

# MAZARS U.S. TAX DESK NEWSLETTER

July 2017



## IN THIS ISSUE!

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

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

In this edition, we are delighted to include content from Mazars Brazil. This considers how technology is driving increased transparency.

Our contributors from 6 various countries discuss:

- Achieving Transparency through Technology – Brazil's SPED system in light of BEPS;
- U.S. Brazilian subs dealing with BEPS Action 13;
- Proposal Dutch dividend withholding tax;
- Dutch signing ceremony multilateral instrument;
- Impact of US tax reform on Ireland;
- Luxembourg Intellectual Property Tax Regime Reform;
- Nexus approach ("action 5") and qualifying expenditures (development of R&D) in Luxembourg;
- German federal constitutional court rules that parts of the German change of control rules are unconstitutional;
- Implementation of a licence barrier;
- Improving tax transparency for large businesses in the UK; and
- 2017 Election result.

## 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 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 US Tax Desk is a platform for companies with existing international operations and those looking to enter other jurisdictions.

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 the world, 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.

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## ACHIEVING TRANSPARENCY THROUGH TECHNOLOGY BRAZIL'S SPED SYSTEM IN LIGHT OF BEPS



With the benefit of hindsight in a post-financial crisis world, the G-20 group concluded that enhancing transparency for tax administrations was key for tackling base erosion and profit shifting (BEPS). G-20 commissioned the OECD to analyze the problem in 2009. In 2013, the OECD announced the action plans on BEPS intended to modernize the global tax system at a moment of transition between industrial and digital economies and counterpoint tax avoidance strategies that take advantage of gaps of the legislation.

Brazil's public digital bookkeeping system (SPED) was introduced in 2007 to address the roots for BEPS through fraud and evasion. SPED unifies the activities of reception, validation, storage and authentication of electronic documents that integrate tax, accounting, financial and labor & social security corporate data. The electronic flow is based on 2001 legislation on authenticity, integrity and legal validity of documents in electronic form, supporting apps and the use of digital certificates in secure electronic transactions.

SPED is the cornerstone of the electronic framework intended to improve data quality, reduce costs and promote mutually transparent relationship between tax authorities and taxpayers. All levels of tax jurisdiction in Brazil (federal, state and city) are users of SPED and have the ability to obtain real time assessment of data and cross-reference information. SPED has imposed substantial changes on corporate compliance, investments in technology, training and demanded integrated actions from different areas of the business: finance, HR, I&T, bookkeeping, supplies, production, inventory, sales, purchases, payables & receivables. If inconsistencies and operational errors are subject to visibility and monitoring by tax authorities, SPED allows companies to improve compliance, reduce costs and errors.

SPED is an ongoing process of evolvement with the design of more electronic environments. Each pillar is grounded on detailed data collection – e.g., (i) e-Invoice: different type of electronic invoices, (ii) EFD: different types of digital fiscal bookkeeping according to the nature of taxes, (iii) ECD: digital accounting bookkeeping (journal register and supporting records, general ledger and sub-ledgers, daily trial balances and balance-sheets into a single file, (iv) ECF: the tax accounting bookkeeping system that replaced the corporate income tax return, (v) e-Financial (a more detailed FATCA) and (vi) e-Social that contains labor & social security data, including litigation procedures. Aside from SPED, other electronic systems of information exist: SISBACEN for domestic and

cross-border financial data, SISCOMEX for customs, and SISCOSERV for inflows and outflow of intellectual capital and property.

The conversion of BEPS plans into the Brazilian tax system, the adoption and translation of IFRS into local GAAP, the harmonization of accounting and tax rules and the solid support of tax courts on the economic substance and business purpose doctrines are also drivers to tackle BEPS in Brazil.

