MAZARS U.S. TAX DESK NEWSLETTER

April 2018

IN THIS ISSUE!

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

The last quarter has yielded a significant number of changes in the international tax landscape. These have ranged from domestic changes to withholding tax treatments, to the publication by the European Commission of draft directives on the taxation of the digital economy.

In this issue, we give our insights and analysis on issues such as:

- EU digital taxation;
- China's position on the payment of expatriate expenses;
- How Germany could perceive the US as a tax haven;
- Implementation of the anti-tax avoidance directive; and
- Belgian corporate tax reform.

The above is only a sample of the wide array of contributions in this issue. Please see page 2 for a full listing.

We are delighted that this quarterly publication is continuing to grow in content and circulation numbers. If you would like to share your country insights, please feel free to contact us.

CONTENTS

		Page
EUROPE		
Germany	USA – A potential tax haven?	4
Luxembourg	Anti-avoidance directive II – Time for (re) actions!	5
	Exchange of Information: New 2018 measures	10
The Netherlands	Repair tax entity changes	11
	Reduction on redistribution of dividends	13
United Kingdom	UK tax developments – BREXIT	14
Ireland	EU digital tax	16
	Do I have a permanent establishment?	18
Romania	Implementation of ATAD and overhaul of the SSC taxation system	21
Belgium	Corporate income tax reform enacted	23
Croatia	Changes in the Croatian tax system	25
ASIA		
China	Income tax case: Expatriate taxation	28
Hong Kong	Two tier tax systems for SME's and new incentives for innovation and technology sector	30
SOUTH AMERICA		
Chile	Expiration of relief for US shareholders	32
Argentina	Implementation of BEPS measures	33

EUROPE

USA – A POTENTIAL TAX HAVEN?

Without doubt, one of the most important elements of the US tax reform is the reduction of the corporate income tax rate to 21%. Such a decrease in the income tax rate may result in the application of the German CFC regime for German dominated US subsidiaries:

The aim of the CFC regime (as laid down in Sec. 7 and 8 Foreign Tax Law (Außensteuergesetz, "*AStG*") is to prevent erosion of the domestic German tax base by shifting income to jurisdictions with no or only low taxes. This is similar to the "US Subpart F regime". If considered a CFC, an US subsidiary would be regarded for German tax purposes as if the income of the US subsidiary was directly realized by its German shareholder(s).

The relevant Sec. 7 and 8 AStG require that the CFC must:

- Qualify as a corporate entity under the German Corporate Tax Act;
- have its seat in a foreign country;
- not be subject to zero taxes or a low tax regime (effectively below 25%) in the country of residence;
- be controlled by a German tax payer, i.e. the tax payer holds more than 50% of the shares or the voting rights in the CFC at the calendar year end;
- receive so called "passive" income; and
- not be pursuing an economic activity in the foreign country (exception clause - solely applicable to European Union or European Economic Area member states).

The determination whether an entity acts in the legal form of a corporation or a partnership is determined (independent from the classification in the source jurisdiction) based on the principles of the German tax law.

The term "income taxes" itself is not defined by law. However, the German tax authorities determine this term as any income tax burden of an entity triggered by the seat, the place of management and control or a foreign tax nexus (Decree dated 14 May 2004, Nr. 8.3.1). Based on an opinion in the professional literature also US state and local taxes should be considered in the determination of the effective tax rate (Kraft, AStG, Nr. 834).

PARTNERSHIP/ PERMANENT ESTABLISHMENTS

The German CFC regime also applies (in an analogous manner) to foreign permanent establishments of an individual or a corporation subject to German resident taxation (Sec. 20 Para. 2 AStG). In such a case, the exemption method (as provided for in the Germany - U.S. double tax treaty) does not apply. Any double taxation should not arise by virtue of the so-called credit method. However, as foreign taxes are solely credited against the German corporate income tax and not against trade tax, only foreign taxes up to a 15% rate are creditable. Any excess would not be creditable. This should result in an increase in the group's effective tax rate.

This provision regularly applies to foreign partnerships. However, it is currently unclear whether this provision also covers foreign partnerships taxed in the source jurisdiction as an opaque entity (Blümich, AStG, Sec. 20, Nr. 30)(so called qualification conflicts).

CONCLUSION

Based on the principles outlined above, in the event that the effective US income tax rate – i.e. including state and local taxes - is reduced to less than 25%, an US corporation may become subject to the German CFC regime.
Additionally, for US permanent establishments or partnerships, double taxation should be avoided by the unfavorable credit method rather than the exemption method if the criteria outlined above are fulfilled.

CONTRIBUTOR DETAILS

Andreas Lichel

Email: andreas.lichel@mazars.de
Phone: +49 30 20 8888 – 1002

Praxity MEMBER
GLOBAL ALLIANCE OF INDEPENDENT FIRMS

MAZARS

LUXEMBOURG

ANTI-AVOIDANCE DIRECTIVE II: TIME FOR (RE-) ACTIONS!

On 29 May 2017, the Economic and Financial Affairs Council ("ECOFIN") of the European Union ("EU") unanimously adopted the Council Directive amending Directive (EU) 2016/1164 (so-called "ATAD 1" formally adopted during the ECOFIN Council meeting of 12 July 2016 containing measures to prevent hybrid mismatches between EU Member States) which builds on the provisions of ATAD 1 as regards hybrid mismatches involving EU third countries (so-called "ATAD 2").

ATAD 2 has been designed in the ECOFIN meeting of 12 July 2016 where a request was put forward for a European Commission proposal on hybrid mismatches with EU third countries. ATAD 2 is directly rooted in the political agreement reached by EU Member States in the ECOFIN Council of 21 February 2017 as well as in the opinion of the European Parliament issued on 27 April 2017. In addition, the explicit aim (as mentioned in the preamble of ATAD 2) is to provide for rules consistent with and no less effective than the explanations and examples contained in the OECD recommendation on the Organization for Economic Co-operation and Development ("OECD") Base Erosion and Profit Shifting ("BEPS") report on Action 2 (Neutralize the Effects of Hybrid Mismatch Arrangements) which should be used "as a source of interpretation" in so far as they are consistent with the provisions contained in the directive and more generally in the EU law.

Though the terms and concepts contained in ATAD 2 are quite close to the recommendations of the OECD BEPS report on Action 2, ATAD 2 includes additional provisions and provides as well for secondary rules, which were not necessary in an intra-EU context.

ENTRY INTO FORCE

The ATAD 2 provisions must be transposed by each EU member state by 31 December 2019 at the latest and should be in force as from 1 January 2020. There is one important exception though regarding the reverse hybrid entity measure (requiring taxation of income to the extent not otherwise taxed) which has a longer timeline than the one originally foreseen in an EU context by the ATAD 1 (i.e. transposition by 31 December 2018 at the latest) at it must be transposed by each EU member state by 31 December 2021 at the latest and should be in force as from 1 January 2022. However, payments to reverse hybrids will however not be deductible anymore as from 1 January 2020.

SCOPE OF ATAD 2

ATAD 2 has a kind of double "kiss-cool" effect in the sense that it not only broadens geographically ATAD 1 to hybrid mismatches with EU third countries but it also extends the scope of those covered by ATAD 1 (situations of double deduction or deduction without inclusion resulting from hybrid entities or hybrid financial instruments) to more categories of mismatches (save for some exceptions).

A hybrid mismatch will generally arise in situations between associated enterprises or between the head office ("HO") and the permanent establishment ("PE") or between two or more PEs of the same entity or under a structured arrangement.

In principle, ATAD 2 rules would apply when a shareholding relationship of at least 25% exists, i.e. the concept of "associated enterprises" covers the situation where a minimum participation of 25%, including voting rights, capital and profit entitlement is reached. However, in some situations, ATAD 2 increases the shareholding relationship of 25% to 50%, i.e. targeting any non-resident entity holding at least 50% of the voting rights, capital interests or rights to a share of profit in a hybrid entity located within the EU. ATAD 2 covers also situation where a person – who acts together with another person in respect of the voting rights or capital ownership of an entity – shall be treated as holding a participation in all of the voting rights or capital ownership of that entity that are held by the other person:

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

MAZARS

this may lead to some complex interpretation due to the lack of definition and guidance in the ATAD 2 itself (though one may found some guidance in the BEPS Action 2 report under the "acting together" concept targeting a number of situations from the most basic ones (e.g. members of the same family) to more sophisticated (e.g. the ownership or control is managed by the same person or group of persons).

