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AUSTRALIA

MORE AUSTRALIAN TAX FOR FOREIGN INVESTORS

Draft law has been released in Australia for proposed changes to taxation of stapled trust-company structures, measures targeting thin capitalisation and reversal of tax concessions for foreign pension funds and foreign government funds (e.g. sovereign wealth funds) that will impact the after tax outcomes that apply to foreign investors in many Australian investments.

Taxation of stapled structures

Earlier this year the Australian Taxation Office ('Tax Office') identified concerns regarding arrangements which attempt to fragment integrated trading businesses in order to re-characterise trading income into more favourably taxed passive income for non-resident investors (see diagram on following page).

Stapled arrangements are broadly where the same investors hold 80% common ownership in two or more entities irrespective of whether the ownership interests in these entities are bound together by a formal legal arrangement.

On 17 May 2018 the Federal Treasury released exposure draft legislation (draft legislation) to combat the issues identified by the Tax Office. However, the proposed changes in the draft legislation will impact many foreign investors, not just those who invest in stapled arrangements.

However, to minimise the impact of these changes on existing investments, the proposed amendments include transitional arrangements of between 7 and 15 years for some investments.

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EDITOR'S LETTER

Welcome to this issue of *BDO World Wide Tax News*. This newsletter summarises recent tax developments of international interest across the world. If you would like more information on any of the items featured, or would like to discuss their implications for you or your business, please contact the person named under the item(s). The material discussed in this newsletter is meant to provide general information only and should not be acted upon without first obtaining professional advice tailored to your particular needs. *BDO World Wide Tax News* is published quarterly by Brussels Worldwide Services BVBA. If you have any comments or suggestions concerning *BDO World Wide Tax News*, please contact the Editor via the BDO Global Office by e-mail at mireille.derouane@bdo.global or by telephone on +32 2 778 0130.

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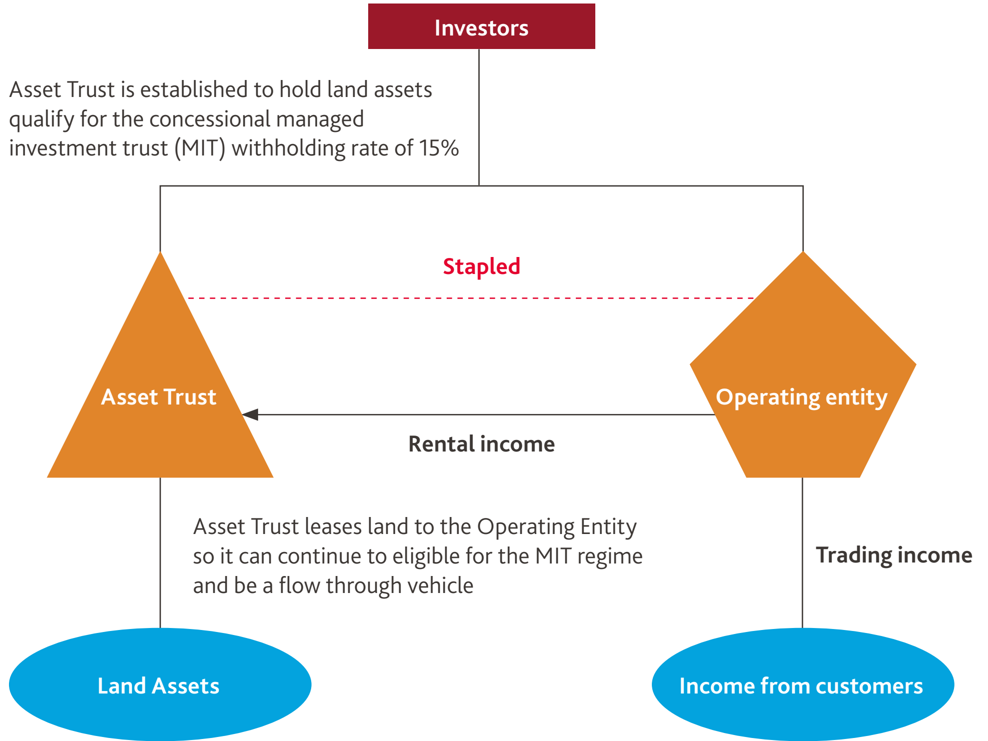
Typical rental stapled structure



Stapled structures involving managed investment trusts

Fund payments made from 1 July 2019 by a managed investment trust ('MIT') to a foreign investor will be subject to MIT withholding tax at the top corporate tax rate (currently 30%) instead of the 15% MIT rate, to the extent they are attributable to non-concessional MIT income. Non-concessional MIT income is broadly income that is either an amount from certain cross staple arrangements (e.g. assessable income derived by MIT asset entity from a business operating entity in a stapled arrangement) or a distribution from an entity that carries on or controls a trading business.

There are exceptions including:

- Amounts attributable to a cross staple arrangement which are attributable to third party rent (i.e. not a stapled entity in the arrangement) are excluded;
- A 5% of assessable income de minimis exception; and
- The 15 year 'approved economic infrastructure asset' exception (approved by the Federal Treasurer).

There are also transitional rules that delay the operation of these rules where:

- The stapled structure was in relation to the acquisition or creation of assets that was approved and publicly announced by an Australia Government agency and significant preparatory steps had been taken before 27 March 2018; or
- An entity entered into a contract before 27 March 2018 in relation to a stapled structure arrangement.