Bottom line based on the Brazilian experience: a successful BEPS policy based on the OECD action plans seems not enough. Today's reality is way too complex and massive investments in technology and the development of digital platforms appear to be mandatory to ensure transparency. An example is the Car Wash operation, the largest money laundering investigation in the world's history. The use of SPED combined with the actions of the Lab of Technology of the Brazilian Federal Revenue against Money Laundering (LAB-LD) and task forces have led to almost 1.000 tax inspections since 2014 and assessments in the ballpark of USD3,3billion so far. <sup>1</sup>



<sup>1</sup> [http://www.consystem.com.br/newsletter/abr2016\\_o-uso-do-sped-na-operacao-lava-jato.html](http://www.consystem.com.br/newsletter/abr2016_o-uso-do-sped-na-operacao-lava-jato.html); <http://blogdosped.blogspot.com.br/2017/01/receita-federal-cobra-mais-de-r-10-bi.html>

## U.S. BRAZILIAN SUBS DEALING WITH BEPS ACTION 13

On 28 December 2016, the Brazilian Federal Revenue enacted Regulation #1.681 introducing the rules on the *Country-by-Country (CbC) Reporting* standard under the Base Erosion and Profit Shifting (BEPS) Action 13. The rules are applicable to FY2016 and information must be reported in the ECF tax returns transmitted until 31 July 2017.

The CbC reporting is an annual compliance obligation if tax resident companies are the final controlling entities of the multinational group. They are exempt if the multinational group's consolidated revenue for the fiscal year prior to the CbC filing is not greater than BRL2.260 billion (if the final controlling entity is Brazilian), or EUR750 million (or equivalent amount in the currency the final controlling entity's jurisdiction based on the spot FX rate of 31 January 2015).

The Brazilian company must check the box to inform whether it is the final controlling entity or the substitute entity; if not one of these two, it must identify the company and jurisdiction of the CbC filing entity. However, even if not the final controlling entity, the Brazilian company will prepare the CbC reporting if one of the following situations takes place: (i) the group's final controlling entity is not required to deliver the CbC report in its own jurisdiction; (ii) the foreign jurisdiction of the final controlling entity enters into Competent Authority Agreement with Brazil, but it is not valid until the deadline for the filing of the CbC report; or (iii) there is a systemic failure<sup>2</sup> at the jurisdiction of the controlling entity.

Now even if one of the situations above takes place, the Brazilian non-final controlling entity will not prepare the CbC report if the following conditions are met on a cumulative basis: (i) the multinational group indicates a substitute entity to file CbC, which notifies its tax jurisdiction that it is responsible for the CbC report (the Brazilian Federal Revenue must be notified as well), (ii) the tax jurisdiction of the substitute entity requires the filing of CbC, (iii) the substitute entity files the CbC report in its tax jurisdiction until the 12<sup>th</sup> month of the last fiscal year of the return of the group, and (iv) there is no formal notification of systemic failure.

For FY2016 only, if a Brazilian resident entity is not the final controlling entity of the group and there is no indication of a substitute entity, the Brazilian Federal Revenue will accept the indication of the final controlling entity from a non-CAA jurisdiction.

If until 31 December 2017 no CAA between Brazil and the U.S. has been concluded, the subsidiary will have 60 days to amend its ECF tax return. Either the Brazilian company will prepare the CbC report or indicate a substitute entity. If the Brazilian company will prepare the CbC report, the following will be disclosed: (i) per jurisdiction in which the multinational group has operations, CbC must indicate (a) total revenues and those obtained from related and unrelated parties, (b) profit & loss before corporate income taxes (CIT), (c) CIT paid and due, (d) share capital, (e) accumulated profits, (f) number of employees, and (g) tangible assets other than cash and equivalent ones; (ii) identification of each member of the group by indicating the tax jurisdiction of residence, and the main economic activities; and (iii) additional clarification in the appropriate space of the ECF return if the multinational group deems necessary.

All in all, U.S. parents must track the negotiations of a future CAA between Brazil and the U.S., and consider a strategy for FY2016 if the CAA does not come into effect this year.

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<sup>2</sup> Systemic failure refers to a situation where a given jurisdiction has a CAA with Brazil but suspended the automatic exchange of information for reasons not provided in the agreement or failed consistently to automatically provide to Brazil CbC reports of multinational groups with at least one Brazilian resident company.

# THE NETHERLANDS

## PROPOSAL DUTCH DIVIDEND WITHHOLDING TAX

On May 16, 2017 Dutch Ministry of Finance published a draft legislative Proposal for public consultation regarding the changes to the Dutch dividend withholding tax (“DDWT”) rules.

