

# MAZARS U.S. TAX DESK NEWSLETTER

October 2018



## IN THIS ISSUE!

Welcome to the latest edition of the Mazars U.S. Tax Desk Newsletter!

With the return of many Governments after the summer break, the roll out of tax changes is in full flow. This is coupled with many jurisdictions being in the midst of budget season. This is the final quarter before many European jurisdictions implement E.U Directives in January 2019.

In this issue, we explore and share our perspectives on:

- Germany's new tax liability for indirect sale of German real estate;
- New Dutch Transfer Pricing Decree;
- France's ratification of the Multilateral Instrument;
- The Transfer Pricing and BEPS Legislation Passed in Hong Kong" and
- Chilean Tax Reform 2018.

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

We are delighted that our 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.

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# EUROPE

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## NEW TAX LIABILITY FOR INDIRECT SALE OF GERMAN REAL ESTATE

### GENERAL

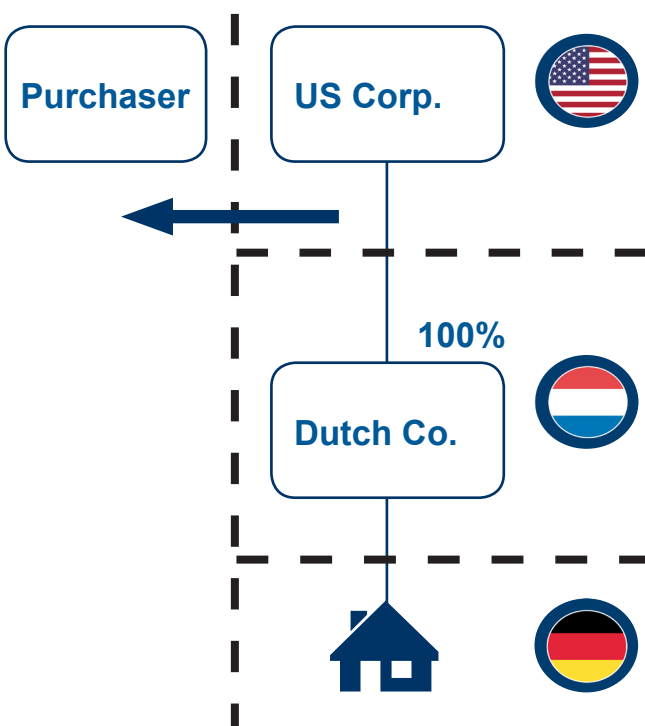
In most German cities, prices for real estate have significantly increased over the past few years. Many German and foreign investors have sold German real estate with a capital gain or are planning to do so. Under current tax rules in Germany it is possible for foreign investors to realize an – indirect – capital gain from German real estate without paying German income taxes.

The German government is under increasing pressure to change this. As a consequence, the German legislator is planning to introduce a limited tax liability for the sale of foreign corporations with domestic real estate assets.

### BACKGROUND

The sale of real estate (asset deal) located in Germany by a foreign corporation (e.g. Dutch BV) leads to domestic commercial income. This income is subject to limited corporate income tax liability in Germany.

In contrast, the gain on the sale of shares of a foreign corporation whose assets predominantly consist of real estate held in Germany (share deal) by another foreign company or individual is currently not subject to German taxation.



The more recent German double taxation agreements grant the right of taxation in the country where the real estate is located in accordance with Art. 13 para 4 of the OECD model treaty. However, the taxation right is currently not exercised by the German tax authorities due to the requirements of German national tax law. The capital gain realized by the sale of shares in a corporation is only taxable if that corporation has its registered office or place of management in Germany.

### PROPOSED CHANGES

According to a recent draft bill, this will be changed. The taxation of capital gains will include shares of foreign real estate companies if:

- at least 50 per cent of the value at any time during the 365 days period prior to the sale directly or indirectly consisted of domestic real estate;
- the shares were attributable to the seller at that time; and
- the sale takes place after 31 December 2018.

According to the explanatory notes to the draft bill, indirect participations should be taken into account by means of a consolidated analysis. The 365-day period is intended to prevent the company's asset structure from being changed shortly before the sale of the shares so that the 50 per cent limit is not exceeded. Relevant are only changes in value after 31 December 2018. Value changes mean increases in value as well as reductions.

If the seller is a qualifying corporation, the capital gain should generally be subject to the German participation exemption (sec. 8b CIT Act). Sec. 8b CIT Act stipulates that the capital gain is tax free, but 5% of the capital gain is added back as a deemed non-deductible expense, resulting in a 95% tax exemption. Certain corporations (e.g. financial institutions) are not eligible for this tax exemption.

Recently, the Federal Tax Court ruled that the add-back of 5% does not apply to foreign corporations which do not have a permanent establishment in Germany. If this opinion prevails and is not corrected by another bill, the new legislation will not have any effect as far as the participation exemption applies.

### OUTLOOK

While the new rule looks like a small “technical” amendment to the law, it will lead to a German taxation right for a number of existing and future investments in German real estate.

For existing real estate holding structures, the value of the shares (and properties) as of 31 December 2018 can be decisive with respect to a future taxation in Germany. Therefore, a valuation as of that date to “conserve” the current value for any future disposal will be recommendable.

In addition, many questions are not answered by the new bill or the legislative commentary – for example the issue of a double taxation in certain cases due to the 365-days-rule, the details of the capital gain calculation for companies that are not subject to German GAAP or the above mentioned application of the participation exemption in the context of this new legislation. It will be up to the tax courts to provide answers to these questions.

## CONTRIBUTOR DETAILS

### Andreas Lichel

Email: andreas.lichel@mazars.de

Phone: +49 30 20 888 – 1002

### Dr. Ragnar Könemann

Email: ragnar.koenemann@mazars.de

Phone: +49 30 20 888 - 1536

## NEW DUTCH TRANSFER PRICING DECREE

On 11 May 2018, the Dutch State Secretary of Finance published a new Transfer Pricing Decree IFZ2018/6865 (the “Decree”). The Decree replaces the former transfer pricing decree from 2013, IFZ 2013/184M, and aims to align the Dutch transfer pricing regulatory guidance with the outcome of the OECD Base Erosion and Profit Shifting project, as well as the changes in the 2017 OECD Transfer Pricing Guidelines (“OECD Guidelines”). The Decree aligns itself with the new wording and terminology used by the 2017 OECD Guidelines and provides further guidance on application of the arm’s length principle, especially in cases where the OECD Guidelines leave room for interpretation.

### OVERVIEW

The most important changes included in the Decree are:

- A clarification on the process of accurately delineating and characterizing intercompany transactions;
- Additional explanation on the application of transfer pricing methods in specific situations;
- Adjustments to the section on the pricing of transactions involving intangibles for which valuation is highly uncertain at the time of the transaction; and a new section on ‘hard-to-value’ intangibles;
- A new section on the purchase of shares in an unrelated company followed by a business restructuring; and
- A section on the definition and remuneration for ‘low value adding services’.