The ATAD 2 covers:

- hybrid transfer mismatches: covering hybrid mismatches that result from payments under a financial instrument which may arise in any arrangements involving the transfer of financial instruments where differences in the tax treatment of that arrangement result in the same financial instruments being treated as held by more than one tax payer;
- hybrid PE mismatches, i.e. hybrid mismatches that are a consequence of differences in the allocation of payments made to a hybrid entity or PE, including situations where payments made to a disregarded PE are not taxed at the level of the HO;
- hybrid mismatches that result from payments made by a hybrid entity to its owner or deemed payments between the head office and PE or between two or more PEs;
- imported mismatches which may arise in any arrangement under which the deduction resulted from a hybrid mismatch arrangement that was produced in a different jurisdiction, is imported top a third jurisdiction and offset any income in that third jurisdiction: in other words, an entity (the payee) sets off a hybrid mismatch payment against an otherwise taxable receipt arising on a payment from the payer;
- dual resident mismatches which may arise where the taxpayer is a dual resident and makes a payment that is deductible under the law of both jurisdictions and that the double deduction ("DD") outcome results in a hybrid mismatch;
- reverse hybrid mismatches which may cover the situation of any hybrid entity that is treated as a taxable entity by the residence state of the investor and as a transparent under the state of establishment of the entity and for which both a deduction and a non-inclusion ("D/NI") outcome may arise. ATAD 2 typically targets here the situation where an entity is established in a EU Member State and treated as tax transparent whereas at the level of the non-resident investors in the same entity, the latter is viewed as opaque: in this situation, the income might bene fit from double non-taxation.

THE RESPONSE OF ATAD 2 IN CASE OF HYBRID MISMATCH OUTCOME: DD-D/NI-NT/NI-DTR COUPLED WITH SECONDARY RULES

First of all, in addition to the classical the DD or D/NI, the two following additional outcomes have been added:

- non-taxation without inclusion ("NT/NI") which may arise where the PE is disregarded under the of the state of the establishment of the branch leading to a non-taxation of the related income generated by the PE and a no-inclusion in the other state (as the branch will qualify as an exempt PE in a foreign jurisdiction);
- double tax relief at source ("DTR") which may arise where an instrument or a payment has different characterization in two different jurisdictions: in this situation, if the character of the payment qualifies it for double tax relief under the laws of the payee jurisdiction, such as an exemption from tax, a reduction in the rate of tax or any credit or refund of tax, the payment should be treated as giving rise to a hybrid mismatch to the extent of the resulting undertaxed amount. Important to note is that ATAD 2 specifies that any payment under a financial instrument should not, however, be treated as giving rise to a hybrid mismatch where the tax relief granted in the payee jurisdiction is solely due to the tax status of the payee or the fact that the instrument is held subject to the terms of a special regime.

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS
MAZARS

We summarized hereafter the main response and related outcome outlining applicable secondary rules:

- DD outcome (hybrid entity, financial instruments and imported mismatch) or D/NI outcome for imported mismatches: the EU Member State shall deny the deduction unless (secondary rule), such deduction has already been denied by the third-country/country of the investor. Nevertheless, any such deduction shall be eligible to be set off against dual inclusion income whether arising in a current or subsequent tax period.
- D/NI outcome for Hybrid entity and financial instruments: the EU Member State shall deny the deduction to the extent such EU Member State is the payer jurisdiction or (secondary rule) the EU Member State shall include the amount of the payment in its taxable basis to the extent the third-country/country of the investor is the payer jurisdiction (unless the latter has already denied the deduction).
- NT/NI outcome for disregarded PE: the EU Member State of the HO shall include in its taxable basis the income attributed to the third-country/PE state unless such income if exempt under the applicable double-tax treaty concluded between said EU Member State and said third-country.
- DTR outcome for hybrid transfer: the EU Member State shall limit the benefit of the relief granted to more than one of the parties involved by the third-country for tax withheld at source in proportion to the net taxable income related to the payment unless such tax relief has already been denied in the relevant third-country.
- Reverse hybrid outcome: the EU Member State shall tax the income from the entity involved (i.e. the entity resident of the EU Member State of incorporation or establishment) to the extent this income is not otherwise taxed in the third-country involved.
- Dual tax residency mismatches resulting in a DD outcome: the EU Member State of the tax payer shall deny any deduction to the extent the third-country involved allows the duplicate deduction to be set off against income that is not dual-inclusion income. If both jurisdictions are EU Member States, the EU Member State where the taxpayer is not deemed to be a resident according to the relevant double tax treaty between the two EU Member States shall deny the deduction.

SOME (WELCOME) OUT OF SCOPE SITUATIONS FROM ATAD 2

In addition to some exception under specify rules (e.g. reverse hybrid mismatches rules not applicable to collective investment vehicles), here below are the other welcome situations not targeted by ATAD 2.

- Differences in tax outcomes that are solely attributable to differences in the value ascribed to a payment, including through the application of transfer pricing, should not fall within the scope of a hybrid mismatch.

- ATAD 2 limits it on rules to “deductible payments” only – therefore:

  - in principle, ATAD 2 provisions apply only to payment and not, e.g. to provisions booked with respect to financial ng instruments – in addition, there are some debate on whether partial payments may be caught as hybrid instruments mismatch: however, to be on the safe side, assumption should be taken that anti-hybrid rules under ATAD 2 are likely to apply;
  - in addition, as the payment must be deductible, the concept excludes any non-deductible payments excluding, for instance, deemed deduction on equity or (but this is more debatable) notional interest deduction on debt.

- As jurisdictions use different tax periods and have different rules for recognising when items of income or expenditure have been derived or incurred, those timing differences should not generally be treated as giving rise to mismatches in tax outcomes under ATAD 2 but only to the extent that the income cannot reasonably be expected to be included in income within a reasonable period of time – for the purposes of ATAD 2:

  - a payment under a financial instrument shall be treated by the EU Member State of the payee as included in income within 12 months of the end of the payer's tax period or as determined under the arm's length principle; or,
  - it is reasonable to expect that the payment will be included by the EU Member State of the payee in a future tax period and the terms of payment are those that would be expected to be agreed between independent enterprises (i.e. at arm’s length): this seems to allow the possibility for taxpayers to evidence that the payment will be included in a future tax period.

- ATAD 2 recognizes that a payment should not give rise to a hybrid mismatch that would have arisen in any event due to the tax-exempt status of the payee under the laws of any payee jurisdiction which covers also D/NI arising when an instrument is subject to the terms of a special regime.

- Last but not least, ATAD 2 expressly states that any adjustments that are required to be made under said Directive should in principle not affect the allocation of taxing rights between jurisdictions laid down under a double taxation treaty: if tax treaties rank prior to domestic tax law in the normative hierarchy, we do not see how a tax treaty would rank prior to the rule set by the domestic Law in accordance with the EU Directive as the latter ranks senior to the double tax treaty.

TIME FOR (RE-)ACTIONS!

From a practical perspective, several structures would need to be screened and potentially aligned in light of the ATAD II as well as other EU and international regulations, such as (non-exhaustive list): US tax reforms, UK Brexit, EU state-aid rules, (UK) anti-hybrid rules, possible renegotiation of the Luxembourg-US double tax treaty related to PE and to specifically address US non-trading branch providing outbound financing.

Luxembourg has always been seen a “crown-jewels” for holding location and core structuring and used as a jurisdiction of choice for many multinationals companies (“MNC”), real estate or private equity funds, due to the investors profile and the structuring and financing of acquisitions (and repatriation thereof). We outlined hereafter some illustrations (non-exhaustive) of typical Luxembourg structures and instruments that may be impacted:

- Financing (general): close-eyes would need to be kept for example on any financing activity and especially to potential impacts of the imported mismatch rules where, e.g. a loan granted to an EU target company is funded by a loan between its non-EU parent company and another non-EU group company: in case this situation would result in a hybrid mismatch, the ATAD 2 foreseen that the EU Member State of the target company should deny the deduction up to the mismatch created (unless of the EU jurisdictions provides for specific rules to neutralize the effect of the mismatch).

- Financing and use of preferred equity certificates (“PECs”) instruments: in principle, assuming that it is reasonable to expect that the payment (i.e. income at the level of the payee) will be included by the jurisdiction of the payee in a future tax period and that the interest rates (leading to the related deduction and terms of payment) are at arm’s length – which should be normally the case as the interest rate of the PECs would need to be priced through a transfer pricing study or, in case the PECs finances shareholder loan (on the assets side of the Luxembourg entity), the margin to be realized at the level of the Luxembourg entity shall be supported by a transfer pricing study in Luxembourg (covering as well the related deduction on the interest rate).