The aim of the rules of the draft Proposal aims to align the treatment of dividend distributions of cooperatives with Dutch companies with share capital such as private and public liability companies (“BV/NV”).

Currently, cooperatives are exempted from DDWT while Dutch BV/NV’s are not, with the exception of an artificial structure for abuse. The draft Proposal intends the following two major changes:

- qualifying participations in so-called ‘Holding Cooperatives’ will be brought within the scope of the DDWT rules and
- the DDWT exemption will be extended provided anti-abuse rules are met.

### QUALIFYING PARTICIPATIONS IN HOLDING COOPERATIVES

The first change intends to bring qualifying participations in a holding cooperative within the scope of the DDWT in the same manner as Dutch BV’s/NV’s.

A Holding Cooperative is defined as a cooperative of which the activities consist mainly (for 70% or more) of holding participations and/or financing of affiliated persons or entities.

A qualifying participation in a Holding Cooperative is a membership interest that entitles the holder to at least 5% of the Holding Cooperative’s annual profit or liquidation proceeds. In determining whether a member has a qualifying participation, the Proposal also takes interests held by affiliates of such member into account.

### EXTENSION DDWT EXEMPTION AND ANTI-ABUSE RULES

The second change proposes to extend the DDWT extension to participations held by shareholders/members that are located in jurisdictions with which the Netherlands has concluded a tax treaty and in which a dividend provision is included. The DDWT extension will be subject to anti-abuse rules.

Under the proposed anti-abuse rules, the DDWT exemption is denied if:-

- the shareholder/member holds the shareholding/membership interest with the main purpose or one of the main purposes of avoiding DDWT by another (the subjective test) and
- there is an artificial structure or transaction or a series of artificial arrangements or transactions (the objective test).

As part of the objective test the Proposal deems a structure/transaction not to be artificial if the holding entity of the Dutch company, has so-called ‘relevant substance’. An entity has relevant substance if, in addition to the current substance-requirements, the entity incurs labor costs up to € 100,000 and has an office space in which its activities are carried out.

## IMPLEMENTATION

The draft Proposal has been published by the Ministry for public consultation. The consultation period during which parties could comment to the draft Proposal ended on 13 June 2017. The final version of the Proposal is expected to be submitted to Dutch Parliament in September 2017 and should enter into effect from 1 January 2018.



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# THE NETHERLANDS

## SIGNING CEREMONY MULTILATERAL INSTRUMENT

On 7 July 2017, officials from more than 60 countries, including the Netherlands, came together to formally sign the multilateral instrument. In addition, certain other countries expressed their intention to sign the multilateral instrument in the near future. The multilateral instrument is developed by the Organization for Economic Co-operation and Development (OECD) in its Action Plan against Base Erosion and Profit Shifting (BEPS), and aims to implement the BEPS measures against tax avoidance into bilateral tax treaties as quickly and as efficiently as possible.

### BACKGROUND

The multilateral instrument is a key part of the OECD's effort towards implementation of BEPS measures into tax treaties. The multilateral instrument intends to function alongside existing tax treaties and will modify the application of existing tax treaties in order for them to implement the BEPS measures. Rules included in the multilateral instrument are, amongst others, rules to prevent treaty shopping and dispute resolution.

The instrument will consist of, on one hand, provisions that reflect treaty-related minimum standards and, on the other hand, provisions that do not reflect minimum standards. With regard to the provisions that do not reflect minimum standards, the instrument provides flexibility which is reflected in, among other things, the allowance for countries to opt out of provisions or apply optional or alternative provisions.

For the specific tax treaties between countries, governments had to prepare lists of treaties to be covered by the multilateral instrument and also had to consider which options to select and reservations to make. Unilateral choices made by countries shall not enter into force until both parties to a specific tax treaty agree to the same options and reservations.

### FURTHER STEPS AND EFFECT

The multilateral instrument will only enter into force with respect to a country after the country has ratified the multilateral instrument in accordance with its local laws. It is expected that the multilateral instrument will enter into force with respect to the first treaties in 2018. The ratification process in the Netherlands is expected to start in September 2017.