In these situations, the transitional rules will result in MIT fund payments being taxed at the current 15% rate until the following times:

- For economic infrastructure assets the new measures do not commence until the later of 1 July 2034 or 15 years from when the asset is first used to generate assessable income, but not after 30 June 2039.
- For other assets – until the later of 1 July 2026 or 7 years from day in which the asset is first used to generate assessable income, but not after 30 June 2031.

Amendments to thin capitalisation rules to prevent double gearing

The draft legislation includes two measures from 1 July 2018 to target those structures that use 'double gearing' in order to:

- Gear a structure in excess of what was intended under the thin capitalisation regime;
- Access the lower 10% withholding rate for interest payments; and/or
- Decrease the overall effective tax rate.

This double gearing is currently possible where there are entities in a group that are less than 50% owned by the group, in which case the debt in those entities is not taken into account for the group's thin capitalisation calculations. To counter this the exposure draft proposes firstly a reduction in the threshold at which a trust or partnership becomes an associate entity from ownership of 50% to 10% or more for the purposes of applying the thin capitalisation rules.

Secondly there are amendments to clarify that for the purposes of determining the arm's length debt amount, the debt to equity ratios of any entities in which the entity has a direct or indirect interest is a factor that must also be taken into account.

Foreign pension funds with non-portfolio investments now subject to withholding tax

The draft legislation proposes from 1 July 2019 to limit the withholding tax exemption to foreign pension funds with portfolio-like interests, being those interests in entities that are less than 10% ownership interests and do not carry an ability to influence the entity's decision making. A superannuation fund for foreign residents will be liable to pay withholding tax on payments of interest, dividends or non-share dividends from an entity unless the foreign superannuation fund has a portfolio-like interest in the entity making the payment and does not exert relevant influence over the entity.

There is a seven-year transitional rule for investment assets held by a pension fund for foreign residents on or before 27 March 2018 and payments of interest, dividends or non-share dividends made from such investment assets on or after 1 July 2026.

Legislating the tax exemption for foreign governments including sovereign wealth funds

The proposed amendments enshrine in legislation, from 1 July 2019, the current sovereign immunity tax exemption, which is currently based on the International Law doctrine of 'sovereign immunity'. However, the legislative approach will limit the sovereign immunity exemption to income and gains from portfolio-like interests of less than 10% and only where the sovereign investor cannot influence key decision-making of the portfolio entity, i.e. where the interests in the entity confer rights to vote at a meeting of its Board of Directors, participate in key decisions or deal with the assets of the second entity.

A sovereign entity will not be liable to tax on amounts paid by another entity if:

- The sovereign entity has a portfolio-like interest in the entity making the payment;
- The interest in the paying entity was not acquired in the course of carrying on a business activity; and
- The sovereign entity does not exert relevant influence over the entity.

Investments in existence at 27 March 2018 will have access to a seven-year transitional period.

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HONG KONG

FIRST BATCH OF AMENDMENTS TO THE PROPOSED TRANSFER PRICING REGULATORY REGIME AND DOCUMENTATION REQUIREMENTS

In late April 2018 the Hong Kong Government released the first batch of amendments to, inter alia, the new transfer pricing regulatory regime and documentation requirements proposed in the Inland Revenue (Amendment) (No. 6) Bill 2017 (discussed in our earlier newsletter: **Hong Kong Introduces Tax Bill to Implement Minimum Standards of the Base Erosion and Profit Shifting – Transfer Pricing Regulatory Regime and Documentation**).

We highlight in this newsletter the key changes proposed in the first batch of amendments.

References to sections and schedules refer to existing or proposed new sections and schedules to the Inland Revenue Ordinance (IRO), unless otherwise stated.

What is changed?

1. **Master File and Local File Documentation Threshold and Timeline**

   (a) Exemption Criteria by Business Size

   The revenue based and asset based thresholds in the exemption criteria by business size have been relaxed. A Hong Kong entity is not required to prepare a Master File and Local File for an accounting period if any two of the three conditions below are satisfied:

Exemption Criteria by Business Size (2 out of 3)	Original Threshold	Revised Threshold
Total revenue for the accounting period	≤HKD 200 million	≤HKD 400 million
Total value of assets at the end of the accounting period	≤HKD 200 million	≤HKD 300 million
Average number of employees during the accounting period	≤100	≤100 (no change)

   (b) Exemption Criteria by Size of Related Party Transactions

   The thresholds in the exemption criteria by size of related party transactions remain **the same** as shown below:

Exemption Criteria by Size of Related Party Transactions (by Type of Transactions)	Threshold
Transfer of properties (excluding financial assets/intangibles)	≤HKD 220 million
Transactions in respect of financial assets	≤HKD 110 million
Transfer of intangibles	≤HKD 110 million
Any other transactions (e.g. service income/royalty income)	≤HKD 44 million

   (c) Timeline

   The timeline under which a Hong Kong entity is required to prepare both Master File and Local File if it exceeds the above thresholds has been relaxed from six months to nine months after the year-end.

2. **Exemption for domestic transactions**

   The Government states that the amendments in relation to the exemption for certain domestic transactions from transfer pricing rules and Master/Local File documentation requirements will be provided in the second batch of amendments to come.