- Financing and use of convertible preferred equity certificates (“CPECs”) instruments: in principle, the likelihood that CPECs may qualify as hybrid instrument in the future with a risk of non-deductibility of the yield accrued and re-qualification as hidden dividend payment is high. Therefore, most of (if not all) CPECs structures and instruments features thereof may have to be re-visited in the future. Indeed, ATAD 2 should target the CPECs with respect to the in addition to the deduction of the interest including upon repurchase of the CPECs at a premium (in case of possibility to isolate an interest component payment) as well as under imported hybrid mismatch rules at the level of the target considering the deduction of interest on loans financed by CPECs. Those may still work in specific situation such as CPECs used to financed exempt assets/exempt income (dividends, capital gains or liquidation proceeds) held/received by a Luxembourg entity: in this case, as the asset and income are exempt, the CPECs and accrued interest thereof are non-.tax deductible in Luxembourg and, therefore, there should be no hybrid nature at the level of the Luxembourg company itself. Hoverer, as mentioned earlier, that the situation would need to be screened as well from a BEPS point of view at the level of investors (e.g. US) in case the same hybrid mismatch is recognized at their level, e.g. treatment as equity leading to a deferral of taxation. Finally, it should be checked how imported mismatch rules would be implemented under local law.

- Financing and use of US PE: in principle, the use of US PE should only be used to finance US outbound. Leaving aside whether US PE whether the US Branch can be considered a disregarded permanent establishment caught by ATAD 2 which should be checked on a case-by-case basis, one may still consider to continue to use US PE in case for instance where none of the entities in the structure are hybrid entities, none of the instruments are

considered hybrid instruments, where interest expense on the loans are recognized for Luxembourg (at the level of the US Branch) and US, where interest income on the same loan is recognized for Luxembourg (at the level of the US Branch) and in the US which may or may not consider the US Branch as a permanent establishment for US federal income tax purposes. Alternatively, one may also consider the possibility to use US active lending PE or US PE with active trade of business and carrying on the financing activity as well.

- Financing and use of interest free loan ("IFL"): as this kind of instrument might be potentially caught as well by ATAD 2, one may consider to continue to use this kind of instrument in in case for instance where – in addition to the absence of payment under the IFL – none of the entities are hybrid entities, none of none of the instruments are considered hybrid instruments, and where interest expense on the interest bearing loan is recognized in Luxembourg (country of the lender) and in the EU/non-EU country (of the borrower under the same the interest bearing loan), the interest income on the same interest bearing loan is recognized in Luxembourg (country of the lender) and in the same EU/non-EU country (of the borrower), the interest expense on the IFL is recognized for Luxembourg tax purposes (in the country of the borrower of the IFL), the interest expense on IFL is not recognized for tax purposes in the EU/non-EU country (of the lender under the IFL, e.g. Ireland) and interest income on the IFL is not recognized for tax purposes in the EU/non-EU country (of the lender under the IFL, e.g. Ireland).

CONTRIBUTOR DETAILS

François Kàrolyi

Email: francois.karolyi@mazars.lu
Phone: +352 27 114 602

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

MAZARS

EXCHANGE OF INFORMATION: NEW 2018 MEASURES

Within the ongoing international and European arsenal measures to fight tax avoidance, tax abuse and tax fraud. EU Member States have improved exchange of information between Member States by introducing Council Directive 2011/16/UE (so-called "DAC") which have since been implemented into Luxembourg tax law. The main aim of the DAC is to allow local tax authorities of EU Member States to exchange information of foreseeable relevance to their enquiries, but only to the extent that the request for information made by a foreign tax authority can be seen as of "foreseeable relevance".

In 2014, further to the peer review by the Global Forum on Tax Transparency and Exchange of Information for Tax Purposes, Luxembourg changed its legislation for the exchange of information upon request and extended the information gathering and enforcement powers of the tax authorities – thus, reducing in parallel taxpayer's rights. More specifically, when transposing the DAC, Luxembourg reserved the right to review the legality of the request made by a foreign authority to the Luxembourg tax authorities themselves – in order words, Luxembourg did not give the right for a tax payer or third party, who is required to give information to the national tax authorities upon request, to have access to a judicial remedy against the legality of the request itself. In addition, the law allowed the Luxembourg tax authorities to levy a fine on a tax payer or third party who failed to provide the relevant information upon request.

On 16 May 2017, in its decision on Berlioz Investment Fund case (C-682/15), the European Court of Justice (Grand Chamber) issued a landmark decision in favor of the taxpayer (a Luxembourg company) recognizing the right for the latter to rely on the EU Charter of Fundamental Rights to challenge on one hand the Luxembourg tax authority's penalty for not providing information ordered pursuant to a request under the DAC to the Luxembourg tax authorities from the French tax authorities. On the other hand, the ECJ recognized the right to the taxpayer to contest the legality of the request itself considering that the condition foreseen in the DAC regarding the "foreseeable relevance" of the information was also a necessary condition of the legality of the information order issued by the Luxembourg tax authorities.

Further to the Berlioz case and as an anticipation of the impact of any amendment on Luxembourg's rating by the Global Forum, a change in the Luxembourg legislation had to occur to take into account the ECJ decision by reintroducing certain taxpayers' rights – namely, that a tax payer has a judicial remedy to challenge the validity of an information request made by a foreign tax authority.

NEW 2018 LUXEMBOURG MEASURES

The Luxembourg draft law for the 2018 budget foresees that the taxpayers will have the right to file nearby the Luxembourg administrative courts a claim against any information order received from the Luxembourg tax authorities. Important to note is that such claim has a suspensive effect so that the taxpayers are not obliged to provide any of the information requested until the final court proceeding decision on the claim.

In addition, to enhance juridical proceedings' timing and review:

- the draft law provides (mainly) a reduction in the delay of fling the claim to 1 month after the notification of the information order by the Luxembourg tax authorities as well an appeal within 15 days after the Luxembourg administrative tribunal decision;
- in the same vein, the courts review is limited to an analysis whether the requested information manifestly has no foreseeable relevance.

CONTRIBUTOR DETAILS

François Kàrolyi

Email: francois.karolyi@mazars.lu
Phone: +352 27 114 602

THE NETHERLANDS

REPAIR TAX ENTITY CHANGES

On 22 February 2018, the EU Court of Justice ruled that despite the fact that tax payers cannot form a tax entity with their EU subsidiaries, they do qualify for the benefits of separate elements of the tax entity regime. According to the state secretary, this ruling results in a structural loss of tax revenues that may amount to several hundreds of millions of euros per year. For this reason, the state secretary, in anticipation of the ruling, had already announced repair measures that will have retroactive effect.

The EU Court of Justice ruled in the case concerning an international group consisting of, among others, a Dutch company and an Italian subsidiary. The Dutch company paid interest to its Swedish parent company. This interest was affected by the Dutch interest deduction restrictions. If the Dutch company could have formed a tax entity with its Italian subsidiary, it would have been able to deduct the interest. According to the EU Court of Justice, the interest deduction restrictions are therefore contrary to EU law.

The consequences of the ruling of the Court of Justice are both positive and negative. The negative consequences relate to the announced repair measures that will have retroactive effect until 25 October 2017, 11 am.

POSITIVE CONSEQUENCES

Insofar assessments on previous years, until 25 October 2017, 11 am, have not been established irrevocably, tax payers may rely on the ruling of the EU Court of Justice. Based on this ruling, the benefits of a tax entity may in principle no longer be withheld from tax payers in EU situations.

NEGATIVE CONSEQUENCES

As of 25 October 2017, 11 am, several regulations in corporate income tax and dividend tax must be applied as if there were no tax entity. Among others, this applies to the interest deduction restrictions. With the emergency repair measures, it is achieved that for the application of those regulations in domestic relationships as well, the consolidation resulting in the tax entity is not affected. Therefore, the tax entity will henceforth be ignored for the relevant regulations. In principle, each tax entity will have to check for itself whether the measures have consequences.

WHAT WILL CHANGE PRECISELY?

The state secretary has announced that the legislative proposal with the repair measures will be submitted to the Lower House of Parliament in the second quarter of 2018. Only then will there be clarity on what is exactly going to change.

Furthermore, the state secretary has stated that within the foreseeable future, the repair of the tax entity will have to be followed by a group scheme that is future-proof. In the new regulation, the consolidation element of the current regulation appears not to return.

TO WHICH SITUATIONS MAY THE MEASURES RELATE?

Among others, the announced repair measures may have the following consequences:

- If loans have been taken out by a tax entity in which that loan is used for the distribution of profits, the payment of capital or the acquisition / expansion of an interest;
- If there is an excessive interest in a loan that has been taken out to finance a participation
- Certain situations in which a tax entity holds a foreign participation
- If a participation has been bought that has carry over losses; and / or

CONTRIBUTOR DETAILS

Frederik Habers

Email: Frederik.Habers@mazars.nl
Phone: +31 88 277 2309

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

MAZARS

THE NETHERLANDS

REDUCTION ON REDISTRIBUTION OF DIVIDENDS

On October 10, 2017, the new Dutch government presented its Coalition Agreement "Confidence in the Future". In the coalition agreement, the four parliamentary parties presented the measures they aim to implement in the coming period of government (2017 through 2021). One of the most eye-catching measures is the planned abolishment of withholding tax on dividends. Below, we briefly address the most important tax measures for international businesses.

