.

The CIT rate will be reduced from 20% to 15% for small and start-up companies with an annual taxable income not exceeding €25,000.

INCREASE IN THE MINIMUM NET WEALTH TAX (“NWT”)

The minimum NWT for financial participations companies (SOPARFI) will increase from €3,210 to €4,815 (including the solidarity charge). SOPARFI’s are typically established to either hold and manage shares in a group of companies, or to be a vehicle to finance and hold investments in risk capital and private equity.

The minimum NWT applicable to all other corporations having their registered office or central administration in Luxembourg will remain unchanged.

LIMITATION ON THE USE OF FUTURE LOSSES

The regulations concerning carried forward tax losses will change in 2017. Currently, tax losses can be carried forward indefinitely. As from 2017, the tax losses permitted to be carried forward will be limited to a maximum period of 17 years. This period has been specifically chosen as authorities believe that a viable company should be able to fully utilise its losses within that timeframe. This limitation is only applicable to CIT and Municipal Business Tax (“MBT”).

NEW TASK MEASURES

- The use of the electronic tax return will be mandatory in 2017. Tax returns for companies which pay corporate tax will no longer be allowed to be sent by post. This measure is expected to reduce delays in tax reporting assessments.
- Investments in commercial, industrial, mining or handmade corporations registered in Luxembourg will benefit, upon request, from an income tax rebate. To make Luxembourg more attractive, the Government has decided to increase the investment tax credit. The Complementary and Overall Investment Tax Credits will be increased from 12% to 13% and from 7% to 8% respectively. The investment tax credit for assets under the special depreciation regime will also be increased from 8% to 9%.
- The reform takes into account the European Court of Justice's decision (C-287/10 Tankreederei); hence it is decided to extend the investment tax credit to investments made in other European Economic Area member states.
- The reforms foresee the removal of the practice of applying a fixed registration rights charge of 0.24% for debt obligations registration on notarial acts when the registration is not mandatory. The fixed charge will continue for acts where the registration is mandatory.



LUXEMBOURG

5. TAX TRANSPARENCY & NON-HARMFUL PRACTICES

Luxembourg is committed to promoting transparency in all fields of its tax legislation, including new transfer pricing rules and the introduction of the Country-by-Country Reporting (“CbCr”).

NEW TRANSFER PRICING RULES

The Luxembourg transfer pricing (“TP”) rules are based on art. 56 of the Luxembourg Income Tax Law (“LITL”). Reforms under Bill “7050” proposes to introduce the art. 56bis LITL, which incorporates some of the key principles of the 2016 Revised OECD TP Guidelines.

The new article is composed of seven paragraphs:

- §1 deals with definitions,
- §2 to §6 emphasize both principles and methodologies (comparability analysis, the five factors needed to be considered for the control of the transactions, the traditional transaction and transactional profits methods...); and
- §7 introduces a General Anti-Avoidance Rule (“GAAR”) - type measure which indicates that a lack of valid commercial rationality behind a transaction can constitute a matter of non-recognition of the transaction itself.

Art. 56 bis LITL will formally bring into Luxembourg law some of the key principles of the current OECD TP Guidelines.

This should not result in a significant change to Luxembourg’s TP regime, since the Luxembourg Government is one of many Governments which formally subscribes to the OECD TP Guidelines. Nevertheless, art. 56bis LITL can constitute a legal reference when a TP report is needed to be done in Luxembourg, and also calls for an update of the existing TP documentation in accordance with the new amendment brought to the OECD 2016 TP Guidelines. A new TP circular on financing activity may be expected soon to comply with the new OECD TP guidelines in term of intra-group financing activity.

The introduction of GAAR-type measure in paragraph 7 warrants significant consideration. The measure provides that the lack of valid commercial rationality behind transactions can constitute a matter of non-recognition. Hence, in order to avoid being within the scope of this provision, constructive support proving the commercial rationality behind all controlled transactions becomes fundamental in Luxembourg TP documentation.

COUNTRY-BY-COUNTRY REPORTING

The Luxembourg parliament issued a draft law on August 2nd, implementing directive (UE) 2016/881 related to the automatic exchange of tax information and CbCr.

It is proposed that CbCr will be applicable in Luxembourg for 2016. Although this is still a draft law, no changes as regards the implementation date are expected. When the ultimate parent is not required to file a CbCr in its jurisdiction of residence, then there is an obligation of surrogating filing obligation at a lower level.

Assuming that the US will delay the application of the CbCr to 2017 or later, then a gap year will appear between the US and Luxembourg. Consequently, there will be a surrogating filing for Luxembourg entities which are subsidiaries of US parent companies.

In the case where the ultimate parent is not located in Luxembourg, a local reporting limited to the contact details of the parent company will need to be done to the Luxembourg tax authorities via an electronic filing. Additional guidelines in this respect are expected soon about this matter from the tax authorities.