3. **A range of arm's length provisions**

   Express note is now included to recognise that a range of provisions may be produced when applying the OECD transfer pricing rules where each provision constitutes an arm's length provision. If a Hong Kong entity proves that its reported income or loss in a related party transaction is within an arm's length range (i.e. as an equally reliable measure or a more reliable measure of the arm's length amount), the reported income or loss should be acceptable.

4. **Change of commencement date for certain provisions**

   Authorised OECD Approach – The transfer pricing rules for the attribution of income or loss to a Hong Kong permanent establishment of a non-Hong Kong tax resident person (i.e. Section 50AAK) will apply in relation to a year of assessment beginning on or after 1 April 2019.

   Taxation of development, enhancement, maintenance, protection, or exploitation (DEMPE) Functions – The deeming provision that deems taxable in Hong Kong a part of the profits derived by a non-Hong Kong tax resident from intellectual property to which its Hong Kong associate has made value creation contributions (i.e. Section 15F) will apply from the year of assessment beginning on or after 1 April 2019.

5. **Country-by-Country Return Filing Threshold for non-Hong Kong Tax Resident Ultimate Parent Entity (UPE)**

   The meaning of the threshold amount for a multinational enterprise group whose UPE is tax resident outside Hong Kong is clarified to mean either the threshold as specified by the UPE's jurisdiction, or if there is no such specification, the amount in the currency of the UPE's jurisdiction equivalent to EUR 750 million as at January 2015.

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INDIA

RECENT TAX TRIBUNAL RULINGS AND A NEW GOVERNMENT NOTIFICATION

Domain registration fees taxable as royalty

The taxation of products and services in digital space has been a matter of litigation in India. The definition of 'royalty' and its ambit is under examination at various legal forums, the latest being in the context of domain registration services disputed before the Delhi Bench of the Tax Tribunal.

In the case under consideration, the taxpayer was an accredited domain name registrar authorised by the Internet Corporation for Assigned Names and Numbers (ICANN). The taxpayer claimed that income from domain registration fees for assisting clients in registration of their websites with ICANN was not taxable in India. The Tax Tribunal held that domain registration charges are in the nature of royalty under the Indian Income Tax law (IT Act).

In this case the taxpayer was not eligible to treaty benefits. The Tax Tribunal referred to judgements in the context of intellectual property rights disputes that held that internet domain names are subject to legal norms applicable to other intellectual properties such as trademarks. The domain name is a valuable commercial right having all the characteristics of a trademark. A domain name is more than an internet address and is entitled to protection as a trademark. The Tax Tribunal held that rendering of services for domain registration is rendering of services in connection with the use of an intangible property which is similar to a trademark and, therefore, charges received by the taxpayer for services rendered in respect of domain name is royalty.

[Godaddy.com LLC. I.T.A No. 1878 of 2017 (Delhi Tribunal)]

Losses due to low selling price not capital expenditure

E-commerce companies (online marketplaces) in India often adopt a strategy of marketing through deep discounts. Such discounts/ expenses are claimed as revenue expenditure, leading to losses and thus no tax liability. The Indian tax department has been challenging the taxpayers' positions in respect of discounts, advertisement and marketing expenses to promote the brand. The contention is to reclassify such expenses as capital in nature, thus reporting a profit for tax purposes.

In the Bangalore Tax Tribunal case of Flipkart, the taxpayer (one of India's largest e-commerce portals) sold goods to retailers at a discounted price. The tax officer concluded that the loss incurred by the taxpayer through predatory pricing was in the creation of marketing intangible assets and therefore should be treated as capital expenditure. In coming to this conclusion, the tax officer also noted that though the taxpayer has consistently made losses for five years, it still has a high valuation and has attracted investments at a high premium. The tax officer adopted the cost approach recommended in the BEPS Action Plan for valuation of intangibles whereby profit foregone (difference between sale price of taxpayer and sale price of normal wholesaler) was considered as cost of marketing intangibles.

The Tax Tribunal ruled in favour of the taxpayer, holding that the loss declared in its tax return should be accepted. The Tax Tribunal noted the following, while coming to its conclusion:

- A tax officer cannot disregard profit or loss disclosed, unless he is not satisfied about correctness or completeness of accounts or if the method of accounting is not regularly followed. In the absence of any reasoning, the tax officer was not empowered to go beyond the book results.
- The tax officer was not right in ignoring book results and resorting to estimating income. What can be taxed is only income accruing or arising under the IT Act. There is no provision in the IT Act by which a tax officer can ignore the sale price declared by a taxpayer and proceed to enhance the sale price without any material evidence to show that the taxpayer has in fact realised a higher price.
- There is no accrual of any liability or outflow of funds for creating intangibles/brand. It cannot be presumed that profit foregone is expenditure incurred.
- There is no material on record to substantiate that the premium on shares was due to value ascribed to brand or goodwill or intangibles.

[Flipkart India Pvt. Ltd. I.T.A No. 693 of 2018 (Bangalore Tribunal)]

Exemption from Angel Tax to eligible start-ups

Section 56(2)(viib) of the IT Act taxes consideration received for the issue of shares by an Indian company in excess of the fair market value (FMV) of the shares. Several start-ups receiving funding from angel investors (believed to have received consideration in excess of FMV of shares) were issued notices by the tax department. This commonly termed 'angel tax' has been adversely affecting the financing of start-ups.