REDUCTION OF CORPORATE INCOME TAX RATES

The corporate income tax rate will be reduced in steps from 25% to 21% in 2021. The rate for the first bracket, which will remain €200,000, will be reduced from 20% to 16%.

INNOVATION BOX

The Innovation box regime aims to encourage investment in R&D activities in the Netherlands. Qualifying box income is currently taxed at an effective rate of 5%. According to the Coalition Agreement, the effective rate will be increased to 7%.

EARNING STRIPPING

To comply with the EU Anti-Tax Avoidance Directive (ATAD), the Netherlands will introduce an earning stripping rule. According to the rule, the taxpayer's net interest expense will generally be deductible only up to 30% of the taxpayer's EBITDA. For the application of the rules, a threshold of €1 million of net interest will apply.

LOSS CARRY FORWARD

Currently, losses may in principle be offset against profits of the prior year and the subsequent nine years. The Coalition Agreement announces to limit the loss carry forward period to six years. The loss carry-back period remains one year.

WITHHOLDING TAX

According to the Coalition Agreement, withholding tax on dividends will be abolished as of January 1, 2020, except in case of abusive situations or distributions to low-tax countries. A withholding tax on interest and royalties to low-tax countries will be introduced.

The plans of the Coalition Agreement do not replace the proposal to change the Dutch withholding tax rules as from 1 January 2018. See issue 5 of the Newsletter for our commentary on these proposed changes.

30% RULING

The 30% ruling is a facility for incoming highly skilled employees. Provided that certain conditions are met, the employer may grant a tax-free allowance for 30% of the gross salary. Currently, the 30% ruling may be granted for a maximum period of eight years. According to the Coalition Agreement, the maximum period will be reduced to five years.

IMPLEMENTATION

The Coalition Agreement only provides limited information about the proposed measures. Further information is expected in the coming years, including the legislative proposals.

CONTRIBUTOR DETAILS

Frederik Habers

Email: Frederik.Habers@mazars.nl
Phone: +31 88 277 2309

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

MAZARS

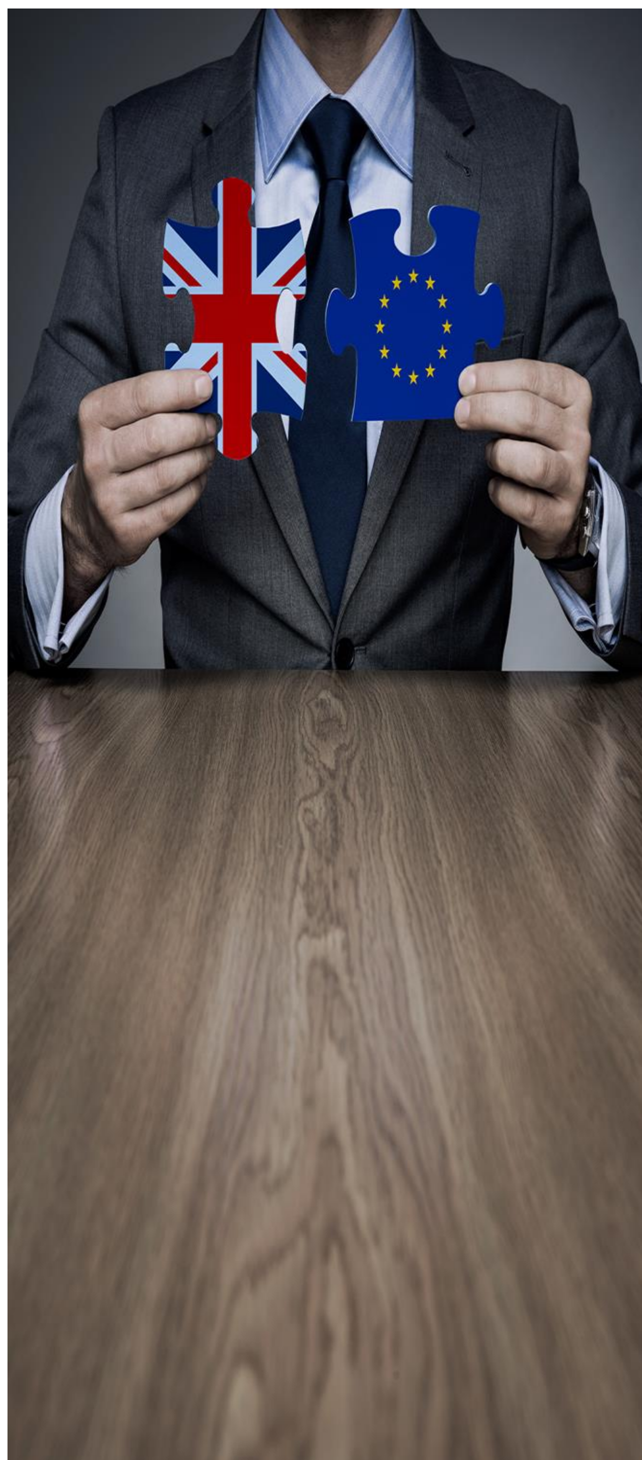
UNITED KINGDOM

UK TAX DEVELOPMENTS - BREXIT

On 19 March 2018 the EU and UK reached agreement on the withdrawal arrangements for Brexit.

The UK will leave the EU on 29 March 2019, but the transition period will last until 31 December 2020. The existing customs procedures for movements of goods will continue during transition. VAT and excise duty will also continue to apply as they do now, during this period. This will also apply to transactions which commence during transition, but end after, with VAT obligations being extended in respect of these transactions to 5 years after transition.

Greater clarity around the transition arrangements and an extended timescale are helpful. However, work should continue on assessing the implications for supply chains and necessary business re-organisations. While a "no-deal" scenario now looks less likely, the phrase "nothing is agreed until everything is agreed" still stands. Pressure on time and resources will greatly increase the closer 31 December 2020 gets.



TAX AND DIGITAL ECONOMY – CHANGE IS LIKELY IN THE SHORT TERM

In the 2017 Autumn Budget, the UK government argued that value created by active participation and engagement of UK users of digital platforms was not being fully taxed in the UK. An update on the Government's position paper published with its 2018 Spring Statement reiterated its commitment to address these issues. The preferred long-term option is to arrive at an international consensus. However, the UK will consider unilateral action if necessary with an interim solution being a possible revenue based tax. This type of interim measure is also being considered in Europe.

The Autumn Statement proposal to apply withholding tax and reporting requirements on non-UK entities making payments to certain non-UK jurisdictions from April 2019 has not yet been ruled out, although the onerous reporting requirements originally proposed may be watered down.

In the meantime, measures are well under way to tighten up on VAT obligations, together with new penalties, for online marketplace operators and those who use them.

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

MAZARS

TAXING ALL UK IMMOVABLE PROPERTY GAINS OF NON-UK RESIDENTS AND INTRODUCTION OF CORPORATION TAX FOR NON-RESIDENT LANDLORDS OF UK PROPERTY

The 2017 Autumn statement announced proposals to apply capital gains tax on all UK immovable property gains (both residential and non-residential) made by non-UK residents from April 2019. This is separate to the already announced proposal to bring corporate non-resident landlords within the charge to corporation tax on property rental profits from April 2020. This, together with other UK BEPS reforms could have significant implications for financing structures used in this sector. The UK also plans to introduce a register for beneficial ownership of UK immovable property by non-UK legal persons by 2021. The implications of these changes should be considered as a matter of urgency.

REFORMS TO BEPS MEASURES AND ENSURING THE UK TAX SYSTEM KEEPS THE UK IN A COMPETITIVE POSITION

Reforms made to the UK patent box to bring it into line with OECD accepted practice are now being implemented. In addition, from 1 January 2018 the rate of tax relief for qualifying R&D expenditure by large business has improved. The rules on taxing gains on corporate and institutional investments in companies have been relaxed. Further consultation is under way on possible improvements to the UK's corporate taxation of intangible assets.

REFORMS TO THE TAXATION OF LABOUR

Debate continues on how to rationalise the different incidence of taxation on the self-employed and the employed, with further announcements on direction in this area expected by Autumn 2018.