For the Netherlands it is expected that the multilateral instrument will adjust more than 40 bilateral tax treaties at once, depending on the selected options and the reservations made. The amount of adjusted tax treaties will increase further if more Dutch treaty partners join the multilateral instrument.



## IMPACT OF US TAX REFORM ON IRELAND

There has been much media coverage in relation to the proposed Trump administration's tax reform agenda. There has been no major tax reform in the US since 1986 and as a result there was a growing consensus that the US tax system was uncompetitive. There have been attempts to overhaul the tax system in the 1990s and 2000s, none of these were successful. While the administration's proposals are only at an early stage and still need to be considered by Congress, if some of these proposals came to pass, consideration would need to be given to the impact they would have on FDI.

This article considers what impact the proposed reform would have on Irish FDI.

### REDUCED CORPORATION TAX RATE

While a reduction in the US federal tax rate may dilute the attraction of Ireland's 12.5% corporate tax rate and help to make the US more competitive, there is still likely to be a significant differential between the two tax rates, as a result of the additional State tax charge in the US which averages at 4%.

This rate reduction will likely result in US companies taking decisions to invest overseas more cautiously; we do not predict that it will impact materially on existing US investment in Ireland.

For companies operating in sectors such as technology, often the key driver to locate in Ireland is access to employee talent as opposed to tax. A readily available pool of potential employees, coupled with a lower cost base, will continue to be important factors for organisations. This will ultimately prove beneficial given the international focus of a "nexus" approach.

#### Summary of Key US Tax Proposals

1. Reduce the federal rate from 35% to 15%.
2. Change the US tax system from a worldwide system to a territorial system.
3. A one-time tax on all profits held offshore by US companies and their subsidiaries
4. Eliminate tax breaks for special interests

### FROM WORLDWIDE TO TERRITORIAL REGIME

It is not envisaged that the introduction of a territorial system should adversely impact Ireland as a location for US investment. Most countries with territorial systems have specific anti-avoidance provisions to deter companies moving profits overseas. Sometimes a minimum tax rate that the overseas country must apply is specified. This will most certainly be something which will require careful monitoring by US companies doing business in Ireland.

### MANDATORY DEEMED REPATRIATION

The proposed "mandatory deemed repatriation" or one-time 10% tax on overseas profits is unlikely to have a significant impact on US FDI in Ireland. It is likely that many US multinational companies would, from an overall perspective, welcome the opportunity to repatriate profits back to the US at a reduced rate. We do not anticipate that Irish headquartered companies would be impacted significantly by this introduction. US multinationals are

continuing to invest in capital projects. At present, there is a significant upsurge in datacentre developments in Ireland.

## OUTLOOK FOR THE FUTURE

Ireland continues to have a strong competitive position and provides significant opportunities for new FDI in Ireland. Economically, the country is currently the fastest growing member of the EU. While some US entities appear to be adopting a “wait and see” approach in respect of their international investments, even if the proposals were enacted, Ireland will continue to be an integral cog in the tax landscape. It is speculated that the US proposals represent the ideal position and what may actually come to pass is a rate in the region of 20%. Should this occur, this will ensure a continued significant differential between Irish and US headline rates, resulting in the continued case for Ireland as a hub.

### HERE TO HELP YOU!



The members of the US Desk are here to help you!

If you have US clients looking at establishing internationally, or indeed who have existing international operations, we are here to provide you with answers.

Desk members can serve as a single point of contact for you. We can liaise with other offices and introduce you to the right people.

The contact details for Desk members are enclosed. We can also be found at <https://www.linkedin.com/groups/8356656>

# LUXEMBOURG

On 26 April 2017, Prime Minister Xavier Bettel held his annual speech on the state of the nation. During this event, he confirmed the implementation of a new intellectual property (“IP”) tax regime for 2018.

Mentioned in the 2016 budget law, this modernization of the IP framework was expected by the professionals. It follows naturally after the establishment by the OECD of the document of October 2015 on “*Action 5: Agreement on Modified Nexus Approach for IP Regimes*” developed in the scope of the Base Erosion and Profit Shifting Project (“BEPS”).