### CHARACTERIZATION OF A TRANSACTION

The Decree follows the provisions of the OECD Guidelines on comparability analysis, stating that the first aspect in the analysis is to identify the commercial or financial relations, and the conditions and economically



## THE NETHERLANDS

relevant circumstances attaching to those relations. The Decree adopts the new six-step risk analysis framework described in the OECD Guidelines. The Decree follows the definition of “control over risks” and “the financial capacity to bear the risks” as provided in the OECD Guidelines. Furthermore, the Decree clarifies that in a situation where more than one party exercise control over risks, the Profit Split method may be appropriate.

The Decree adopts the OECD view with respect to the recognition of the accurately delineated transaction and when the transaction can be disregarded.

### TRANSFER PRICING METHODS IN SPECIFIC SITUATIONS

The Decree reiterates that the taxpayer should take into account the reliability of a specific method when selecting whether to apply it, though there is no explicit requirement to assess all methods to substantiate the selection of a specific method.

Furthermore, the Decree specifically addressed application of cost-based methods and provides additional examples on cost-based remuneration when selling goods through an intermediary, and clarifications on when the raw materials costs should be included in the cost base

### INTANGIBLES

The Decree adopts DEMPE (Development, Enhancement, Maintenance, Protection and Exploitation) as the relevant functions when analyzing the contribution to the value of intangibles and the remuneration thereof. Contrary to the OECD Guidelines, the Decree stipulates that the Development and Enhancement functions should receive a higher weighing than the rest of the functions.

The Decree also stipulates that legal ownership by itself will only justify a limited remuneration if the legal owner lacks the relevant functionality and risks assumption.

With respect to pricing of transactions involving intangibles for which valuation is highly uncertain at the time of the transaction, the Decree confirms that price adjustment clauses in the agreement (to align the remuneration with anticipated benefits) should be acceptable between related parties where independent enterprises would have included similar adjustments.



In relation to Hard-To-Value Intangibles (“HTVI”), the Decree adopts the guidance outlined in the 2017 OECD Guidelines. In the situation where following the transfer of the HTVI, the actual results deviate significantly from the projections, and this deviation cannot be explained by the facts that took place following the transfer, the assessed value of the HTVI can be challenged by the Dutch Tax Authorities. A deviation is considered “significant” if there is more than 20% between the projections and the actual results. If significant deviations start to materialize only after a 5-year commercialization period following the year in which the HTVI first generated unrelated party revenues for the transferee, the intangible will not be considered HTVI.

## PURCHASE OF UNRELATED COMPANY SHARES FOLLOWED BY A BUSINESS RESTRUCTURING

The Decree includes a new section to address a situation where a taxpayer purchases shares in an unrelated entity, whereby, following the acquisition of shares, a business restructuring takes place and the intangible of the acquired entity is being transferred. The Decree stipulates that the value of the intangible as established in the share purchase documentation should be a good indication for a minimum price the seller would like to receive when transferring the intangible in a business restructuring. Furthermore, the seller will usually also consider the tax costs related to the transfer when determining the minimum price.

In cases where entrepreneurial function and related intangibles are transferred to an associated enterprise, and only one routine function remains, the Dutch tax administration will usually take the position that for the purpose of establishing an arm’s length value of the transfer, the routine function should not be discounted perpetually since such function can be easily replaced in the market. This will usually lead to a higher value for the intangibles transferred.

## LOW VALUE ADDING SERVICES

The Decree adopts the definition and application of a simplified approach for low value adding services, including acceptance of a 5% mark-up on the cost base (direct and indirect costs incurred in provision of such services).

## OTHER REMARKS

The Decree refers to the transfer pricing documentation requirements as stated in the Dutch regulations, and further reiterates that penalties will be imposed in case of shift of profits in a non-arm’s length manner.

## CONTRIBUTOR DETAILS

### Tanya Gartsman

Director Transfer Pricing

Email: [Tanya.Gartsman@mazars.nl](mailto:Tanya.Gartsman@mazars.nl)

Phone: +31 88 277 24 72



## IRELAND'S CORPORATION TAX ROADMAP

On 5 September 2018 the Department of Finance published Ireland's Corporation Tax Roadmap. This document addresses Ireland's interaction on the international tax scene and actions Ireland has taken on corporate tax to date, while further considering Ireland's future tax policy. This Roadmap is useful as it should give some insight into how measures will be announced in the upcoming Budget 2019 and subsequent Finance Bill.

In the Corporation Tax Roadmap, the Department of Finance has set out a history of changes warranted on the journey so far, while noting that the present international tax approach: -

“that was established in the 1920s has formed the bedrock of how companies are taxed around the world. This framework has however been questioned in recent years as the business environment in which companies operate has become increasingly globalised and digitalised.”

Reacting to these challenges, Ireland has implemented the OECD BEPS project, Common Reporting Standard (CRS) and the US FATCA agreements. Ireland acted on and made changes to its tax residence rules in 2013 and 2014, preventing Irish incorporated companies from being stateless for tax purposes and to close off aggressive tax planning arrangements, which relied on exploiting mismatches between national tax rules.

The first key deliverable following agreement of the BEPS reports was the introduction of Country by Country Reporting (CbCr), requiring large multinational groups to provide an annual report to tax authorities on where their business activities are located and where taxes are paid. Ireland introduced CbCr in Finance Act 2015.

At EU level we have worked to transpose EU ATAD Directives into national legislation, discussed in further detail below.

## THE DETAIL

The roadmap is bedded in three principal areas, that is, the EU Directives Anti-Tax Avoidance Directives (ATAD), OECD BEPS Project and Coffey Review, and sets out timelines around these key commitments.

### ATAD

#### INTEREST RULE DEDUCTION

Ireland is required to implement an interest limitation rule compliant with the ATAD. The proposed ATAD interest limitation rule operates by limiting the allowable tax deduction for “exceeding borrowing costs” in a tax period to 30% of Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA).

The general implementation date for the ATAD interest limitation rule is 1 January 2019. However, a derogation is provided in Article 11 such that Member States having national targeted rules which are equally as effective at preventing BEPS risks as the ATAD interest limitation



ratio, may defer implementation until an agreement on a minimum standard for BEPS Action 4 is reached at OECD level, but no later than 1 January 2024.

In an Irish context, our legislation seeks to limit interest deduction based on a qualifying purpose method, whereas the Directive seeks to apply a strict ratio-based approach to the interest restriction. The Roadmap acknowledges that initial responses from the Commission are tentative at best around the derogation, yet the Department of Finance remain of the view that our interest provisions, though structurally different, remain equally as effective as the ATAD.

The roadmap also states that work has commenced examining options to accelerate the transposition process from the originally planned deadline of the end of 2023 to Finance Bill 2019 at the earliest. In addition, a public consultation seeking views on the linked issues of the ATAD interest limitation and anti-hybrid rules is planned for the end of 2018.

#### EXIT TAX

In simplicity, the EU Directive seeks to provide an exit tax for entities who migrate their tax residence from one jurisdiction to another, primarily assessed on assets transferred with latent unrealised Capital Gains Tax.

Domestic exit tax legislation is already in place in Ireland. It is envisaged that legislation to implement the Directive, replacing the current provisions, will be introduced with effect from 1 January 2020. Primary discussions arising from the Public Consultation are focused on the rate to apply, with 12.5% suggested for trading assets.

The Department of Finance views this introduction as a behaviour influencing measure and not a revenue generating measure, despite the proposed broader application of the EU Directive.