CONTRIBUTOR DETAILS

Stephen Fuller

Email: Stephen.Fuller@mazars.co.uk
Phone: ++44 20 7063 4497

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

MAZARS

IRELAND

EU DIGITAL TAX

The European Commission issued two draft Directives on the taxation of the digital economy in March 2018. The drafts propose that companies would have to pay corporate income tax in each Member State where they have a significant digital presence. In the period prior to the enactment of this proposed legislation, the Commission has also proposed an interim measure of a 3% revenue-based Digital Services Tax. This interim tax measure would be levied on specific digital services where the main value is created through user participation.

Certain EU Member States are coming under increasing political pressure to tackle the taxation of the digital economy. It is estimated that the proposed EU-wide Digital Services Tax would generate revenues estimated to be worth up to €5 billion a year. It is also argued that such a centralised measure would help to avoid the possibility of individual member states implementing their own unique legislation, and consequently creating a plethora of potentially conflicting regimes.

DIGITAL SERVICES TAX - AN INTERIM PROPOSAL

The Commission is proposing a 3% Digital Services Tax (DST) on gross revenue arising from the supply of certain digital services. These services are characterised by user value creation, namely;

- online placement of advertising;
- sale of collected user data; and
- digital platforms that facilitate interaction between users, who can then exchange goods and services directly via the platform.

The DST proposal indicated that the provision of digital content, payment services, online sales of goods or services, and certain regulated financial and crowdfunding services should be excluded from the new tax.

The intention is that the DST should target businesses with:

- total consolidated annual global revenues in excess of €750 million, and
- annual revenues from taxable digital activities in the EU in excess of €50 million.

It is proposed that the tax will apply irrespective of whether a business is established within the EU.
In line with the concept of user value creation, the tax will be payable to the Member State where the users are located. Where users are located in different Member States, one Member State will be responsible for collecting the tax and allocating it to the other Member States, based on allocation keys.

A single EU-wide payment and reporting portal will be established, based on the One Stop Shop model currently used for VAT. Businesses will be required to self-assess the tax liability, payable on an annual basis. Consolidated groups will be able to nominate one company to deal with compliance and payment. It is proposed that Member States will allow resident businesses to deduct Digital Services Tax paid to any Member State from the corporate tax base. The tax is intended as a temporary solution while the common EU solution is being discussed, developed and implemented by Member States.

SIGNIFICANT DIGITAL PRESENCE

In addition to the DST proposal, the Commission is also proposing common EU rules which permit Member States to tax profits generated from a significant digital presence in their jurisdiction, regardless of physical presence. This proposal would extend the current permanent establishment rules by creating a nexus for digital businesses which operate cross border where at least one of the following conditions is met with respect to a tax year:

- revenues from digital services provided to users located in a Member State exceed €7 million;
- Number of active users of digital services located in a Member State exceeds 100,000; or
- Number of business contracts for digital services concluded by users located in a Member State exceeds 3,000.

These thresholds apply by reference to the activities of the services supplied by the entity itself aggregated with those supplied by any associated company. The associates test is widely drafted and includes situations where there is significant influence through participation in management, a direct or indirect holding that exceeds 20% of voting rights, or participation in the capital through a direct or indirect right of ownership that exceeds 20% of the capital.

The draft directive defines a digital service to be in line with the existing VAT rules as *"a service that is delivered over the internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention".* Services which may trigger a significant digital presence are listed, and the sale of goods or services online is specifically excluded.

The proposed transfer pricing principles concerning the allocation of profits / losses to the significant digital presence, follow the established methodology of determining profits that would have been earned by a 'separate independent enterprise' taking into account the functions performed, assets used and risks assumed through a 'digital interface'. A number of additional data and user-related criteria are proposed to recognise the value of user participation and data, including: the collection, storage, processing, analysis, deployment and sale of user-level data; the collection, storage, processing and display of user-generated content; the sale of online advertising space; the making available of third-party created content on a digital marketplace; and the supply of any other digital service. The functions related to the development, enhancement, maintenance, protection and exploitation of intangible assets should be taken into account even if these are not linked to people functions in the same Member State.

The directive proposes that the profit split method should be used to attribute profits to the significant digital presence, unless the taxpayer proves that an alternative method based on internationally accepted principles is more appropriate. Possible profit splitting factors could include expenses incurred for research, development and marketing as well as the number of users in a Member State and data collected per Member State.

The Directive would apply between Member States and override tax treaties which would exist between the jurisdictions. It would also apply in instances where a business established in a non-EU country operates through a significant digital presence in a Member State and there is no tax treaty in place. The Commission has recommended that Member States should update their existing treaties with non-EU jurisdictions to incorporate corresponding rules on a significant digital presence and profit allocation in line with the proposals.

NEXT STEPS

The directives are only in draft format and have not been enacted by Member States. The draft Directives requires unanimous agreement by Member States if they are to be adoption. If agreement is reached, Member States must adopt and publish legislation to comply by 31 December 2019. The measures would then apply from 1 January 2020.

CONTRIBUTOR DETAILS

Cormac Kelleher

Email: ckelleher@mazars.ie
Phone: +353 1 449 4456

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

MAZARS

DO I HAVE A PERMANENT ESTABLISHMENT?

The concept of what constitutes a permanent establishment and ultimately whether there is a taxable presence, is an issue frequently faced by international organisations and tax practitioners alike. Unfortunately, there is no easy answer. Typically, interested parties will rely on the OECD commentary to article 5. While this is only commentary, it provides insight into the spirit and intention of what the model treaty intends to capture. Given that the vast majority of treaties negotiated by sophisticated jurisdictions tend to follow the OECD framework, this commentary can be persuasive. The challenge now though is that in light of the BEPS project and roll out of its recommendations, there is renewed uncertainty as to when a PE will be triggered. The position is made all the more challenging by the recent Swedish case, Dunlop Tyres.

DUNLOP CASE

Dunlop Tyres, a German tax resident company, was held to have a Swedish PE. The well-known Dunlop group had a company engaged in the development of tyre inflation software systems to unconnected car manufacturers. As part of its development process, on an annual basis, Dunlop sent some of its German based employees to Sweden to test developed software and gather data on how its product performed in the inclement Nordic environment. This testing period lasted approximately three to four months per annum.

While it was accepted by all parties that the research undertaken in Sweden was for the purposes of testing and data collection, there was a divergence in opinion as to whether the nature of the work could be considered “preparatory or auxiliary in nature”.

In order to arrive at its decision, the Swedish court considered the overall business and how integral the work undertaken was overall. The court held that the work undertaken in Sweden, which was performed by the same people and using the same procedures as when the activities were performed in Germany, to be a significant driver in the overall generation of corporate profit. It was felt that it was difficult to delineate between the Swedish activities and those undertaken in Germany.

Additionally, the court considered the nature of the activities performed in Sweden and the context in which this occurred. It was felt that the testing of the product in the cold Swedish environment was crucial in the development of the underlying product. This was evident from the fact that Dunlop had tested its products in this manner for each of the previous ten years.

The learning from this ruling is that the concept of “preparatory or auxiliary in nature” needs to be considered in a renewed light. It is no longer adequate to endeavour to argue that the period is of such a short duration that a PE cannot be triggered. A greater understanding of the business process is required and the importance (if any) of the stages in the product lifecycle. While the Dunlop case does not carry any legal weight in the Irish courts, the movement to an understanding of business operations and value drivers, is likely to be a focus which courts will move to.

BEPS

A second wave of change is coming in the form of BEPS. Action 7 considered the definition of what constitutes a PE. The recommendations and proposed changes have now been published. These will have a significant impact on what we theretofore have considered a PE and how organisations have been structured.

The fundamentals of what will constitute a PE remain unchanged. A taxable presence will continue to arise if a company is carrying on a business through a fixed place of business.

Praxity MEMBER
GLOBAL ALLIANCE OF INDEPENDENT FIRMS
MAZARS

There are two significant amendments proposed to the rule. The first being the operation of agents and commissionaire structures, while the second revolves around the scope of the PE exclusion rules. There is an optional anti-fragmentation rule that jurisdictions can sign up to which will further increase the risk of creating a PE.

AGENTS AND COMMISSIONAIRE ARRANGEMENTS

The current rules indicate that an agent will only create a PE where they habitually conclude contracts in the name of the enterprise, and the agent is not legally and economically independent from the principal. To manage this potential PE issue, typically organisations ensured that the signing of contracts was undertaken in the enterprises home territory. Consequently, it was arguable that the sale was concluded in the home territory and taxable solely in that jurisdiction.

The proposed changes indicate that if the agent undertakes a significant portion of the work and no material changes are made in the home territory other than signing the contract, a PE could be considered to arise in the foreign jurisdiction. The new commentary also includes provisions to capture situations where the contracts are concluded in the agent's name, but using the principles IP or goods. The bar on what will constitute independence has been raised. Consideration will need to be given to whether the agents business is largely or wholly dependent on business derived from the principal. If this is the position, the agent will no longer be considered independent.