The Central Government has now exempted start-ups from the operation of the above section, in cases where the consideration received from an investor is in accordance with approval granted by the Inter-Ministerial Board of Certification as notified by the Department of Industrial Promotion and Protection. Start-ups can apply for such approval if the following conditions are satisfied:

- The aggregate amount of paid up share capital and share premium of the start-up after the proposed issue of shares **does not exceed** INR 100 million;
- The investor/proposed investor has **minimum net worth** of INR 20 million on the last day of the preceding fiscal year or an **average returned income exceeding** INR 2.5 million in the preceding three fiscal years;
- A report from a merchant banker specifying the fair market value of shares is obtained.

This applies retrospectively from 11 April 2018.

[Notification No. SO 2088(E) [No. 24/2018 (F.NO. 370142/5/2018-TPL (PT)] dated 24 May 2018 read with Notification No. GSR 364(E) [F.NO. 5(4)/2018-SI] dated 11 April 2018]

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SINGAPORE

CHANGES TO BASIS OF ASSESSMENT FOR SERVICE COMPANIES

Some changes to the basis of assessment for service companies will apply from Year of Assessment (YA) 2018 onwards. A service company refers to a company that provides services only to related companies. Services may include management services, technical support services, procurement, administrative support services and customer support services. It is essentially a cost centre rather than a profit-making entity, normally reimbursed by their related parties at cost or cost plus a certain margin.

Cost-plus mark-up basis of assessment

As an administrative concession to ease the compliance burden of such service companies, the Inland Revenue Authority of Singapore ('IRAS') has accepted a simple cost-plus mark-up basis of assessment ('CM basis').

The IRAS generally allows the chargeable income of a service company to be computed based on the mark-up on the total expenditure incurred by the service company, without any further tax adjustments.

The IRAS does not allow a service company adopting the CM basis to make the following claims:

- Double or further tax deductions;
- Productivity and Innovation Credit (PIC) enhanced deduction and cash payout;
- Capital allowances and losses;
- Donations and deductions under the Business and IPC Partnership Scheme; and
- Foreign tax credit.

The IRAS has clarified that the CM basis will continue to be available as an administrative concession to service companies that fall within the following scenarios:

- The routine support services fall within Annex C of the IRAS e-Tax Guide entitled 'Transfer Pricing Guidelines';
- The service provider does not offer the same routine support services to an unrelated party; and
- All costs, including direct, indirect and operating costs relating to the routine support services performed, are taken into account in computing the 5% mark-up.

From YA 2018 onwards, new service companies which do not qualify for the CM basis will need to adopt the NTC basis from inception.

Existing service companies that have adopted the CM basis but do not meet the above conditions for CM basis to apply will be required to prepare their tax computations on a normal trading basis ('NTC basis') by YA 2020 at the latest.

Normal Trading Company Basis

Under the NTC basis, a company's chargeable income is ascertained after detailed examination of its accounts and making tax adjustments in accordance with the provisions of the Income Tax Act, such as:

- Deducting non-taxable income (such as gains arising from sales of fixed assets, non-trade income, etc);
- Adding back disallowable expenses (private car expenses, non-business expenses, etc);
- Claiming double and further deductions for qualifying expenditure;
- Claiming capital allowances and donations; and
- Setting off brought forward losses, capital allowances and donations.

Transitional adjustments from CM basis to NTC basis

The IRAS has recently issued guidelines for service companies that have adopted the CM basis and are required to transition to the NTC basis. Briefly, these companies that are transitioning to the NTC basis should apply the following rules in the YA of transition:

Action required

Service companies which have prepared and filed their tax returns on the CM basis should start to review the scope of services they provide to ensure that they will continue to qualify to apply this basis. In the event that they do not, and a change to the NTC basis is required, the company should start to prepare for the transition, including:

- Review and enhance its accounting records and documentation to provide more transactional details so that tax adjustments (e.g. private car expenses, capital items, exchange differences) can be made.
- Revisit its business plans and commercial activities to explore possible tax concessions, e.g. double deductions for expenses incurred for internationalisation of its business.
- Review its capital expenditure budget for capital allowances claims, although service companies generally are not expected to require significant fixed assets.
- Consider the need to engage a tax agent to prepare the tax computation since there is an increase in complexity of the tax compliance work.

While there is some increase in the tax compliance burden, with careful attention to additional data collation and analysis, there could be benefits that service companies may enjoy under the NTC basis. An early review of business plans and accounting systems will help to ensure a smooth transition and also position the company to benefit from the availability of the various deduction schemes.

We would be happy to advise companies affected by this change to the basis of assessment – please feel free to contact us.

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Tax items	Tax treatment
Section 14Q deduction (renovation or refurbishment incurred prior to the transition YA)	If the expenditure has been capitalised in the accounts, Section 14Q may be computed based on the net book value (NBV) at the transition YA
Capital allowances (qualifying plant & machinery acquired before the transition YA)	If the expenditure has been capitalised in the accounts, capital allowances may be computed based on the NBV at the transition YA
General provisions made prior to the transitional YA	Provisions utilised may be allowed and provisions written back may not be taxed
Specific provisions made prior to the transitional YA	No adjustment will be required on provisions utilised or provisions written back
PIC claim on expenditure incurred prior to the transitional YA	No PIC claim will be allowed

BELGIUM

CORPORATE INCOME TAX REFORM – ATAD IMPLEMENTATION – NEW CFC RULES

On 25 December 2017, the Belgian corporate income tax (CIT) reform act (the Act) was officially published (see also WWTN October 2017 issue). The eye-catching feature of the Act is, no doubt, the significant decrease of the corporate tax base. The law also transposes the European Anti-Tax Avoidance Directives (ATAD) into Belgian domestic tax law. In a series of articles we will briefly address the ATAD transposition rules and the various options Belgium has taken in this respect, starting with the transposition of controlled foreign company (CFC) measures.