#### GAAR-GENERAL ANTI ABUSE RULES

Domestic Irish legislation is already viewed as being sufficiently robust when viewed alongside GAAR. No amendments to our national legislation are proposed by the Department of Finance.

#### CONTROLLED FOREIGN COMPANIES (“CFC”)

In general, CFC rules operate in higher tax jurisdictions, where parent companies own or control entities in lower tax jurisdictions, designed to limit or provide an artificial deferral of tax by using offshore low taxed entities.

The proposed ATAD CFC rules will apply when an entity is 50% or more controlled by a parent entity, and the tax paid in the foreign jurisdiction is less than half of that which would have been payable in the parent company jurisdiction.

The Department of Finance has elected to implement Option B of the ATAD CFC rules. This requires an analysis as to whether the CFC would own the assets or would have undertaken the risks which generate its income if it were not controlled by the parent company which undertakes the significant people functions relevant to those assets, income and risks.

Legislation will be introduced in Finance Bill 2018, with CFC rules in effect from 1 January 2019, in line with the ATAD.

#### HYBRID MISMATCH RULES

The Department of Finance have proposed a two-step implementation approach in line with the ATAD, that is, 1 January 2020 for the Anti-Hybrid legislation, and 1 January 2022 for the follow up Anti-Reverse Hybrid legislation.

Considering the complexities of the area, the roadmap has suggested that further public consultation on technical issues in this area is undertaken in advance of Finance Bill 2019, and again for the 1 January 2020 implementation date.

#### TRANSFER PRICING (“TP”)

The Department of Finance will introduce legislation updating Ireland’s TP rules in Finance Bill 2019 for implementation by 1 January 2020.

It is intended for public consultation to take place in early 2019 allowing stakeholder input on the changes needed to be made to Ireland’s tax legislation so as to ensure that Irish TP rules are effective in ensuring tax is paid where a value is created. This is in line with the Department of Finance’s view that TP rules are complex and important to our open economy, delivery of new standards should be clear and defined and strengthening of our TP regime is an important element in defending Ireland’s tax regime in international fora.





## CONSIDERATION OF A TERRITORIAL REGIME

Our current legislation around double taxation (Schedule 24 of the Taxes Consolidation Act) is very complex. This is a result of our utilisation of a worldwide tax system.

The proposed transition to a territorial tax system arising from the Coffey Review, would allow for less complex rules and provide greater certainty for business. However, this must also be accompanied by robust anti-abuse measures.

In adopting the preceding ATAD EU Directives it is now considered the time to move forward with review and simplification of the double tax relief rules, alongside a public consultation to be launched in early 2019, and transition to a Territorial Tax Regime.

## OTHER INTERNATIONAL COMMITMENTS

The report has also highlighted other international commitments under way, including the following: -

### OECD BEPS MULTILATERAL INSTRUMENT

In summary form, rather than amending all the international tax treaties that interlace the globe, this instrument will bolt on to and directly amend the existing treaties to ensure they comply with the OECD BEPS recommendations without the need for separate bilateral negotiations.

### DAC6 – MANDATORY DISCLOSURE

Simply referred to as DAC6, these amendments introduce an obligation on persons to disclose potentially aggressive tax planning arrangements and then for the tax authorities to subsequently exchange this information. DAC6 reflects many of the underlying principles and concepts contained in our own domestic tax legislation, mandatory disclosure reporting requirements introduced by FA 2011, set out in Sections 817D-817R TCA 1997.

### DISPUTE RESOLUTION MECHANISM (DRM) DIRECTIVE

With so many changes to the international tax landscape, it is inevitable that disputes and disagreements among

tax authorities will increase. To ensure that disputes are resolved in a timely manner, the DRM Directive was agreed to enhance the framework for mandatory binding arbitration of tax disputes in EU law. Work is underway on implementing this Directive before July 2019 to provide Irish taxpayers with access to this new arbitration framework.

## INTERNATIONAL MUTUAL ASSISTANCE BILL

Ireland ratified the OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters in 2010. However, Ireland lodged several reservations when depositing our instruments of ratification in respect of the Convention.

The Taxation and Certain Other Matters (International Mutual Assistance) Bill, when enacted, will facilitate the withdrawal of Ireland's reservations regarding the recovery of tax and service of documents, except in respect of taxes imposed by or on behalf of political subdivisions or local authorities and social security contributions.

The Taxation and Certain Other Matters (International Mutual Assistance) Bill will also enable Ireland to complete the ratification of some remaining provisions of the EU / Switzerland Anti-Fraud Agreement, which Ireland has partially ratified.

The Coffey Review recommended that the passage of the Taxation and Certain Other Matters (International Mutual Assistance) Bill through the Dáil and Seanad Éireann should be facilitated. The Bill cleared pre-legislative scrutiny during 2017 and work is ongoing on finalising the drafting of this Bill.

## SUMMARY

This Roadmap is a very welcome document given the current international tax landscape. It provides clarity and timelines to Multi-National Companies doing business in Ireland, to assess the potential impact of changes to international tax legislation on their operations.

Further, the government have underlined their commitment to the 12.5% corporate tax trading rate, a solid tax regime, and maintaining Ireland's reputation as a first-class economy.

## CONTRIBUTOR DETAILS

**Cormac Kelleher**

Email: [ckelleher@mazars.ie](mailto:ckelleher@mazars.ie)

Phone: +353 1 449 4456



## TAXATION OF CARRIED INTEREST AND CLOSELY HELD COMPANIES

The Swedish Supreme Administrative Court recently delivered a judgment regarding the taxation of individuals who receive carried interest, the judgment will have great impact for shareholders who receive carried interest.

### TAXATION OF CLOSELY HELD COMPANIES

Because of the difference in tax rate between salary (progressive tax rate) and capital gain (flat tax rate) in Sweden, owners of closely held companies prefer dividends relative to salary in order to minimize tax payments.

To avoid this income offset, regulations are in place for closely held companies where four or less shareholders own 50% or more. Active shareholders count as one shareholder. An active shareholder is a natural person who gains income for the company. This means that the rules are applicable for partnerships, i.e. law firms or audit firms that could house hundreds of active owners.

The rules are not applicable when inactive shareholders own 30% or more, since there are no incentives for active shareholders to convert salary to dividends in those companies. There has also been case law where the regulations are viewed as inapplicable since the company's income is derived from assets that gain value by themselves, i.e. shares or real estate which can result in great profits without involvement from shareholders.

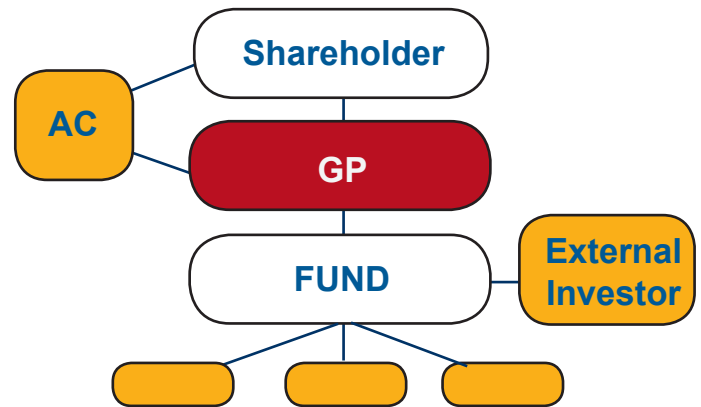
### THE CONCEPT OF CARRIED INTEREST

Carried interest was believed to be one of the exceptions, since the funds owners were not active in the funds, and the carried interest they received was derived from shares.