PERMANENT ESTABLISHMENT EXCLUSION RULES

Current rules allow a blanket exclusion of certain operations such as warehouses, procurement offices or information collection. These scenarios are considered to be non-value adding and or a preparatory nature. Where an activity can be captured under one of these exemptions, the organisations are not considered to have permanent establishments.

The proposed changes will limit the scope of the exclusions. This is due to the extension of the "preparatory and ancillary test" from a section in its own right to cover the entire exceptions category. The proposed revised test is grounded in the concept that the activity must be of a short-term duration (preparatory), and not being an essential and significant part of the activity (ancillary). This is a significant limitation to the activities which will be able to avail of the PE exemption. The proposed new commentary gives an example of a distribution warehouse for an online retailer. Under the current rules, the warehouse would not be considered a permanent establishment as it typically falls within the scope of the exclusion contained in most tax treaties. However, under the new provisions, the warehouse would be considered a permanent establishment as it is not considered to be temporary and that the distribution of said products would be perceived as essential to the business.

ANTI-FRAGMENTATION RULE

The optional anti-fragmentation rule permits a jurisdiction to group a number of operations in the same jurisdiction performed by closely related parties in order to determine that there is a permanent establishment. This is in order to combat the use of multiple subsidiaries in an endeavor to avoid a permanent establishment. However, this is limited to a certain extent by the inclusion of a clause requiring these complementary functions to be part of a cohesive business operation that is not of a preparatory or ancillary nature as described above. An extension of this rule covering timelines is also included to address the concerns of connected enterprises taking shorter contracts in succession to avoid creating permanent establishments. This requires groups to take a holistic view of their operations in any single country to ensure that they do not inadvertently create a PE.

WHEN DOES THIS COME INTO EFFECT

The OECD's published Multilateral Instrument enables countries to quickly implement the changes to bilateral treaties proposed by the BEPS project. At the official June 2017 signing ceremony, 68 countries signed up to it, Ireland inclusive. More countries have subsequently followed suit.
103 jurisdictions participated in the BEPS project. If implemented, the Instrument could result in more than 2,000 treaties being amended. This would equate to more than two thirds of the world's double taxation agreements. While the proposed changes have the potential for significant change, it would be preferable if there was widespread adoption. At least if this were to occur, it would ensure consistency and certainty for businesses and tax authorities.

With a renewed zeal to increase tax base, what is certain is that the concept of PE will come under renewed focus by tax authorities. Tax functions, be they internal or external, need to have an understanding of organisations, how they operate and the jurisdictions in which functions (e.g. sales, development etc.) are performed. A more detailed understanding will help in assessing if a potential tax issue arises by virtue of this new approach to PE's. Proactivity as opposed to reactivity is required in order to manage risk and this potential new challenge.

CONTRIBUTOR DETAILS

Cormac Kelleher

Email: ckelleher@mazars.ie
Phone: +353 1 449 4456

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

MAZARS

ROMANIA

IMPLEMENTATION OF ATAD AND OVERHAUL OF THE SSC TAXATION SYSTEM

With effect from 1 January 2018, significant changes have been brought into effect regarding both the corporate taxation system, as well as the personal tax system.

IMPLEMENTATION OF THE ANTI-TAX AVOIDANCE DIRECTIVE

- **INTEREST DEDUCTION LIMITATION RULE**

The rules applicable at this moment in respect to the deductibility of interest for intra-group loans will be amended and replaced.

The limitation applies to affiliated entities, consolidated groups and permanent establishments which have an interest expense in excess of €200,000. Interest deductibility will be limited to up to 10% of the following tax base:

"Taxable income – Non-taxable income + Corporate income tax expenses + Exceeding borrowing costs + Fiscal depreciation"

Should the tax base be a negative amount or has a value equal to 0, excess interest expense will represent non-deductible expenses in the related fiscal period, and can be carried forward for an indefinite period.

- **EXIT TAXATION**

An exit tax will be applied for assets transfers between entities part of the same company (i.e. head office and permanent establishment – "PE") which would result in Romania losing the right to tax such transferred assets.

The tax base of the exit taxation is formed by the difference between market value and the fiscal value at the date the assets are transferred. If this difference is a gain, it is taxable at a rate of 16%. However, should a loss arise, it will be offset against gains resulting from operations of the same nature during the next 7 years.

- **GENERAL ANTI-ABUSE RULE (GAAR)**

Although Romania already had an anti-abuse rule regarding artificial transactions, the additions bring a new definition by which transactions that do not have valid commercial reasons, carried out for the main purpose of obtaining a tax advantage, are to be ignored by the tax authorities for the purpose of calculating the corporate tax liability.

- **CONTROLLED FOREIGN COMPANY RULES**

Controlled foreign company (CFC) rules have been introduced in order to prevent cases when income is artificially diverted to other subsidiaries.

PERSONAL INCOME TAX AND SOCIAL SECURITY CONTRIBUTIONS

- The income tax rate is decreased from 16% to 10**%** for the majority of the revenues obtained by individuals.
- The rate of social security contributions will be decreased **(**from 39.25% to 35.00% applied to the gross income**)** and will be fully transferred from the employer to the employee.
- The employer will incur work insurance contribution in the amount of 2.25% to the gross salary.
- For employees that benefit from the personal income exemption (e.g. software developers, individuals performing R&D activities, etc.) a special compensation mechanism has been put in place in order to ensure that they will still benefit from a real exemption following the transfer of the social security contributions from the employer, to their responsibility.

MICRO-ENTERPRISES TAX REGIME

The revenue thresholds for application of the microenterprise tax regime is increased from €500,000 to €1 million. The regime is mandatory. This is notwithstanding the nature of the revenue or their object of activity (the provisions under which taxpayers could opt in for the corporate income tax regime provided that their share capital was at least RON 45,000, has been eliminated). Accordingly, with effect from 1 January 2018, all entities that qualify for the microenterprise tax regime under the newly enacted provisions will apply a tax rate between 1% and 3%, depending on the number of employees it has.

It is possible that the provisions of the Parent Subsidiary Directive may no longer be applicable. This is by virtue of the fact that the microenterprise tax regime is not among the taxes referred to in the Directive as a mandatory condition to be met.

The tax measures are currently in force based on Emergency Ordinances issued by the Romanian Government. Also, these have to be approved into law by the Romanian Parliament, and potential further changes to be above may be brought forward.

CONTRIBUTOR DETAILS

Edwin Warmerdam

Email: Edwin.Warmerdam@mazars.ro
Phone: +40 31 229 26 00

CORPORATE INCOME TAX REFORM ENACTED

On 22 December 2017, the Belgian Parliament approved the Belgian tax reform bill implementing a major corporate tax reform in Belgium with effect as of 2018. This bill was published in the Belgian Official Gazette on 29 December 2017 and was signed by the Belgian King on 25 December 2017.

The crown jewel of the major CIT reform is the gradual decrease of the corporate income tax rate to 25% (for MNE's) and to 20% (for SME's) and the introduction of tax consolidation as of 2019.

The rate will be reduced from 33,99% to 25% in 2020. A considerably reduced rate of 20% will apply to SMEs with a taxable base up to €100,000 as from 2018.

The reform will be budget neutral. The measures will be gradually implemented in 3 main phases, part of them becoming effective as of 2018, and other as of 2019 or 2020.

We provide you with a concise overview of the measures of particular relevance for the MNE's, as they might impact the deferred tax position in the 31 December 2017 accounts, since the Belgian tax reform law has been substantively enacted in 2017.

INCENTIVES 2018

- ### GRADUAL DECREASE OF THE CORPORATE TAX RATE

The standard CIT is gradually reduced from 33,99% to 25% in 2020 for large companies. At the same time the surcharge of 3% will be limited to 2 % for 2018 and 2019 which will be abolished completely as of 2020. The corporate tax rate evolves to:

- 29,58% for income year 2018 and 2019
- 25% as from income year 2020

For small and medium-sized enterprises, the rate decreases to 20% as from 2018 on the taxable basis below €100.000, subject to the payment of a minimum salary of € 45.000 to an individual manager

- ### 100% PARTICIPATION EXEMPTION INSTEAD OF 95% ON DIVIDEND INCOME

The participation exemption on dividends is extended to a full 100% exemption of the dividends received as from 1 January 2018 instead of 95% currently. The Fairness tax on the subsequent dividend repatriation to the shareholders will be abolished as from income year 2018. This will reinforce the attractiveness of the Belgian holding regime.