The main purpose is to make the countries change their IP tax treatment with a view of attributing the tax benefits in the respective countries only to the taxpayers who engaged expenditures on R&D which generates the IP income.

Several earlier measures have prepared this tax transition, like the abolition of the initial regime on income tax for new entrants in 2016 and at the beginning of 2017, on net wealth tax (“NWT”).

This specific tax treatment is abolished gradually (I) for a new regime on which there is not yet a project of law but only main lines (II).

## REMOVAL OF THE INITIAL IP TAX REGIME IN LUXEMBOURG

Luxembourg, as the Netherlands and Belgium, owned an advantageous IP tax regime for the holder of IP assets and rights.

The necessary compliance with the BEPS recommendations has obliged Luxembourg and other members of OECD to review their specific IP tax regime called “*Patent box*”.

The OECD gives instruction on the final abolition of the old regime, “*In order to give protection for taxpayers benefiting from existing regimes, countries are allowed to introduce grandfathering rules.*” This instruction will be followed by Luxembourg and it has already begun to abolish tax benefits on two subjects, namely:

- Exemption on income tax; and
- Total exemption on NWT

### EXEMPTION ON INCOME TAX

Article 50*bis* of the Income Tax Law (ITL) foresees an 80% income tax exemption which applied to income arising from qualifying IP assets and capital gains on the sale of such assets.

The budget law dated 18 December 2015 abolished this article as of 1 July 2016, but maintains the tax benefits under conditions until 30 June 2021.

These conditions are that the IP rights and capital gains must have been created or acquired before 1st July 2016 taking into account the improvements, if they were realized before the date previously indicated.



When the IP is acquired from a related party, according to Article 50bis, after 31 December 2015, the tax benefits will be until 31 December 2016. However, the tax treatment is still applicable until 30 June 2021, if the related party was under the Luxembourg IP regime or an equivalent foreign IP regime at the time of the transfer.

## TOTAL EXEMPTION ON NWT

This exemption extracted from the §60bis of the modified law of 16th October 1934 which applied to qualifying IP assets for NWT purposes was abolished as of 1 January 2017 by the budget law in its article 5.

Similar to the previous exemption, the transition is gradual and the term is fixed at 1 January 2021 if the IP rights were created or acquired before 1 July 2016.

The term is fixed at 1 January 2018 if the IP was acquired from a related party after 31 December 2015. Another exception allows the tax treatment to still apply until 1 January 2021, if the related party was under the Luxembourg IP regime or an equivalent foreign IP regime at the time of the transfer.

We can underline that the conditions for the extension of the tax regime are the same for both cases.

In Luxembourg, there is not yet a project of law which enables to know what tax treatment Luxembourg will apply for the IP matter.

However, it is obvious that the next tax regime will have to follow the lines of the Action 5 BEPS document.



# LUXEMBOURG

## THE FUTURE LUXEMBOURG IP REGIME WITH THE BEPS LINES

The BEPS report provides that countries, such as Luxembourg, with IP regimes which do not conform to the “nexus” approach, have to amend their regimes. The report requires a “nexus” between the income receiving the benefits and the expenses contributing to that income.

### THE NEXUS APPROACH AND THE QUALIFYING EXPENDITURES

According to the “nexus” approach, the IP assets which could be qualified for tax benefits under an IP regime are patents and, as indicated in the Action 5 report, IP assets “functionally equivalent to patents if those IP assets are both legally protected and subject to similar approval and registration processes, where such processes are relevant.” Guidelines will be issued by the OECD to define these IP assets equivalent to patents.

The purpose of this new vision of the IP regime is to develop R&D activities and to grant benefits to taxpayers which engage in such R&D activities. The taxpayer will have to demonstrate that the IP income it received was created or generated by the expenditures it made.

The report proposes that the qualifying expenditure should be incurred directly by the corporation claiming the tax benefits.