6. POTENTIAL AMENMENTS OF THE GERMAN TAX LAW

The upper house of the German parliament (*Bundesrat*) issued on September 23, 2016 its comments to the draft tax law implementing (to some extent) the proposals of the OECD BEPS-initiative. The finance committee of the lower house of the German parliament scheduled an expert session on the new draft tax law on October 19, 2016. The lower house of the German parliament issued recommendations for decisions (*Beschlussempfehlungen*) on November 30, 2016.

It has to be noted that the potential amendments described are neither final nor implemented. It is currently unclear whether and to what extent these amendments will be finally implemented in the German tax law.

BEPS – TACKLING OF DOUBLE-DIP STRUCTURES

Partnerships are, according to German tax law, transparent for corporate income tax purposes and opaque for trade tax purposes. Thus, any income generated at the level of the partnership is allocated for corporate income tax purposes to the individual partner and is for trade tax subject to tax at the partnership level.

Financing costs triggered by a partner due to the refinancing of their equity stake in a German partnership are so called special purpose expenses (*Sonderbetriebsausgaben*). These are tax deductible at the level of the partnership, consequently reducing the trade tax liability of the partnership and the corporate income tax base allocable to the respective partner. In the event a foreign jurisdiction also grants a tax deduction for these expenses, it is possible to achieve a deduction of the same expenses twice (double-dip).

Against this background, the upper house of the German parliament proposes to implement in the draft tax law a new provision (Sec. 4i EStG (*Einkommensteuergesetz* – Income tax law)) disallowing a tax deduction of such interest expenses, if the same expenses also reduce the tax base in a foreign jurisdiction. Based on the wording of the draft tax law, the taxpayer has to prove that the respective expense does not reduce the tax base in a foreign jurisdiction to achieve a tax deduction in Germany.

GOING FORWARD

This proposal should become effective on 1 January 2017.

7. DISPOSAL OF SHARES IN REAL ESTATE ENTITIES

Investments in German real estate can be made by foreign corporations without establishing a German permanent establishment.

Up to now, the disposal of shares in such foreign corporations owning German real estate is not subject to the German disposal gains taxation. However, several double tax treaties recently concluded comprise in Art. 13 (OECD-MC) the assignment of the taxation right for the disposal of the shares in foreign corporations holding German real estate, to the jurisdiction where the real estate is located. Examples would include the DTT Germany-Luxembourg (if the value of the German real estate is more than 50% of the company's assets, DTT Germany-The Netherlands (if the value of the German real estate is more than 75% of the company's assets)).

To enable Germany to apply the taxation right assigned by the DTTs, it is intended to implement a new tax nexus aiming for the taxation of real estate companies, if the value of the German real estate is, directly or indirectly more than 50% of the company's assets. Technically, this tax nexus is created as a fact pattern subject to German non-resident taxation in the domestic tax law (Sec. 49 Para. 1 Nr. 5 Sent. 1 let. 1c EStG-Draft). Moreover, the taxation right should be regularly applied independent from the ownership percentage by way of withholding tax deduction.

It has to be noted that the finance committee of the lower house of the German parliament seems not to have included this proposal of the upper house of the German parliament in the issued recommendations for decisions (*Beschlussempfehlungen*) on November 30, 2016.



8. GERMAN CFC TAXATION

Germany provides for a controlled foreign company (“CFC”) regime laid down in the German Foreign Tax Act (*Außensteuergesetz*; hereinafter “AStG”). The aim of the CFC-regime is to prevent erosion of the domestic German tax base by shifting income to jurisdictions with no or lower taxes.

If considered a CFC, a foreign corporation (and also a partnership or a permanent establishment under certain circumstances, Sec. 20 Para. 2 AStG) would be regarded for German tax purposes as if the income of the foreign corporation is directly realized by the German shareholder. The CFC income allocated to the German shareholder would be subject to German corporate income tax, solidarity surcharge and trade tax (any taxes paid in the foreign jurisdiction are potentially deductible from the German income tax burden).

The relevant Sec. 7 and 8 AStG require for a CFC that:

- it qualifies as a corporate entity under the German Corporate Tax Act;
- it has its seat in a foreign country;
- it is subject to no taxes or a low tax regime (effectively below 25%) in the country of residence;
- it is controlled by the German tax payer, i.e. the tax payer holds more than 50% of the shares or the voting rights in the CFC at the fiscal year end;
- it receives so called “passive” income; and
- it is not pursuing an economic activity in the foreign country (escape clause for entities located in an EU or EEA member state).

The German Federal Tax Court ruled on 11 March 2015 that the CFC income generated relates to a foreign permanent establishment. Consequently this has to be deducted for German trade tax purposes pursuant to Sec. 9 Nr. 3 GewStG. Any CFC income allocated to the German shareholder would be solely subject to German corporate income tax and solidarity surcharge (not trade tax) and thus the effective German tax burden for this subject would be reduced by approx. 50%.