- ### ABOLISHMENT OF THE SEPARATE CAPITAL GAINS TAX ON SHARES

The capital gain tax on shares of 0,412% (for shareholding more than 1 year) for large companies will be abolished. The conditions to benefit from the 100% tax exemption will be aligned with the 'participation exemption' conditions for dividend income: in addition to the subject-to-tax test and the one-year holding period, a minimum shareholding requirement of at least 10% or €2,500,000 will apply.

- ### EXTENDED TAX BENEFITS FOR INNOVATION

In addition to the new innovation deduction introduced, the salary withholding tax exemption for scientific personnel will be extended to certain bachelor degrees in biotechnical, industrial sciences and nautical sciences as of 2018.

The R&D investment deduction and the R&D tax credit are maintained. As a result of the lower corporate tax rate, the effective tax rate on IP income that qualifies for the new innovation deduction could drop to 3,75% as of 2020.

- **TAX CONSOLIDATION (AS FROM 2019)**

Belgium will introduce tax consolidation as of 2019, based on a 'Group Contribution' system. Group companies (in tax paying position) will be able to make a group contribution to group companies (in tax loss position), where the latter will be able to offset this group contribution against their current year tax loss.

The tax group contribution system will be annually determined off balance via a group contribution contract and shall apply to Belgian resident companies and establishments of foreign companies resident in a member state or the EEA and subject to certain specific conditions (o.a. limited tax consolidation perimeter).

COMPENSATING MEASURES 2018

- **INTRODUCTION OF A MINIMUM TAX BASE - LIMITATION OF CERTAIN TAX DEDUCTIONS**

Inspired by Germany, the use of certain tax deductions will be limited to (i) the taxable profit up to €1 million, and (ii) 70% of the profits exceeding the €1 million threshold. The remaining 30% of the tax base in excess of €1 million cannot be offset and will be fully taxable, introducing a 'minimum tax base'.

- The tax deductions included in the 'basket' should be applied in the following order: incremental notional interest deduction of the year, carry forward of dividend received deduction, carry forward innovation income deduction, losses carried forward, and finally (old) notional interest deduction.
- Current year dividend received deduction, Innovation income deduction of the year, the investment deduction and the group contribution (in terms of the fiscal consolidation that would be introduced) would not be included in the basket and therefore could be fully deducted from the taxable profit before the basket limitation is taken into account.

- **INCREMENTAL NOTIONAL INTEREST DEDUCTION**

As of 2018, the notional interest deduction will only apply to the incremental adjusted equity in excess of the average equity of the preceding five years. The notional interest deduction ("NID") will hereto only be calculated on the incremental equity (capital increases + retained earnings) and no longer on the total equity of the preceding year. This measure will substantially lower the benefit of the NID. The applicable NID rate for assessment year 2019 (financial year 2018) is 0,746%.

- **LIMITATION OF TAX DEDUCTIBILITY OF PROVISIONS**

Provisions for risks and charges will only be tax-deductible if at the end of the taxable year an 'obligation' actually exists at the end of the financial year. Provisions based on a contractual, regulatory or legal obligation will thus be tax-exempt.

CONTRIBUTOR DETAILS

Joeri De Ceuleneire

Email: joeri.deceuleneire@mazars.be
Phone: +32 (0)9 265 83 20

CROATIA

CHANGES IN THE CROATIAN TAX SYSTEM

As part of the comprehensive reform of the Croatian tax system that was introduced in 2017, certain changes are put in force as of 1 January 2018. Please find below high-level overview of these changes

INPUT VAT ON CARS AND CAR RELATED PURCHASES

One of the most significant changes in the Croatian value added tax system that came into force on 1 January 2018 is the enabling of 50% input VAT deduction related to procurement of personal cars and car-related goods and services.

Up to year 2012, 70% of input VAT on car-related purchases was deductible. From 2012 to 2018, taxpayers were not entitled to deduct any input VAT on cars and car-related purchase.

Further to this, taxpayers should be cautious in future periods when supplying cars (both to employees as income in kind or to third parties) given that, in line with general VAT rules, VAT is due on car-related supplies if input VAT was deducted (regardless of the deducted proportion).

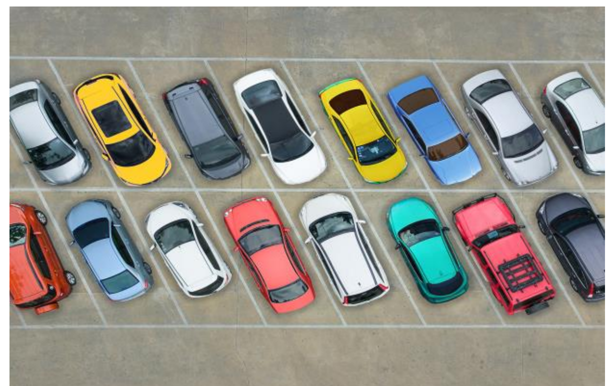
INPUT VAT ON IMPORT

One of the general rules of the Croatian VAT system is that VAT on imports is paid together with other import-related charges (i.e. customs). In other words, taxpayer's cashflow is inevitably temporary burdened in case of import given that the VAT liability cannot be offset with the correspondent input VAT deduction in the monthly VAT return.

This rule still remains in vast majority of VAT taxable imported goods. However, latest amendments of the VAT Act and Rulebook provide for the possibility of offsetting VAT liability and input VAT within the VAT return for certain categories of imported goods if their value exceeds HRK 1m. These goods include, inter alia, nuclear reactors, piston engines, electromotors, windshield wipers etc. Prior consent of the Customs Office is needed in order to apply this treatment.

CHANGES IN CORPORATE TAXATION

As of 1 January 2018, 50% of personal car and car-related purchases is treated as a non-deductible expense. This means that corporate tax is to be paid on half of car-related purchases instead of the previous 30%. Thus, although taxpayers undoubtedly benefit from the newly introduced possibility of input VAT deduction, the additional CIT obligation somewhat decreases this benefit.



PERMANENT ESTABLISHMENT ISSUES

Beside changes in valid provisions, it is worth noting that the Croatian Tax Administration's (TA) interest in permanent establishment (PE) issues has noticeably increased in recent periods. Although Croatia had fully incorporated PE provisions into its legal system, the TA has not put significant efforts to charge tax on account of this area of corporate taxation in the past. However, such efforts are noticed in recent periods so taxpayers ought to get acquainted with their rights and obligations emerging from this issue in order to avoid burdensome default interest and penalties.

CHANGES IN PERSONAL INCOME TAXATION

Water and other warm and cold beverages that the employer enables to the employees during the working hours on his expense are not deemed taxable receipts arising from employment (except beverages that contain alcohol).

CONTRIBUTOR DETAILS

Pere Mioč

Email: pere.mioc@mazars.hr
Phone: +385 (0)1 48 64 424

ASIA

CHINA

INCOME TAX CASE: EXPATRIATE TAXATION

The Chinese Local Tax Authorities have expended significant effort in enforcing individual compliance, in particular that of foreign expatriates working in China.

Recently, the Beijing Local Tax Authority launched an investigation on a Chinese subsidiary of a Fortune 500 Company, focusing on individual income tax of the expatriates. The triggering point for the investigation is that the quantum of fringe benefits provided to these expatriates far exceeds that of expatriates of comparable entities in the industry. The back taxes and penalties imposed on the Chinese subsidiary are well over RMB 28 million (circa USD$4.5m).

RECAP – TAXATION TREATMENT OF FRINGE BENEFITS FOR EXPATRIATES

Under the current PRC individual income tax regulations, certain fringe benefits received by expatriates are exempt from individual income tax. These benefits as prescribed by Caishuizi (1994) 20 and Guoshuifa (1997) 54 are:

- Housing, meal and laundry allowances received in a non-cash form or on a reimbursement basis;
- Reimbursement of relocation expenses upon commencement or cessation of China assignment;
- Travel allowance earned by an expatriate for travel within or outside China provided that the amount is reasonable and receipts of the relevant transport and accommodation expenses or travel schedules can be submitted to the tax authorities;
- Home leave allowance for trips from China to the taxpayer's home (or the home of the taxpayer's spouse or parents), up to two trips per calendar year;

- Language training for the expatriate and children education allowance provided the amount is reasonable and used in China.

Generally, as these fringe benefits form part of the compensation to the employee, the costs incurred are often deductible to the employer as they are expenses incurred to earn assessable profits.

THE CASE

During the investigation on the Chinese subsidiary, the Beijing Local Tax Authority noted that the quantum of fringe benefits provided to the expatriates exceeded 50% of their regular compensation. As compared to the average percentage of fringe benefits (i.e. 20%) offered by foreign invested enterprises in Beijing, the Beijing Local Tax Authorities were of a view that the fringe benefits received by the expatriates of this subsidiary seemed to be unreasonable.