With this new approach, the following formula will determine what potential income may benefit from tax benefits:

$$\frac{\text{Qualifying expenditures incurred to develop IP asset}}{\text{Overall expenditures incurred to develop IP asset}} \times \text{Overall income from IP asset} = \text{Income receiving tax benefits}$$

For the amount of qualifying expenditures, countries may allow taxpayers to apply a 30 percent “uplift” to expenditures that are included in the qualifying expenditures (this measure is optional).

### WHAT IS LUXEMBOURG PLANNING?

Luxembourg will have to develop its IP regime and to make it the most attractive possible. Several options provided in the BEPS report could be envisaged for Luxembourg (e.g., broad definition of qualifying IP income, 30 percent “uplift” on qualifying expenses, etc.).

We have now to wait while the legislator drafts a project of law to see which way the Luxembourg will take for its IP regime future.

# GERMANY

## GERMAN CHANGE OF CONTROL RULES ARE UNCONSTITUTIONAL

The German Tax Code provides for a provision to avoid the trafficking of losses laid down in Sec. 8c Corporate Income Tax Act (Körperschaftsteuergesetz, "CITA") (German change of control rules).

According to this regulation, in case of a transfer of more than 25% of the capital or voting rights (or similar events) in a corporation are transferred to one acquirer within five years (harmful acquisition), any loss carryforwards, current losses and interest carryforwards of the corporation which were present until the harmful acquisition are forfeited in the amount of the capital or voting rights which were transferred.

If more than 50% of the subscribed capital or voting rights (or similar events) are transferred to one acquirer, any loss carryforwards, current losses and interest carryforwards which have not been used are forfeited completely. However, if hidden reserves exist, the losses will be retained equivalent to the sum total of hidden reserves (hidden reserves clause). Another regulation stipulates that there are certain circumstances in which the transfer of shares within a group does not lead to forfeiture of losses (group clause).

The Federal Constitutional Court has now declared parts of these regulations to be unconstitutional in a decision made on the 29 March 2017 and published on 12 May 2017. However, the Federal Constitutional Court ruled only on Section 8c Para. 1 Sent. 1 CITA. The Federal Constitutional Court found that sentence one violates the general principle of equality (Article 3 Para. 1 of the German Constitution). The decision therefore relates solely to the proportionate forfeiture of the loss carryforwards, current losses and interest carryforwards of a corporation in the event that more than 25% and up to 50% of the shares are transferred within five years. For the time being, the finding of unconstitutionality only applies to the period between 1 January 2008 to 31 December 2015.

The Federal Constitutional Court expressly left open the question of whether the complete forfeiture of losses in the event of a harmful acquisition of more than 50% of the shares within five years (Section 8c Para. 1 Sent. 2 CITA) is also unconstitutional.

It is expected that the German legislator will make use of the option to revise the regulation in Section 8c Para. 1 Sent. 1 CITA as permitted by the Federal Constitutional Court.

But, the reaction itself remains unclear. In light of the fact that a final decision regarding the constitutionality of some parts of the German change of control rules has not been made, particularly as regards the constitutionality assessment after 31 December 2015 and the complete forfeiture in the event of a harmful acquisition of more than 50%, cases affected by this legislation should be kept open.



# GERMANY

## IMPLEMENTATION OF A LICENCE BARRIER

The German legislator proposed a new provision to be entered into the law dealing with licence expenses/ payments (Sec. 4j Income Tax Act (Einkommensteuergesetz, "ITA")). The second chamber of the German parliament (Bundesrat) recently agreed to this provision.

Up to now, licence expenses are for corporate income tax ("CIT") purposes fully deductible (assuming the expenses comply with the arm's length principle). For trade tax ("TT") purposes in summary 6.25% of the expenses are picked up (however a threshold for all of the TT pickups of €k 100 applies). In addition, Germany implies a withholding tax including solidarity surcharge on licence payments (at the (deemed) payment date), which could be lowered under the EU-Interest-Royalty Directive (Sec. 50g ITA) or the respective double tax treaty ("DTT").

The aim of the licence barrier is to avoid the erosion of the German tax base by shifting income from Germany to a jurisdiction which provides for a preferential tax regime for intellectual property ("IP") which does not meet the OECD criteria (so called nexus approach). As an effect of this provision, expenses for licence expenses are disregarded to the extent of the effective tax rate at the level of the licensor.