Background

ATAD is basically a coordinated implementation at EU level of part of the anti-BEPS measures recommended by the OECD. It aims at a 'consistent' implementation in the Member States of (minimum) tax avoidance measures on **interest deduction limitations, exit taxation, general anti-abuse rules, controlled foreign company (CFC) legislation and hybrid mismatches**, to be transposed by 31 December 2018 (ATAD I) and 31 December 2019 (ATAD II) (certain exceptions apply). However, no uniform implementation of ATAD across the EU is expected and differences in anti-tax avoidance rules between Member States (fueling tax competition) will continue to exist. Indeed, ATAD foresees multiple options for implementation of certain provisions, 'exemption' of implementation if local tax law already has adequate tax avoidance measures and implementation of more stringent domestic or agreement-based provisions to protect the domestic corporate tax base.

CFC rules

CFC rules have the effect of re-attributing the (undistributed) income of a low-taxed controlled subsidiary to its parent company. Then, the parent company becomes taxable on this attributed income in the State where it is resident for tax purposes.

CFC rules under ATAD

To qualify as a CFC, there is **an ownership and subject-to-tax test**, i.e. more than 50% direct or indirect ownership by the parent in the CFC is required, and CIT paid by the CFC should be less than the difference between the CIT due according to the tax rules of the parent company and the actual CIT paid by the CFC. Foreign PEs of the CFC not subject to or exempt from CIT in the CFC jurisdiction are to be excluded for the subject-to-tax test.

Determination of CFC income can be **income based** (targeting passive income) **or transaction based** (targeting non-genuine arrangements put in place for the essential purpose of obtaining a tax advantage).

ATAD includes **optional de-minimis rules** and specific rules for calculating the CFC income to be taxed at the level of the parent company, including a limitation to the parent's ownership in the CFC.

CFC rules in Belgium

Unlike other EU Member States, CFC rules are new in Belgian domestic tax law. Rather than explaining the full transposition of the CFC rules under the Act, we have addressed below certain specific points of relevance:

- The **scope of application** is limited to foreign subsidiaries, not permanent establishments as foreseen under ATAD;
- The Belgian **ownership test** refers to a direct or indirect ownership of at least (instead of 'more than' under ATAD) 50%;
- The Belgian **subject-to-tax test** refers to CIT due at the level of the CFC being less than 50% of the Belgian CIT due if the CFC would have been a Belgian tax resident (calculated according to Belgian tax rules). In practice, the different formulation under ATAD (referring to the difference between the CIT due according to the tax rules of the parent company and the actual CIT paid by the CFC) will likely have limited impact;
- Belgium has opted to apply the **transaction based approach**, with an explicit link to 'risk controlling/significant people functions' and thus substance (authorised OECD approach);
- CFC income inclusion is not limited to the ownership of the Belgian parent company in the CFC. This could give rise to **double taxation** if other parent companies include (the same) CFC income in their taxable basis according to their domestic tax legislation;
- No de-minimis rules;
- To avoid double taxation, previously taxed CFC income will, upon actual distribution, qualify for **participation exemption**. Capital gains realised on the occasion of the divestment of shares in a CFC where CFC income has been previously taxed in Belgium, should equally qualify for **capital gains exemption** (with losses being non-deductible). There is however **no foreign tax credit** against the Belgian CIT due on the CFC income for taxes actually paid by the CFC;
- Unlike other EU Directive based provisions (such as the participation exemption) there is **no exception for CFCs within the EU or the EEA**. As such this is no surprise, since ATAD address aggressive tax planning both within and outside the EU.

Entry into force

The Belgian CFC rules will apply as from assessment year 2020 (accounting years starting on or after 1 January 2019 and ending 30 December 2020 at the latest).

Conclusion

Like other EU Member States, Belgium is required to transpose ATAD into its domestic tax legislation by 31 December 2018 (ATAD I) or 31 December 2019 (ATAD II) at the latest. Through the Act, Belgium has complied with this requirement. As part of the ATAD transposition, Belgium has introduced CFC rules for the first time as from 1 January 2019. Although the Belgian CFC rules are largely in line with ATAD prescriptions, certain provisions are less stringent whereas others go beyond ATAD requirements. In any case, Belgian taxpayers/holding companies are urged to review their current group structure and tax planning strategy to assess if and how they will be affected by these new rules.

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ISRAEL

COURT RULES ON APPROPRIATE INCOME SPLIT FOR VETERAN RETURNING RESIDENT TO ISRAEL

On 22 January 2018, the District Court ruled in the case of *Yehuda Talmi* (24557-02-15) concerning the application of Israel Tax Ordinance (ITO) which grants a 10 year tax exemption on income of an individual who became a new immigrant to Israel or is a veteran returning resident (a veteran returning resident is an individual that is deemed not to be a tax resident of Israel for at least 10 consecutive years) which was generated or accrued outside of Israel or that originates from assets outside of Israel.