The company structures in the carried interest cases are usually quite complex and can for educational reasons in this article be simplified in the below diagram.

The Shareholders own shares in the yellow Advisory Company (AC), and the blue General Partner (GP) who control the funds where the carried interest is generated. The shareholders are full-time employees in the yellow AC company and receive a fair market salary. They are not employed in the blue GP. Depending on the corporate group, the shareholders can hold less than 1% of the total shares. Between the AC and the GP there is an Investment Advice Agreement, where the AC leave investment advices regarding the fund, for this the AC receives payment from the GP at market price, according to The Administrative Court of Appeal.

The GP manages and establishes the Fund. The GP invests 2% of the funds equity, The External Investors (EI) invest 98%. The EI will thereafter receive a dividend



proportional to their share of the fund. However, if the fund generates a dividend greater than 8%, the dividend in excess of 8% is divided with 20% to the GP. This “bonus” dividend is called carried interest. It is considered an incentive for the GP to undertake good investments and a compensation for the risk and costs that establishing a fund involves.

The shareholders therefore presented the carried interest as capital gain in their personal Income Tax Returns for the years 2007 - 2011.

### THE JUDGEMENT FROM THE SUPREME ADMINISTRATIVE COURT

The main question for The Court was whether a shareholder could be deemed an active shareholder in the GP, without working in that company. The reason for this would, according to The Swedish Tax Agency, be that carried interest is derived from the shareholders full time employment in AC and the advice they communicate to the GP.

The Supreme Administrative Court states in short terms that an earlier case from 2013 was applicable and that individuals are active shareholders in the GP.

In the earlier case the inactive shareholders brother worked as a consultant, the remuneration went to the brother's company. The brother was therefore active in the company where he was not employed, and the shareholder was therefore an active shareholder because they were related. The case differs on many points from the carried interest corporate groups, for example regarding headcount and business operations, which makes the Swedish regulation problematic.

This case law however makes the special tax regulation for closely held companies applicable on carried interest cases and therefore convert capital gains with a flat tax rate of 30% to salary with a progressive tax rate of around 57% for most of these incomes.

The exact incomes in the carried interest cases are

confidential, but various sources suggest that the recent judgment increases the individuals tax liability for those years to at least a billion SEK.

## HOW CAN MAZARS HELP

The Swedish regulation is tricky, and the consequences can be devastating for individuals if the tax regulation for closely held companies or carried interest is misunderstood. Mazars Sweden can help you to further explain this regulation or evaluate the effects the regulation can have for your company.

## CONTRIBUTOR DETAILS

**Jenny Stenesjö Wöhrman**

Email: [Jenny.Stenesjo@mazars.se](mailto:Jenny.Stenesjo@mazars.se)

Phone: +46 8 5620 38 08

## MLI AND AGGRESSIVE INTERNATIONAL TAX PLANNING

The law authorizing the Multilateral Instrument (hereafter “MLI”) ratification by France was published on 13 July 2018. As a principle, the MLI should be in force on the first day of the month following a 3-months period as from the deposit of its instrument of ratification. It is expected as the MLI will entry into force before the end of 2018, as the deposit of the instrument of ratification is pending. The promulgation of the ratification law includes France in the number of jurisdictions having validated the MLI. Once the instrument of ratification is deposited, the number of countries having already ratified the MLI would amount to 10 countries.

For countries ratifying the MLI, this instrument will significantly change the way of reading and applying international tax rules. It will no longer be enough to refer to Double Tax Treaties (hereafter “DTT”) concluded between two States to identify the rules applicable. An update of those rules should be done based on the MLI’s provisions, depending if the MLI has been ratified and if applicable rules are symmetrical, due to the optionality introduced in this new international tax instrument. Indeed, the MLI does not automatically apply between two States. The MLI contains:

- certain provisions reproducing the minimum BEPS standards, such as hybrid mismatches (Action 2), treaty abuse (Action 6), permanent establishment (Action 7) and dispute resolution (Action 14). The States will be required to apply these provisions, unless of course those minimum standards would be symmetrically met in alternative ways; and



**FRANCE**

- certain provisions on which countries had the possibility to introduce reservations. These provisions will be entirely optional, and States will apply them only in the situations where they had reciprocally expressed the same reservations.

Prior to the signature of the MLI in Paris, on 7 June 2017, the countries indicated their intention by notifying to the OECD their reservations (the “MLI Position”), and the list of their in force Double Tax Treaties (hereafter “DTT”) which would be subject to the MLI additional provisions. In this context, France already notified a temporary list of DTT which would be impacted by the MLI – 87 DTT are concerned on a total of circa 125 DTT signed by France. The notification concerns notably countries having reciprocally accepted the principle of the MLI e.g. mainly the EU State Members (except Denmark, as there is no DTT in force between France and Denmark), the G20 countries except for USA, Brazil and Saudi Arabia.



It is expected that as from the end of 2018, MLI completes the application of the DTT concluded between France and Austria, New Zealand, Poland, Serbia, Slovenia, Sweden and United Kingdom. As there is no DTT concluded between France and Isle of Man or Jersey, their ratification of the MLI earlier this year should have no impact on the relation between France and those jurisdictions. The application of the MLI by France will be extended to the States ratifying it in alternative ways in the future.

The application of the MLI will be limited by the reservations already notified by France and which mainly concern the hybrid mismatches as France considers that its current legislation is sufficient (transparent entities, dual resident entities, application of methods for elimination of double taxation); treaty anti-abuse rules regarding notably permanent establishments located in third party States;

arbitrage rules.

The likelihood of potential changes due to the ratification of the MLI by France should be closely monitored notably if particular treaty benefits are currently applied at the level of Multinational Groups holding French subsidiaries.

## CONTRIBUTOR DETAILS

### Iosif Cozea

Email: [iosif.cozea@avocats-mazars.com](mailto:iosif.cozea@avocats-mazars.com)

Phone: +33 1 49 97 60 33



## CROATIA

## PROPOSED TAX LAW CHANGES IN THE AREA CORPORATE INCOME TAX

In August 2018, the Croatian Government presented a set of proposed tax law changes in the area corporate income tax, value added tax and personal income tax. The main aim of the proposed changes is to reduce overall tax burden and to simplify administration. The majority of the changes are expected to be enforced in 2019.

Some of the changes are being heavily challenged by experts and the public, so it may be expected that further amendments will be implemented before sending the proposed legislation to the parliament procedure in the coming weeks.

## THE MAIN FEATURES OF THE PROPOSED CHANGES

The key proposed changes include:

- Corporate Income Tax
  - Introduction of new rules to address the prevention of profit shifting (based on Anti-Tax Avoidance Directive ATAD), including interest cost limitation and CFC rules.