Sec. 4j ITA deals with expenses for the permission of use or for the use of rights, especially of copyright and industrial property rights, industrial, technical scientific and similar experiences, expertise and capabilities (e.g. plans, patterns and processes).

In addition, these expenses have to generate corresponding profits which are subject to a preferential tax regime and are subject to an effectively low taxation (lower than 25% CIT) (regimes providing for a standard low tax regime are not covered by this provision).

The following individuals are affected:

- Creditor of the profits from the transfer of rights is a person who is a related person to the debtor in the meaning of Sec. 1 para. 2 Foreign Tax Act
- Intermediary creditors
- Permanent establishments which can be regarded as beneficiaries of the rights for taxation purposes

The licence expenses to be disregarded are determined based on the following formula:

$$\text{Non-deductible expenses} = \frac{25\% - \text{foreign tax burden}}{25\%}$$

The table below depicts the outcome of the application of this formula:

Effective Foreign Tax Rate	Tax Deductibility in Germany	
	Non Deductible License Expenses	Deductible License Expenses
0 %	100 %	0 %
5 %	80 %	20 %
10 %	60 %	40 %
15 %	40 %	60 %
20 %	20 %	80 %
25 %	0 %	100 %
30 %	0 %	100 %

An exemption is applicable if the preferential tax regime complies with the OECD nexus approach. In a case where the taxpayer could demonstrate that the preferential tax regime complies with OECD nexus approach, the licence expenses remain tax deductible (however, still subject to the TT pick up described before).

The new rule applies for expenses which reduce the taxable income after the 31 December 2017.

It has to be note that the definition of preferential tax regime and the evidence that the taxpayer has to compile for the application of the OECD tax nexus approach is currently not determined. Thus, it could not be excluded that this provision is also affecting circumstance for which it was not designed for.



# UNITED KINGDOM

## IMPROVING TAX TRANSPARENCY

Finance Act 2016 introduced a requirement for large businesses to publish their tax strategy on the internet on an annual basis, covering the business's approach to UK tax matters. The rules apply to businesses that have entities in more than one jurisdiction, including the UK, and meet the UK requirement for country by country reporting (or would do so if the parent entity was UK resident, meaning such a group would have consolidated turnover of €750m or more for the previous financial year).

### WHO IS COVERED?

As a broad rule, any business which is dealt with by a Customer Relationship Manager under the Large Business Directorate will have to comply, but other entities meeting the criteria are also caught. The definition of businesses covered includes stand-alone companies, partnerships (including limited liability partnerships), permanent establishments, groups and sub-groups which meet either thresholds of at least £200million aggregate turnover or £2billion balance sheet aggregate gross assets total at the end of the previous financial year.

A UK headquartered group will have to consider the aggregate turnover and balance sheet aggregate gross assets of all of its UK incorporated subsidiaries, regardless of where they are tax resident. If the group meets one of the tests, the rules will apply.

In the context of a foreign headquartered group, a UK permanent establishment of a foreign incorporated company is treated as a UK company for the purpose of the threshold tests. This contrasts with the Senior Accounting Officer rules which do not consider UK permanent establishments of foreign incorporated entities.

However, smaller UK entities may nevertheless still be caught if they are part of a large multinational group – crucially for US parented multinationals, a UK resident business which does not satisfy either the turnover or balance sheet test will still be required to publish its strategy if it is part of a group which has consolidated turnover in excess of €750 million – i.e. it reaches the threshold for Country by Country Reporting (or would do if the parent was UK tax resident).

### WHEN WILL THE RULES COMMENCE?

Affected businesses will have to publish their first tax strategy at the end of their first financial year beginning on or after 15 September 2016. Therefore any business within the scope with a 31 December year will need to publish its first tax strategy by **31 December 2017**.

The tax strategy must remain available free of charge to the public and then be updated for future years, as necessary by no later than 15 months of the publication of the previous strategy document (and in any case before the end of the financial year to which it relates).