This case concerns a veteran returning resident ('the individual') who returned to Israel in 2007 after a long stay outside of Israel. In tax reports submitted to the Israeli Tax Authorities (ITA) for the years 2007-2011, the individual requested to apply the exemption granted by the ITO on employment income he received from a UK resident company employer ('the Company'), for which he worked before his return to Israel. In these reports, the individual noted that only 36.68% of his income from the Company was generated in Israel, which was backed by a letter from his superior in the Company, and therefore he claimed that only this part of his income should be liable to tax in Israel, while the remaining employment income was reported as exempt income since it was generated outside of Israel.

The individual was issued an assessment stating that the majority of the individual's work was performed in Israel and the services provided were rendered to customers in Israel. Notwithstanding, the ITA agreed to recognise some of the individual's income as being generated abroad which would therefore be exempt from tax, with the income split based on the number of business days in which the individual was abroad in the tax year relative to all business days in the relevant tax year.

In the individual's appeal, he argued that his taxable income received from the company should be zero, as he was a veteran returning resident entitled to a tax exemption and that the wages paid to him derived from assets he developed for the company as a UK resident, indicating that this income is derived from an intangible asset developed abroad. Alternatively, the individual petitioned that his taxable income should be the amount stated in his tax reports according to the income attribution as determined by the company.

The District Court, while rejecting most of the appeal, determined with respect to whether the individual's income 'was produced or derived outside of Israel or is sourced in assets located outside of Israel', that the term 'asset' in the context of the ITO should be interpreted in a more comprehensive fashion, such that it should apply to passive and ongoing income sourced from such assets mentioned above. Notwithstanding, a condition for the tax exemption on income derived from an asset abroad is that the taxpayer must prove that he indeed holds such an 'asset' and that this asset is the source of the income. In this case, the court ruled that the individual did not meet the required burden of proof, inter alia, in light of the fact that the individual's superior did not testify during the proceedings. In addition, the individual failed to refute the findings presented by the ITA with respect to whether part of the individual's income deriving from his business activity was carried out almost entirely in Israel, as the ITA claimed, or outside it, as the individual argued.

As such, in the absence of evidence on the part of the individual with respect to the income split between that derived from his work in Israel and that derived abroad, the court accepted the ITA's method which is based on the amount of business days in which the individual was abroad relative to the total amount of business days in the relevant tax year discussed.

We would recommend that any new immigrants to Israel or veteran returning residents who maintain an occupation containing international characteristics, which includes several stays outside of Israel, properly examine the manner of reporting in Israel on their income and the necessary documentation for this purpose.

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ITALY

TAX CREDIT ON INVESTMENTS IN ADVERTISING

Article 57-bis of Law Decree 50/2017 (converted into Law 96/2017) introduced a tax credit for investments in advertising.

Italian resident companies, irrespective of the legal form in which they have been incorporated, can benefit from a tax credit on expenses for advertising in the daily press or periodicals (including on line channels), radio and television on the condition that the investments made in the fiscal year is at least 1% higher than the same investments made in the previous year.

The tax credit applies for investments made from 1 January 2018 but was also extended in the last version of the Law, to investments made in newspaper and magazine advertising in the period 24 June 2017-31 December 2017.

The tax credit is equal to 75% of the incremental value of the investment in respect of the previous year, increasing to 90% for innovative start-up and small companies. Additionally it cannot be cumulated with other tax benefits for the same kind of expenses.

In order to claim the benefit, taxpayers must apply online through the web site of the Italian Revenue Office between 1 March and 31 March each year. For the fiscal year 2018 the application must be submitted within 90 days from the publication of the Ministerial Decree on the Italian Law Bulletin (expected in the next few days). The application must include:

- Details of the taxpayer;
- Total cost for advertising investments made or to be made in the year;
- Total cost for advertising investments made in the previous year;
- Details of the increase for each channel (Publications and radio/television);
- Tax credit applied for each channel (Publication and radio/television);
- Self-certification of the taxpayer confirming the eligibility of the request.

Tax credits, once granted, can only be used on an 'offset basis', meaning that it will be only possible to use them to off-set other tax liabilities under the standard rules.

As an example, let's assume that a corporation spent EUR 150,000 on eligible advertising during 2017 and will spend EUR 250,000 in 2018. A tax credit of EUR 75,000 will be recognised for 2018 (equal to 75% of the incremental value of the advertising investment).

The Italian Government allocated for fiscal year 2018 an amount of EUR 62.5 million, of which EUR 50 million is for investments in newspaper and magazine advertising and EUR 12.5 million for investments in radio and television advertising. If the resources allocated will not be enough to cover all the requests, the attribution of the tax credit will be made on a pro rata basis between all the applications. The maximum floor for expenditure is set annually through a Decree issued by the Italian Government.

The incurring of the expenses must be certified by an auditor or a chartered accountant and if the tax credit requested is higher than EUR 150,000 an additional authorisation from the authorities is required.