In view of this and in order to ensure taxation with trade tax, it is intended to classify CFC income allocated to a German shareholder as generated by a domestic permanent establishment. In such a case, the trade tax deduction according to Sec. 9 Nr. 3 GewStG should not apply.

However, if the taxpayer could demonstrate that the CFC is located in an EU or EEA member state, this proposed amendment of the German tax law should not apply.

UNITED KINGDOM

9. AUTUMN STATEMENT 2017 - TAX IMPLICATIONS FOR MULTATIONALS

The Chancellor, in his Autumn Statement, has confirmed the government's intention to move forward with proposals to limit tax relief for losses and corporate interest payments, in line with the OECD/G20 BEPS initiative. However, the Chancellor has also committed to making the UK a more internationally competitive place to do business by confirming the rate of corporate tax will reduce to 17%, eliminating the streaming of most categories of tax losses, and by expanding the exemptions available for capital gains tax.

In light of the increased pressure on good tax practices in the UK, the government has struck a fair balance between tax revenue and competitiveness.

The following is a brief summary of the legislation as put forward in the Finance Bill 2017, which is due to come into effect from 1 April 2017. The Finance Bill must first pass through the Houses of Parliament before it is enacted into legislation.



SUBSTANTIAL SHAREHOLDING EXEMPTION

The Substantial Shareholding Exemption (SSE) was introduced in 2002 in a bid to attract foreign direct investment into the UK and to promote more productive investment practices for groups established here. If conditions are met, a company will be exempt from paying UK corporation tax on a capital gain arising on certain sales of shareholdings in companies.

The conditions will be relaxed to enable more investing companies to satisfy them in future. The draft legislation in the Finance Bill 2017 proposes to improve the existing conditions by removing the investing company requirement and extending the period from which the non-consecutive 12 month ownership test can be satisfied, from 2 years to 6 years prior to disposal.

INTEREST DEDUCTIBILITY

In line with BEPS recommendations and as previously announced, legislation has been released to restrict tax deductions for interest payments to prevent excessive taxable deductions in the UK, which are not reflective of the economic activity of a company.

The rules are to be applied to groups of companies which have a net interest expense of greater than £2m per annum. Although the restriction may be determined by reference to the worldwide group, it is only UK entities which should suffer a restriction.

The restriction will be the lower of interest deductions in excess of:

- a group's net UK tax interest expense in excess of the global group's net interest position; and

- The higher of:
 - the worldwide consolidated group's net interest expense as a proportion of its group EBITDA, determined from the group's consolidated financial statements. The subsequent ratio is then multiplied by the UK group's tax-EBITDA; or
 - 30% of a UK group's tax-EBITDA.



Excess interest will be disallowable for corporation tax purposes. However, any interest deductions restricted in one period may be carried forward indefinitely, and used as a further interest deduction in a future year.

Finance Bill 2017 proposes certain reliefs for specific sectors that would be unfairly hit. One of which is aimed at public infrastructure projects and referred to as the PBIE. If the qualifying criteria for the PBIE are met, then the interest restriction rules will not apply to any third party interest expense incurred by the entity.

An appointed reporting company of a worldwide group will be required to submit an "interest restriction return" to HM Revenue & Customs. This return sets out the amounts of interest and other financing amounts that are to be disallowed or reactivated, and how they are allocated to companies in a group

LOSS REFORM

As previously announced, Finance Bill 2017 proposes changes to the corporation tax loss utilisation rules, which broadly fall into two parts:

- Losses arising from 1 April 2017 can be carried forward and set against different types of taxable profits within that company and against the taxable profits of its group members, through group relief. Currently group relief is only available for in year profits and losses. Losses arising prior to 1 April 2017 remain subject to existing restrictions with respect to the profits they can be offset against. This is a positive move which will allow greater flexibility in the offset of losses.
- The amount of annual profit that will be able to be relieved by carried-forward losses would be limited to 50% from 1 April 2017, subject to an allowance of £5 million per group. There are no restrictions on the carry-back of losses and groups will have full discretion as to the allocation of the £5 million allowance between group members. A group for these purposes will be all companies within 75% group (i.e. both ownership and beneficial entitlements).

Losses covered by the changes include; trading losses, non-trading loan relationship deficits, UK property losses, management expenses and non-trading losses on intangible fixed assets. The capital losses rules are proposed to remain unchanged.

CONCLUSION

With the corporation tax rate falling to 17% by 2020, by far the lowest in the G20, there has never been a better time to do business in the UK. It will, however, be important to engage in dialogue early in 2017 to understand the impact of the changes to loss and interest relief on your structure.

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