### THE TAX STRATEGY DOCUMENT

The Tax Strategy will need to cover a number of key areas about the group's tax policy, as regards UK taxation, including:

- Its approach to tax planning as it affects UK tax;
- The level of risk in relation to UK tax the business is prepared to accept;

- Its risk management and governance processes in relation to UK tax;
- Its attitude to dealing with HMRC; and
- That it meets the business's Finance Act 2016 obligation to publish a tax strategy.

UK taxes for this purpose cover a slightly wider range of taxes than are covered under the Senior Accounting Officer rules, but the main ones for most businesses would be corporation tax, income tax, VAT, PAYE, NIC, SDLT and SDRT.

The document should also provide relevant background information about the business to put it into context, and it may also cover other information in relation to tax, whether UK tax or not.

The tax strategy may be prepared for, say, the UK group or sub-group as a whole, or by reference to individual group members. It is an important, public facing document, and should be **approved by the Executive Board** and published on the website either as part of the annual report or separately. There is no requirement, however, to publish details of taxes paid or the effective rate of tax as part of the tax strategy document.

Penalties can be applied if a company does not publish its tax strategy, or if HMRC judges that it is not complete. Penalties can also be charged if the document does not remain publicly accessible for the full 12 month period. There is an initial penalty of up to £7,500, with further penalties if the failure continues.

## HOW MAZARS CAN HELP

The issue of tax transparency is of huge significance and affected businesses can expect their published strategy documents to be subject to intense scrutiny.

Mazars has taken a lead in driving the discussion on tax transparency, and we can help you to develop a tax strategy by helping your business consider such questions as:

- How involved does the board need to be in setting and monitoring tax policy?
- What controls are in place to manage tax risk?
- What is 'aggressive tax planning' and is the business involved in it – where do its tax planning activities sit on what is a broad spectrum?
- How will staff and other stakeholders view the published policy?
- How concerned would the business be about public and media scrutiny of its tax affairs?
- What taxes other than corporation tax does the group pay to ensure that the tax policy fully reflects its contribution to the Exchequer in all areas?
- How does the business manage its relationship with HMRC?

At Mazars, our tax staff already have wide ranging experience of supporting large businesses in these areas. We have already worked to assist businesses to produce tax strategies, to ensure that they comply with their Senior Accounting Officer responsibilities and in Risk Review meetings with their HMRC Customer Relationship Manager.

# UNITED KINGDOM

## 2017 ELECTION RESULT



The UK general election is over (for now) and the result is a hung parliament; together with a large degree of uncertainty. As a late Labour surge in the polls and the YouGov election forecast model had indicated prior to election day, the Conservative party failed to secure over 50% (326) of the seats in Westminster needed to resume complete control of the Government.

There have been four hung parliaments in recent history. In 2010 the Conservative Government lasted a full term in office, to the detriment of its junior coalition member, the Liberal Democrats. In 1974, the hung parliament lasted for seven months and in January 1910 it lasted for 11 months. The second hung parliament in December 1910 lasted for almost eight years, due to complications that arose as WWI broke out.

The Conservatives winning 318 seats leaves the door open for a coalition government, so the paradigm of 2010 is probably most relevant. At the time of writing, we now know that Theresa May has struck a deal with the DUP (Conservatives 318 plus DUP 10 = 328 MPs, above the 326 threshold) to continue governing. She subsequently went to Buckingham Palace to request the Queen's permission to form a government. The watchword over the short-term, however, will be "uncertainty", over the future and style of Theresa May's leadership, the course of the Brexit negotiations and the stance the European Union might take on the issue.

### WHAT THIS MEANS FOR BREXIT

In terms of Brexit, the result ostensibly makes negotiations more difficult, as the chief negotiator will need a variety of inputs and may not be able to pursue a single-minded strategy. However, it should be noted that even before the election, the elements of the strategy were uncertain. A more broad-based agreement as to the outcome of the Brexit negotiations could also find more broad-based support - not to mention more acceptance by heads of EU states - which could lead to a coherent national plan as to what a post-Brexit Britain will look like. One key point to remember at this stage is that while Europeans were happy to delay the beginning of the negotiation, set for the end of this month, they did not indicate that they would be willing to extend the deadline for a deal, which is in March 2019

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