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THE NETHERLANDS

DUTCH GOVERNMENT PUBLISHES LEGISLATIVE PROPOSAL REGARDING DUTCH FISCAL UNITY REGIME

Recovery legislation with retroactive effect

On 6 June 2018 the Dutch Secretary of Finance published a legislative proposal to modify the Dutch fiscal unity regime. This proposal is in line with previous announcements on 25 October 2017 and contains recovery legislation. With this recovery legislation the consequences of the decision of the Court of Justice of the European Union (CJEU) of 22 February 2018 on the per-element approach are being repaired. We informed you earlier about this decision. The recovery legislation will have consequences for many existing Dutch fiscal unities, as it may result in a higher corporate income tax burden. This may already be the case for the 2017 corporate income tax assessment, as the recovery legislation has retroactive effect to 11:00 am on Wednesday 25 October 2017.

Legislative proposal

On the basis of the proposed recovery legislation several regulations in the Dutch corporate income tax act (DCIT) and the Dutch dividend withholding tax act need to be applied as if 'no fiscal unity exists'. For the purposes of these regulations the existing fiscal unity must be disregarded. The purpose of this legislation is to achieve that in cross-border situations no appeal can be made on the per-element approach (by excluding certain advantages for Dutch residents as well, ensuring equal treatment). The following rules (and all related rules) must therefore be applied as if no fiscal unity exists:

- Base erosion interest deduction limitation rules (Article 10a DCIT);
- Certain aspects of the participation exemption rules (Article 13 Part 9-15 and Part 17 DCIT and Article 13a DCIT);
- Excessive participation interest deduction limitation rules (Article 13l DCIT);
- Loss compensation restrictions in case of a change in beneficial ownership (Article 20a DCIT); and
- For dividend withholding tax purposes, the remittance reduction rules (Article 11 Dutch dividend withholding tax Act 1965).

Following the earlier announcement of the recovery legislation, the question was raised whether these measures would also apply to 'internal loans', i.e. loans that have been entered into between companies that are included in the same fiscal unity. This is relevant for the application of the base erosion interest deduction limitation rule (Article 10a DCIT) and the excessive participation interest deduction limitation (Article 13l DCIT). The legislative proposal stipulates that these internal loans will indeed be affected by the recovery legislation, despite the fact that the fiscal unity effectively does not deduct interest with respect to these internal loans.

Implementation and retroactive effect

The proposed recovery legislation will have retroactive effect to 11:00 am on Wednesday 25 October 2017. The adverse tax consequences of the bill will have impact on many existing fiscal unities. Depending on the specific circumstances of the case, there are possibilities to limit these adverse tax consequences for the future. This must be assessed on a case-by-case basis. We strongly recommend businesses to review the consequences for their specific situation with their tax adviser.

For cross-border situations, the decision of the CJEU can bring tax benefits for (non-final tax years in) the period until 11:00 am 25 October 2017.

Grandfathering rule

The legislative proposal does include a grandfathering rule for the application of the base erosion interest deduction limitation rules (Article 10a DCIT) for the period from 11:00 am 25 October 2017 up to and including 31 December 2018. Basically, the grandfathering rule stipulates that under certain conditions the recovery legislation will not apply for loans that already existed prior to 25 October 2017. The grandfathering rule contains a threshold: it does not apply if the amount of the 'tainted' interest for the fiscal unity as a whole exceeds EUR 100,000 during a 12-month period. If the threshold of EUR 100,000 per twelve months is exceeded, the recovery legislation will apply on the entire amount of tainted interest, hence also on the first EUR 100,000.

This grandfathering rule leads to a benefit in purely domestic situations. In cross-border situations, it could be possible to refer to this grandfathering rule claiming the per-element approach with respect to the base erosion interest deduction limitation rules up to and including 31 December 2018, with a reference to the decision of the CJEU.

Revision of the Dutch fiscal unity regime

The recovery legislation is most likely a temporary solution. The estimation is that the Dutch fiscal unity regime will be radically adjusted to keep it executable and to keep it in line with EU law. In this context, the Dutch Secretary of Finance previously announced that he intends to develop a group regime that is future-proof, both from an operational and legal perspective. This will probably take quite a while. There is also a possibility that the fiscal unity regime will be replaced by a much more limited system. The consequences of such a major change in Dutch corporate income tax are extensive.

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SWITZERLAND

DEVELOPMENTS IN RELATION TO TAX PROPOSAL 17

On 21 March 2018, the Swiss Federal Council published the revised Bill and Dispatch in relation to Tax Proposal 17. In the meantime, the Proposal has been discussed in Parliament by the State Council, and this autumn the National Council will also debate it. So far, it seems that Parliament will pass the bill, and assuming that no referendum is taken, Tax Proposal 17 may enter into force from 1 January 2019 with a two year timeframe for the Cantons to implement the reform into Cantonal law.

The Proposal's objective is to secure the long-term tax attractiveness of Switzerland as a business location and to restore international acceptance of the Swiss tax System.

The proposal will abolish current tax regimes which are no longer in line with international standards. However, it contains measures to ensure that companies can still benefit from a competitive tax environment in Switzerland by introducing for example a Patent Box, additional deductions for R&D expenses and significant reductions of corporate income tax rates, leading to very competitive tax rates between 12%-15% in many Cantons.

Termination of existing tax regimes

Today's privileged tax regimes and existing rules of practice no longer comply with international standards and must be eliminated. At the Cantonal level, tax privileges for holding companies, domiciliary companies and mixed companies are to be terminated. At Federal level, the rules on the tax allocation of principal companies and Swiss finance branches will be cancelled.