The Beijing Local Tax Authority therefore looked at each of the fringe benefits in detail and came up with the following conclusion:

1. Housing allowance – It was found that in addition to rental reimbursements, utilities, property maintenance charges, including cleaning expenses, are also included as tax exempt housing allowance. It is the view of the tax authority that housing allowance should only include direct rental expenses, Supplementary benefits such as utilities, property maintenance charges and cleaning charges should not be within the scope of the exemption.

2. Language training and children education allowance – It was found that children education fees were incurred in respect of schools based outside China. In addition, even in respect of children who attended schools in China, expenses incurred such as meals and transportation should be excluded. The tax authority also found expenses such as piano training expenses, and considered that they are not for language training and should be taxable.

3. Home leave allowance – It was found that the subsidiary also paid for the transport expenses incurred for the expatriate's family members. As noted in Guoshuihan (2001) 336, only transport expenses incurred by the expatriate could be exempted from individual income tax.

4. Travel allowance – As noted above, travel allowance earned by an expatriate for travel within or outside China is exempt from individual income tax provided that the amount is reasonable and receipts of the relevant transport and accommodation expenses or travel schedules can be submitted to the tax authorities. However, no specific criteria have been set to justify the reasonableness of the amount of allowance, which often depends on the interpretation of the relevant tax authorities. Obviously, the Beijing Local Tax Authority was taking a stringent approach in this case, as such allowance was included in the expatriate's taxable income.

In summary, the subsidiary was assessed to additional individual income tax payable on behalf of the expatriates for an amount of over RMB 16 million (circa USD$2.5m), and as no proper withholding tax had been withheld, a penalty of RMB 12 million (circa USD$1.9m), for a total of over RMB 28 million (circa USD$4.5m).

OUR OBSERVATION

Fringe benefits continue to be an effective means to provide tax free compensation to expatriates. Nevertheless, the employer enterprise needs to provide proper documentation, and the fringe benefit has to clearly fit in to the interpretation in order to be able to be exempted from individual income tax. For example, it is not uncommon that an employer would provide for children education allowance for the expatriate's children who may be studying overseas. Such an education allowance would be fully taxable whether it was paid by the Chinese employer or the parent company of the Chinese employer.

Enterprises which attract foreign expatriates by offering substantial fringe benefits should from time to time to review the details and amount of the fringe benefits provided to the expatriates and seek professional advice when necessary.

CONTRIBUTOR DETAILS

Michael To

Email: michael.to@mazars.hk
Phone: +852 2909 5680

TWO-TIER TAX SYSTEMS FOR SME'S AND NEW INCENTIVES FOR INNOVATION AND TECHNOLOGY SECTOR IN HONG KONG

The Hong Kong inflation rate has dropped for 6 consecutive years and the latest unemployment rate dropped to 3.1%, the lowest level in the last two decades. It is estimated the overall GDP growth rate of Hong Kong will exceed 3.5%, better than the annual average of 2.9% over the past decade.

Small and medium-sized enterprises ("SMEs") are the backbone of the Hong Kong economy. For the economic growth of Hong Kong and to promote the innovation and technology development in Hong Kong, two new tax measures have been announced.

NEW TAX MEASURES

- ### TWO-TIER PROFITS TAX SYSTEM

A two-tier profits tax system will be introduced in 2018 whereby a concessionary rate at 50% of the normal profits tax rate be applied to the first HK$2 million (circa USD$250k) annual taxable profits of the taxpayer. To ensure that the tax benefits will target SMEs, only one enterprise nominated by each business group is eligible for the lower tax rate.

- ### SUPER DEDUCTION FOR R&D EXPENDITURE

To encourage research and development ("R&D") investment by the enterprises, the first HK$2 million (circa USD$250k) eligible R&D expenditure will enjoy a 300% tax deduction with the remainder at 200%. It is targeted to double the R&D expenditure as a percentage of the GDP from the current 0.73% to 1.5% within 5 years. Comparing the R&D to GDP ratio of Hong Kong's major competitor, Singapore, which was 2.2% in 2014 (per 2014 data published by OECD in January 2017), Hong Kong has a long way to go.

The intention is to work to increase the total number of comprehensive double taxation agreements ("CDTA") to 50 in the next few years. Hong Kong has presently entered into 38 CDTA.

CONTRIBUTOR DETAILS

Michael To

Email: michael.to@mazars.hk
Phone: +852 2909 5680

SOUTH AMERICA

CHILE

EXPIRATION OF RELIEF FOR US SHAREHOLDERS

The Chilean tax reform 2014 established two general tax systems that came into force on 1 January 2017: *System A* ("Attributed Regime") and *System B* ("Partially Integrated Regime"). Final taxation for non-resident investors, in both regimes, varies and depends on the existence of a Double Taxation Treaty (hereinafter "DTT") in force between Chile and the residence country of the foreign investor.

While the US does not have a DTT in force with Chile, it has been benefited so far from an exemption. This exemption is due to expire on 31 December 2019. What happens after that?

Each taxation system can be quickly explained as follows:

- *System A ("Attributed Regime"):* It levies 25% corporate income tax on all taxable income on an accrual basis, and allocates in the same tax year such income to the shareholders. As a result, 35% WHT will be applied to non-residents, irrespective of whether the company distributes dividend or not. This system allows 100% corporate tax credit to all shareholders, whether a DTT applies or not.

- *System B ("Partially Integrated Regime"):* It levies corporate income tax at a rate of 25.5% for 2017 and of 27% for 2018, for all taxable income on an accrual basis. Under this regime, shareholders will still be allowed to defer withholding taxes until profits are effectively distributed, as was before the Tax Reform.

  However, corporate tax credit is reduced to 65% and therefore final taxation increases from 35% to 44.45% (from 2018 onwards), unless the foreign shareholder is a resident in a country having a DTT in force with Chile. In this case, the final taxation remains at 35%, same as System A.

System	Corporate tax rate	Criteria for final taxation	Tax credit	Final Taxation	Impact of a DTT
Regime A	25% from 2017 onwards	Accrued basis	100%	35%	None
Regime B	25.5% for 2017 and 27% from 2018 onwards	Cash basis	65%	43.93% for 2017 44.45% from 2018 on	DTT in force reduces final taxation to 35%

The good news is that even though the US does not have a DTT in force with Chile, it has been benefiting from a transitory clause in System B. This establishes a 100% of corporate tax credit for countries having a DTT with Chile signed before 1st January 2017, even when it is not in force. The bad news is that this benefit will only remain in effect until 31 December 2019.

With effect from 1 January 2020, the general rule will apply and the only way to access a final taxation of 35% in System B will be by becoming a resident of a country having a DTT in force. Aside from the above, it is necessary to bear in mind that the new Chilean president Sebastián Piñera recently announced his plan for enacting this year a new tax reform bill, whereby it will be restored 100% corporate tax credit to all foreign shareholders, whether subject to System A or B.

CONTRIBUTOR DETAILS

Felipe Yañez

Email: felipe.yanez@mazars.cl
Phone: +56 (2) 29 63 33 00

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

MAZARS

ARGENTINA

IMPLEMENTATION OF BEPS MEASURES

Argentina was among the first 68 jurisdictions to formally sign the Multilateral Convention to implement the Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) in Paris.
The four main goals of this multilateral instrument are focused on:

- Neutralising the effects of hybrid mismatch arrangements to avoid erosion of the taxable bases of the countries concerned (Action 2)
- Preventing the granting of treaty benefits in inappropriate circumstances (Action 6)
- Preventing the artificial avoidance of permanent establishment status (Action 7)
- Making dispute resolution mechanisms more effective (Action 14)

The purpose of this adhesion is to modify the bilateral tax treaties signed by Argentina with other 17 countries in order to comply with the minimum standards agreed on the BEPS measures.

MLI is aimed at providing a framework that could definitely allow amending existing bilateral treaties, bringing them in line with BEPS treaty-related minimum standard and recommendations with no need to initiate complex and lengthy bilateral renegotiations.

With this action, Argentina ratifies its compromise with the BEPS schedule, while the country is heading for an integral tax reform. The Government is now working on a bill concerning the change of the Income Tax, VAT and Tax on credits and debits on bank accounts.

Finally, Transfer Pricing legislation is also expected to introduce modifications in line with the BEPS Transfer Pricing actions.

CONTRIBUTOR DETAILS

Adrian Ramaioli

Email: adrian.ramaioli@mazars.com.ar
Phone: +54 11 4804 6502

US Desk – Here to help you!

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.

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

Praxity MEMBER
GLOBAL ALLIANCE OF INDEPENDENT FIRMS
MAZARS