- Value Added Tax
  - Reduction of standard VAT rate from 25% to 24% (as of 2020) and extended application of the reduced VAT rate of 13% to meat, fish, fruits, vegetables and diapers (as of 2019).
- Personal Income Tax and Contributions
  - Expanding the first monthly tax bracket (taxed at 24%) from HRK 17,500 / EUR 2,300 to HRK 30,000 / EUR 4,000, after which the second tax bracket of 36% would apply.
  - Decrease in employer's part of mandatory social security contributions should result in overall cost saving for the employer of 0,7%.
- Other Changes
  - Real Estate Transfer Tax is to be reduced from 4% to 3%, starting in 2019.

## CONTRIBUTOR DETAILS

### Vladimir Nol

Email: [vladimir.nol@mazars.hr](mailto:vladimir.nol@mazars.hr)

Phone: +385 (0)1 4802 202

# ASIA

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## BENEFICIAL OWNERSHIP – FURTHER GUIDANCE FROM CHINA TAX AUTHORITY

### INTRODUCTION

In order to be able to enjoy tax treaty benefits with China, the tax payer must be a tax resident of the jurisdiction which has entered into the tax treaty with China. Additionally, in order to obtain a preferential treatment on dividends, interest and royalties from China, the non-resident must also be the “Beneficial Owner” of such income.

Since 2009, the State Administration of Taxation (“SAT”) has issued several circulars to assist in the determination of “Beneficial Ownership” (“BO”) status.

These circulars include:

- Guoshuihan [2009] No. 601 (“Circular 601”) which listed seven unfavorable factors for the determination of BO;
- Public Notice [2012] No. 30 (“PN 30”) which provided a safe harbor rule for qualified non-residents; and
- Shuizonghan [2013] No. 165 (“Circular 165”) which provided certain clarifications and relaxation to the determination of BO of dividends received by certain Hong Kong companies for the purposes of the tax agreement between China and Hong Kong, i.e., only applicable to Hong Kong companies.

Despite the issuance of PN 30, taxpayers and local tax authorities have encountered numerous technical problems when considering the application of Circular 601.

On 3 February 2018, the SAT released Public Notice [2018] No.9 (“PN 9”) to address the issue. PN9 abolished Circular 601 and PN30 and consolidated them into one. It updates the assessment principles for the determination of BO. PN9 took effect from 1 April 2018. The SAT had also issued explanatory notes (“Explanatory Notes”) together with PN9.

### IN DETAIL

It is worthwhile taking restock of the provisions of Circular 601. The circular lists 7 factors which could negatively affect an applicant’s status as the beneficial owner. PN9 made some amendments to these factors by tightening the 1st and 2nd factors, deleting the 3rd and 4th factors and retaining the 5th to 7th factors. The new unfavorable factors under PN9 are:

- The recipient of the dividends is obliged to distribute more than 50% of the dividends received to a resident of a third country within 12 months of receiving them. The threshold is thus reduced to 50% from 60% in Circular 601. In addition, the term “obligation” is extended to any factual payment even though the taxpayer has no contractual obligation to re-distribute the income received. Prior to PN9, there would always be an argument that the distribution was the decision of the board of directors and in the absence of any contract, there was no obligation to redistribute. PN9 would counter that argument. The Explanatory Notes also state that certain intercompany transactions could be considered as factual payment. For example, netting off of receivable/payable and extending loans to other group companies by the applicant after receiving the income, may be considered as a factual payment.
- Substantive business activities include substantive manufacturing, trading and management activities etc. PN9 however, clarifies and tightens what constitute “substantive” in assessing whether this unfavorable factor is applicable. Whether an applicant’s business activities are substantive would be assessed based on the functions performed and risks undertaken by the applicant. We have two observations. Management activities continue to be considered as qualifying activities for the purpose of determination of BO. Nevertheless, one must demonstrate that there are management functions being performed and risks undertaken. A mere investment function would not be acceptable. In addition, where an applicant carries out both non-substantive investment and management activities and other business activities, if the other



business activities are insignificant, the applicant's overall business activities cannot be considered as being substantive. The Explanatory Notes give an example in this regard. Where the income generated from the other business activities is less than 8% of the applicant's total income, the other business activities are considered as insignificant.

- The Explanatory Notes also provide some guidance on what constitute investment and management activities. These include pre-investment research, project analysis, investment decision, execution, post-investment management, industry analysis, market research, regional headquarters function, treasury function and financing functions etc. The Explanatory Notes also provide a few number of case studies. Going forward, all these functions must be documented. At a minimum, the management must participate in the board decisions of the Chinese subsidiary.
- The income of the applicant is non-taxable or, if subject to tax, is subject to a low effective tax rate.
- In the case of interest income, there is a loan or deposit contract between the applicant and a third party, the terms of which (i.e., the amount, interest rate, signing dates) are similar or close to those of the loan contract under which the interest income is received.
- In the case of royalty income, there is a license or transfer agreement between the applicant and a third party, the terms of which are similar to the terms under which the royalty income is received.

## EXTENSION OF PN30

PN30 is also to be replaced by the newly issued PN9. The "Safe Harbor Rule" under PN30 provides that if an applicant for treaty benefits is a listed entity, it will automatically be treated as the beneficial owner of "dividends" received from a Chinese company. The same treatment will apply to a 100% directly or indirectly owned subsidiary located in the same jurisdiction as the listed entity, provided the subsidiary itself is not indirectly held through another holding company in a third jurisdiction. This last exception under PN30 has been causing a lot of problems to taxpayers.

PN9 sets out a "same country/same treaty benefit rule" for a multi-tier holding structure with respect to dividends to provide a relief under certain circumstances. This is discussed further below.

PN9 extends the Safe Harbor Rule to dividends paid to governments and individuals. If the applicant is the government, listed company or an individual who is tax resident of a tax treaty jurisdiction, or a company

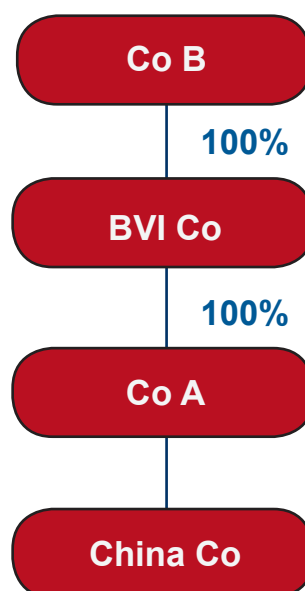
directly or indirectly owned by the above-mentioned government, listed company or individual, the applicant can be considered a beneficial owner of the dividends without the need to assess the case against the five unfavorable factors. In an example given in the Explanatory Notes, the intermediate holding company is in turn owned by a listed company, a government body and individuals which are tax residents of a treaty jurisdiction. As long as the listed company, government and the individual jurisdiction collectively own 100% of the applicant, it would qualify under the Safe Harbor Rule in respect of that jurisdiction.

Secondly, if the immediate dividend recipient cannot be eligible for the Safe Harbor Rule because of, for example, it is either not held by a listed company in the same jurisdiction of the applicant, or there is another holding company in a third jurisdiction between the applicant and the listed company or cannot be assessed as a beneficial owner based on its own facts, it can still be deemed to be a beneficial owner under the following scenarios, named the "same country/same treaty benefit rule".

## SCENARIOS

- Scenario 1: The immediate holding company, i.e., the applicant, would not qualify as a beneficial owner because of the five unfavorable factors, it can be deemed to be a beneficial owner of the dividends if it is 100% held, directly or indirectly through an intermediate holding company, by another company which would have qualified as a beneficial owner, either upon being assessed based on the five factors, or qualified under the Safe Harbor Rule. The applicant and the ultimate holding company which qualifies must however be in the same jurisdiction.

This is explained in the Explanatory Notes by way of an example.



- Both Co A and Co B are, e.g., Hong Kong resident;
- Co A fails the 5 factors;
- Co B meets the 5 factors or is a listed company. Co A is deemed to be a beneficial owner.

This is the so-called “same country benefit” rule. As long as the ultimate holding company, Co B, and the immediate holding company, Co A, are in the same jurisdiction, and the ultimate holding company would qualify as a beneficial owner, either by meeting the five factors or by being a listed company, the immediate holding company would be deemed a beneficial owner. The fact that there is an intermediary holding company, BVI Co, in a different jurisdiction would not matter.

- Scenario 2: This is to take care of the scenario where the applicant and its holding company are in different jurisdictions, the holding company’s jurisdiction has a tax treaty with China, which has the same or a better treaty benefit treatment than the tax treaty between the applicant’s jurisdiction and China. In this scenario, there is no intention for the ultimate holding company to set up an intermediate holding company to make use of the tax treaty between China and the jurisdiction of the intermediate holding company.

This so-called “same treaty benefit” rule would deem an immediate holding company of the Chinese entity, i.e., the applicant, to be a beneficial owner of the dividends, even though it does not qualify as one under the assessment of unfavorable factors. This deeming provision would apply if the applicant is wholly owned, directly or indirectly through another intermediate holding company, by a shareholder in a different tax jurisdiction, and the shareholder or the intermediate holding company would have qualified as a beneficial owner of the dividends, and the tax jurisdiction of the shareholder or the intermediate holding company, as the case may be, has a tax treaty with China which has

the same or better treaty benefit with the tax treaty between China and the jurisdiction of which the applicant is a tax resident.

The Explanatory Notes also give an example. In that example, the Chinese entity is owned by Company G, a Hong Kong tax resident. Company G is 100% owned by Company I, indirectly through a holding company, Company H. Both Company I and H are tax residents of Singapore. Company G does not qualify as a beneficial owner because it fails the five unfavorable factors. It can still be deemed to be a beneficial owner, as long as Company I or H, is tax resident of Singapore, and can qualify as a beneficial owner. The “same treaty benefit” rule applies because Hong Kong and Singapore both provide the same treaty benefits in respect to dividends. In this regard, the shareholder and the intermediate holding companies would need to submit tax resident certificates from their respective jurisdictions.



There are two observations regarding the “same country/same treaty benefit rule”. It only applies to situation where the direct or indirect shareholding percentage of the immediate holding company is 100%. This is to prevent minority shareholders taking advantage of this deeming benefit rule. Secondly, similar to the previous PN30, the Safe Harbor Rule and the “same country/same treaty benefit rule” only apply to dividends and are not applicable to interest article or royalty article under tax treaties.

### OTHER CHANGES

The reference to “conduit company” or “tax avoidance purposes” as originally used in Circular 601 and PN30 is removed. This probably will be dealt with future





amendments, through the Multilateral Instruments (“MLI”), on China’s tax treaties. China has adopted the principal purposes test (“PPT”) with respect to OECD’s BEPS Action Plan 6. The principal purposes test would be used to deny tax treaty benefits in the future if there is indeed tax avoidance.

PN9 also clarifies that recipients receiving dividends, interest and royalties shall not claim themselves as agents to let other parties to enjoy the tax treaty benefit.

## MAZARS’ COMMENTS

The extension of the Safe Harbor Rule and the adoption of “same country/same benefit rule” is a welcomed measure by the SAT. It aligns the interpretation and implementation of tax treaties with international standards.

The strengthening of the first two factors indicates that the Chinese tax authorities will look more into both the form and substance/fact of the arrangements.

Multinational corporations should review their existing investment structure. In order to be a beneficial owner, there must be substantive business activities to be carried out by the immediate holding company, i.e., the applicant. If one were to rely on the facts that investment and management activities could be considered as business activities to be considered, the activities as listed in the Explanatory Notes should be carried out and documented.

## CONTRIBUTOR DETAILS

**Michael To**

Email: michael.to@mazars.hk

Phone: +852 2909 5680

## THE TRANSFER PRICING AND BEPS LEGISLATION PASSED IN HONG KONG

### INTRODUCTION

The legislation to (1) introduce the statutory transfer pricing regime, and (2) implement the various minimum standards under the OECD’s Base Erosion and Profit Shifting (“BEPS”) Action Plans, Inland Revenue (Amendment) (No.6) Ordinance 2018 (the “Bill”) was passed by the Legislative Council on 4 July 2018. Please refer to our February and March 2018 Hong Kong Tax News on the background leading to the then draft legislation (the “Draft Bill”).

In the area of Transfer Pricing (“TP”), the Bill formally introduces a TP regulatory regime and TP documentation requirement into the Hong Kong tax legislation. The Bill also implements the various minimum standards under the OECD’s BEPS Action Plans in Hong Kong.



**HONG KONG**

Further to its joining of the BEPS Inclusive Framework of the OECD in June 2016, Hong Kong is obliged to introduce legislations to implement the various minimum standards under the OECD’s BEPS Action Plans.<sup>1</sup>

The Bills Committee, in reviewing the Draft Bill, confirmed that Hong Kong’s territorial source principle of taxation will not be changed by the new TP rules. Taxpayers should compute income and profits on an arm’s length basis, before the territorial source principle would apply to determine if such income or profits arise in or are derived from Hong Kong.

### IN DETAILS: THE TP REGULAR REGIME

The Bill codifies Hong Kong’s TP regulations, requiring that the OECD TP Guidelines, specifically the 2017 version be followed. It mandates implementation of the arm’s length principle as the fundamental TP rule in Hong Kong. The new legislation empowers the Inland Revenue Department (the “IRD”) to adjust profits or losses where a transaction between two related persons departs from the transaction that would have been

<sup>1</sup> The 4 minimum standards include: Action 5 Review of harmful tax practices; Action 6 Model tax treaty provisions to prevent treaty abuse; Action 13 TP documentation and country-by-country reporting and Action 14 Improvements in cross-border tax dispute resolutions.

entered into between independent persons, in cases in which the non-compliance with arm's length principle has created a Hong Kong tax advantage. The Hong Kong tax advantage would apply to Profits Tax, Property Tax and Salaries Tax. This Fundamental TP Rule is denoted as TP Rule 1 in the legislations.

Certain domestic transactions that do not give rise to any actual Hong Kong tax difference will be specifically exempted from TP rules and TP documentation provided that certain prescribed conditions are met. These conditions include:

- Domestic in nature: The transaction meets the domestic nature test – the transaction made or imposed in connection with the two parties' trade, profession or business carried on in Hong Kong, or that the transaction is connected with one of the parties' trade, profession or business, and that the other party is a Hong Kong tax resident; AND
- No actual tax difference: There is no actual tax difference as a result of the arrangement, meaning each person's income or loss is chargeable or allowable for Hong Kong tax purposes, and no tax concession or exemption applies to any income or loss, as the case maybe; OR the non-business loan test where the lending of money otherwise than in the ordinary course of a money lender or intra-group financing business; AND
- Not utilized for tax avoidance purposes: The main purpose, or one of the main purposes, of the transaction is not to utilize any tax loss for tax avoidance purpose.

Further guidance will be issued by the IRD under a Departmental Interpretation and Practice Notes ("DIPN").

## TP RULE RELATING TO A PERMANENT ESTABLISHMENT (TP RULE 2)

In addition to TP Rule 1, TP Rule 2 is introduced to require the use of the separate enterprises principle for attribution of profits to a permanent establishment ("PE") in Hong Kong of a non-Hong Kong resident. The Bill requires that the Authorized OECD Approach ("AOA") be used to attribute income and profits to the Hong Kong PE according to the Separate Enterprise Principle.

Schedule 17G introduces the meaning of a PE in Hong Kong, with different definitions being used for countries with comprehensive double taxation arrangements ("CDTA") and those without CDTA with Hong Kong. For the former, the definition of PE in the relevant CDTA will be followed. The definition for non-CDTA countries generally follows the recommendation of the OECD BEPS Action Plan 7, in particular the latest post BEPS thinking on preparatory and auxiliary activities and anti-frag-

mentation, as well as the revised dependent agent threshold and independent agent test. This position is more stringent than the existing definition of PE taken in many of Hong Kong's CDTAs.



The AOA gives the IRD the power to assess a Hong Kong branch of a foreign corporation for income attributed to the branch as if it is a distinct and separate entity. Where a branch or PE in Hong Kong has not previously been compensated under the arm's length principle in the past, the AOA would allow more income to be allocated and attributed to the branch or PE. With the application of Hong Kong's territorial source rules, onshore sourced profits related to the PE's operations in Hong Kong will be chargeable to Hong Kong tax. The application of the AOA in conjunction with the source rules may result in more profits of the non-resident entity being subject to Profits Tax in Hong Kong.

This would also create some issues for branches of non-Hong Kong financial institutions. Because of issues that could be faced by financial institutions and the complexity of the AOA approach, the implementation of TP Rule 2 has been postponed by 12 months to the year of assessment 2019/20, to allow sufficient time for taxpayers to transit into the AOA approach.

## TRANSFER PRICING DOCUMENTATION

Hong Kong will adopt the three-tier documentation framework from the OECD BEPS Action Plan 13. The thresholds on the business size test have been relaxed in the final legislation.

## MASTER AND LOCAL FILE

Hong Kong entities shall be required to prepare Master File and Local File for accounting periods beginning on or after 1 April, 2018 when both of the following tests are met.

1. Business size test – Meeting any two of the following:
  - Total annual revenue exceeding HK\$400 million;
  - Total value of asset exceeding HK\$300 million; and
  - Average number of employee exceeding 100
2. Related Party Transaction size test – Meeting any one of the following:
  - Annual amount of buy-sell transactions of tangible goods exceeding HK\$ 220 million;
  - Annual amount of transfer of financial assets/intangible assets exceeding HK\$ 110 million; or
  - Annual amount of other transactions (e.g., services) exceeding HK\$ 44 million.

It should be noted that if a Hong Kong entity has more than one transaction types with a related party, e.g., sales of tangible assets and provision of services, and if one of the transaction type is below the threshold for the accounting period, a Local File would not be required for that category of transaction.

Domestic transactions can be excluded from the preparation of Local File on these transactions if the above conditions exempting domestic transactions from the new TP rule are met.

The contents of the Master and Local Files remain unchanged from the Draft Bill and are consistent with BEPS Action 13. The deadline for preparing the Master and Local Files has been extended from 6 months to 9 months after the accounting year-end and is aligned with the tax return filing deadline.

The Master and Local Files will only be submitted on request by the IRD. However, taxpayers are required to retain the documentation for 7 years. The IRD would conduct desk audits and reviews to ensure compliance. Penalties will apply to taxpayers that do not prepare the documentation on time, which ranges from HK\$ 50,000 to HK\$ 100,000. In addition, the information gathered by the IRD may be provided to other tax authorities under the relevant Exchange of Information provision provided in a relevant CDTA or tax information exchange agreement (“TIEA”).

## COUNTRY BY COUNTRY REPORTING (“CBCR”)

A Hong Kong ultimate parent company of a multinational enterprise group with prior year annual consolidated group revenue of HK\$ 6.8 billion or above (approximately 750 million EUROS), or a Hong Kong entity which is nominated as a surrogate filing entity, will be required to file a CbCR in Hong Kong, unless the surrogate parent entity-filing-elsewhere exception applies.

A CbCR has to be prepared for accounting periods beginning on or after 1 January 2018, with the primary obligation to file falling on the Hong Kong ultimate holding company or the nominated surrogate filing entity. Generally speaking, the deadline for filing a CbCR is within 12 months after the end of the accounting period to which the report relates. Where surrogate parent filing applies and a later deadline for filing CbCR is prescribed in the laws or regulations of the tax resident of the surrogate parent entity, the later deadline will be taken as the filing deadline for the CbCR concerned.

Hong Kong taxpayers that are constituent entities of a multinational enterprise group will have an obligation to file a CbCR notification to the IRD within three months after the end of the accounting period to which the ultimate parent company’s CbCR relates. This is to enable the IRD to obtain the CbCR directly from the other tax authority through the automatic exchange of information mechanism for the exchange of CbCR.<sup>2</sup>

Penalties will apply for non-submission, including a HK\$50,000 to HK\$ 100,000 penalty, plus a daily fine of HK\$500.

## THE DEEMING PROVISION ON INCOME FROM INTELLECTUAL PROPERTY (IP)

Through adoption of the OECD TP Guidelines, important concepts, such as the alignment of value creation with economic returns, were introduced. These concepts are now part of the Hong Kong TP framework. In particular, concepts such as performing of the DEMPE functions (i.e., development, enhancement, maintenance, protection and exploitation) and deployment of the DEMPE assets should be analyzed. Entities in the group would be analyzed as to which are the entities performing the DEMPE functions and deploying DEMPE assets and these entities would be entitled to the associated returns. This is despite of the contractual obligations, which may not be entirely aligned with economic value creation. Taxpayers would need to determine whether the transactions have been delineated appropriately before the preparation of the TP documentation.

<sup>2</sup> The main platform for Hong Kong to obtain CbCR from other jurisdictions would be through the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (Multilateral Convention) and the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (CbCR MCAA).

The Bill introduces a new section 15F such that where a person has contributed in Hong Kong to the DEMPE of an IP and income is derived by a non-Hong Kong resident who is an associate of the person from the use of or a right to use such IP outside Hong Kong, the part of the income that is attributable to the value creation contributions in Hong Kong should be subject to Hong Kong Profits Tax. Such income would be deemed under section 15F to be a taxable trading receipt arising in or derived from a trade or business carried on in Hong Kong. The Bills Committee Report clarifies that in applying the deeming provision, the IRD will make sure that a person will not be subject to double taxation in respect of the same income from an IP. The non-resident associates will not be chargeable to Hong Kong Profits Tax in respect of the relevant sum to the extent that the new deeming provision applies to the taxpayer in Hong Kong.

The introduction of section 15F is controversial, as indicated by various deputations during the Bills Committee stage. As a result, the date of implementation of this provision has been deferred by 12 months to the year of assessment 2019/20, to allow taxpayers time to prepare. In the meantime, it is expected that the IRD will provide more information in a DIPN.



## PENALTIES RELATING TO TP ADJUSTMENT

The Bill introduces an administrative penalty relating to transfer pricing. Given that transfer pricing is not an exact science, the penalties have been set at a level lower than the existing one for other non-compliance under section 82A of the Inland Revenue Ordinance (“IRO”). Specifically, penalties would be imposed where

a tax return was made with incorrect information on transfer pricing without a reasonable rationale or with the intent to evade tax. Such penalty will be an administrative penalty by way of additional tax not exceeding the amount of tax undercharged. That said, the IRD has not ruled out the possibilities of imposing more stringent penalty or initiating criminal prosecutions on blatant cases.

The penalties relating to TP adjustment are imposed in addition to the penalties relating to non-preparation and / or non-submission of Local File, Master File as well as CbCR.

It should be pointed out that the availability of TP documentation alone will not qualify for an exemption from penalties on TP adjustment but will be considered in determining whether the taxpayer has a “reasonable excuse” to be exempt from the penalty.

## ADVANCE PRICING ARRANGEMENT

The Bill also codifies the Advance Pricing Arrangement regime into the Inland Revenue Ordinance (the “IRO”). Unilateral, bilateral and multilateral Advance Pricing Arrangements could be applied. The IRD will be allowed to charge fees in processing the application, review the pricing policies in reaching an agreement. The fees would be on the hourly rates of the IRD officers involved, subject to a cap of HK\$ 500,000.

## OTHER TAX MATTERS

The Bill also introduces other amendments to the IRO relating to the BEPS Action Plans. These tax matters introduced in the Bill are not changed from the previous Draft Bill. Please refer to our March 2018 Hong Kong Tax News for a discussion on the new rules.

## MAZARS’ OBSERVATIONS

Hong Kong is committed to implementing the minimum standards under the BEPS initiatives. The Bill introduces the TP regulations and documentation requirements, and it is expected that the IRD will pay further attention to TP in the future. It is important that taxpayers should review their circumstances and take actions accordingly.

These actions would include:

- Reviewing the key related party transactions that may be subject to the new TP regulations as well as TP documentation. In particular, if the related party transactions are domestic transactions, the taxpayer would need to review these transactions to see whether they could be considered as specified domestic transactions, thus exempting them from the new TP regulations as well as preparation of Local Files. In order to avoid challenges from the tax authority, proper supporting should be gathered.

- Maintaining contemporaneous documentation, such as TP policy, inter-company agreements as well as TP documentation to defend the TP position.
- In the event that there is a gap in information, the taxpayer should ensure the gap is filled such that when TP documentation is required to be prepared such information is available, e.g. special factor analysis.
- The new TP rules are extremely complex, and the IRD has committed to issue DIPNs to deal with some of the issues such as the interaction of the new TP rules with Hong Kong's territorial source principle, deeming provision on IP related income etc. It is important to keep an open eye on the developments in this area.

## CONTRIBUTOR DETAILS

**Michael To**

Email: [michael.to@mazars.hk](mailto:michael.to@mazars.hk)

Phone: +852 2909 5680

# SOUTH AMERICA

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## CHILEAN TAX REFORM 2018

The Chilean President, Sebastián Piñera, recently submitted to the National Congress a Tax Modernization Bill aimed at creating “a simpler and unique tax system, more equitable and fully integrated, for all Chilean companies, except for a more favorable and special regime for small and medium enterprises, which will have lower tax rates”. Among other proposals, the Bill includes new taxation rules for the Digital Economy. The Government’s expectation is that the Bill should be in force since 2019.

### TARGETS OF THE BILL

According to the Bill, the objectives of the Tax Modernization are the following:

- The bill seeks to encourage growth, entrepreneurship, investment, savings and employment.
- In particular, it focuses on making the path easier for small and medium-sized enterprises and entrepreneurs.
- Seeks to provide legal certainty and predictability to all taxpayers.
- Taxing the new digital economy.
- Modernizes the taxpayer’s relationship with the Chilean IRS.
- Reassure fiscal balances.

### SIMPLIFICATION OF THE INCOME TAX SYSTEM

One of the main aspects of the Tax Bill is to establish again a general, single, integrated system of taxation, as it existed in Chile until 2014. The Bill proposes that the total integration of the system, with corporate taxes which would be offset 100% against final taxes (Personal income tax/ Withholding tax), be effective as of the 2019 business year.

In particular, the Bill provides that the Corporate Tax rate remain at 27%, however being totally imputable against Final Taxes paid at the level of the partners or shareholders of the companies, thus reducing the maximum overall tax burden to 35%. Taxation of final taxes will always be based on effective withdrawals.

In addition, this allows for substantially similar treatment for investors residing in countries being Chilean tax treaty partners than for others residing in non-treaty countries, since it allows all investors to use a tax

credit equivalent to 100% of the corporate tax paid by the company deductible from the 35% withholding tax applicable on dividends paid to non-residents.

The proposed changes could thus provide all non-resident shareholders with an effective tax rate of 35% (current general rules in this regard establish a 44.45% final tax burden for individuals/legal entities residing in non-treaty countries<sup>1</sup>).

United States investors in Chile could be most affected, given that the Chile-United States double tax treaty has not yet been ratified.

The Bill also provides for a special system for small and medium-sized enterprises, whose corporate tax rate would be 25% (instead of 27%, which will remain as general rule). This special regime would be subject to the following limitations:

1. Annual gross income not higher than UF 50.000 (US\$ 2.060.000), or Tax Equity not higher than UF 60.000 (US\$ 2.470.000).
2. Related-party control rules applicable to determine the aforementioned limits.
3. Limitations for incomes derived from the following activities, which may not exceed a 35% of the year’s gross income:
  - Any of the activities described in N° 1 (real estate incomes) and 2 (securities incomes) of article 20 of the Chilean Income Tax Law (except for incomes derived from having or exploiting agricultural real estate property).
  - Participation in unincorporated joint ventures agreements and;
  - Holding shares, equity interest and fund quotas.

### TAXES ON THE DIGITAL ECONOMY

Following OECD guidelines, the Tax Bill includes a new and specific tax framework to digital services. In particular, the Bill establishes a 10% flat tax on digital services provided to Chilean resident individuals by non-resident service providers. The tax would be applied on the total transaction amount, without any deductions. The collection of this tax would be in charge of the financial institutions, by means of credit card charges.

### CONTRIBUTOR DETAILS

**Felipe Yañez**

Email: felipe.yanez@mazars.cl

Phone: +56 (2) 29 63 33 00

<sup>1</sup> Law 20.899 contains a transitory provision valid only until 31 December 2021, which establishes that a 35% final tax burden on dividends distribution will be applicable to those countries which have agreed with Chile a Double Taxation Treaty, although it is not yet in force (i.e. USA).



# HERE TO HELP!

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MAZARS



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