Patent Box regime at the Cantonal level

A core element of the Proposal is the introduction of a Patent Box regime in accordance with Organisation for Economic Co-operation and Development (OECD) standards, which is mandatory for the Cantons. In the Box, net profits from domestic and foreign patents and similar rights are to be taxed separately from other net profits, with a maximum reduction of 90%.

The calculation of the Patent Box profit is complicated and involves additional administrative effort. Due to the application of the so-called modified nexus approach, the company must also have sufficient economic substance in Switzerland.

R&D super deduction

The introduction of a super deduction for domestic R&D is Switzerland's commitment to be recognised as an attractive location for R&D activities.

The maximum deduction of 50% is limited to personnel expenses for R&D plus a flat-rate surcharge of 35% for other costs and/or 80% of expenses for domestic R&D carried out by third parties or group companies.

Disclosure of hidden reserves

In the event of a transition from privileged to ordinary taxation, hidden reserves existing at that time, including any self-created goodwill, must be confirmed by the tax authorities. Currently, the Cantons have two different models: a five-year special rate taxation on realisation (the so called two-rate system) or a tax-free revaluation of these hidden reserves in the tax balance sheet with corresponding tax-effective depreciation (the so called step-up model).

Companies that are currently subject to a special tax regime should review whether the tax status should be waived before Tax Proposal 17 comes into force in order to be able to benefit from the step-up model, if beneficial and possible.

Restrictions of overall tax relief

The Patent Box, super deduction on R&D, and possible depreciations from the early transition from privileged to ordinary taxation are subject to restrictions of an overall tax relief. Tax Proposal 17 specifies a maximum tax relief of 70%.

Other tax policy measures

The reduction of Cantonal profit tax rates is not directly covered by Tax Proposal 17; however, many Cantons have already announced that they will reduce corporate income tax rates significantly in order to remain attractive for companies that could previously benefit from a tax privilege.

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PANAMA

PANAMA LEADS THE CENTRAL AMERICAN REGION IN AUTOMATIC EXCHANGE OF INFORMATION (AEOI)

There are three regimes of automatic exchange of financial information between countries, for tax purposes, that coexist today in the Central American region:

1. FATCA (Foreign Account Tax Compliance Act);
2. QI (Qualified Intermediaries); and
3. CRS (Common Reporting Standard).

FATCA and QI are regimes with legislative origin in the United States. FATCA refers to the annual and automatic transmission of information to the United States Internal Revenue Service (IRS) on US accounts opened in non-US institutions. The QI regime refers to the annual and automatic transmission to the United States IRS of reports on payments, mainly of dividends and interest of US source, made by non-US financial intermediaries to their clients.

FATCA – The current position

Considering Central America as Panama, Belize, Costa Rica, Dominican Republic, Guatemala, Nicaragua, El Salvador and Honduras, the IRS has issued a total of 2,927 Global Intermediary Identification Numbers (GIINs), under the framework of FATCA, to entities in the region. Approximately 65% of the GIINS correspond to entities registered in Panama, 20% to Belize, 5.5% to Costa Rica, 4.8% to the Dominican Republic, 2.7% to Guatemala, 0.9% to Nicaragua, 0.7% to El Salvador and 0.4% to Honduras.

Of the countries in the region, only Belize, Guatemala and El Salvador have abstained from concluding intergovernmental agreements (IGAs) with the United States, to facilitate compliance with FATCA, while Panama, Costa Rica, the Dominican Republic, Honduras and Nicaragua have entered into IGAs with the United States. Of these IGAs, only those of Panama and Honduras are fully legally effective, while those of Costa Rica and the Dominican Republic are signed without having yet entered into force. The IGA of Nicaragua has not been signed yet, but is in a transitory status granted by the US Treasury, called 'agreed in substance', that is, that the IGA is negotiated and agreed upon as to its text.

The IGAs of Panama, Costa Rica, the Dominican Republic and Honduras were signed under the US Treasury Model 1. The IGA of Nicaragua was agreed based on Model 2, which implies the transmission of information directly from the Nicaraguan entity to the IRS, unlike Model 1, in which the information is transmitted from the financial institution to the authority competent in their respective country, and it is that authority that shares the information with the IRS. Nicaraguan financial institutions, as they reside in a jurisdiction with IGA Model 2, must directly enter into an 'FFI Agreement' with the IRS, while the financial institutions of Belize, Guatemala and El Salvador, as they do not operate in jurisdiction with IGA, have the option to enter into an 'FFI Agreement' with the IRS. However, if they do not do so, they will be subject to a 30% withholding tax on the US source income they receive.

QI – The current position

The QI regime, different from FATCA and based on other rules of the Internal Revenue Code of the United States, has not led, to date, to the establishment by the IRS of a public access registry that allows determining which financial institutions have acquired the status of 'Qualified Intermediary'. So it is not known how many QIs exist in the world.

However, based on our experience, without a doubt, because Panama is an international financial centre, Panama is the country in the Central American region with the largest number of QIs operating in its jurisdiction.

CRS – The current position

Finally, the CRS, conceived by the Organisation for Economic Cooperation and Development (OECD), based on the IGA Model 1 designed by the United States Treasury and the IRS, consists of the automatic exchange of information on financial accounts between competent authorities of the countries participating in the CRS. However, unlike the IGA Model 1, which facilitates the implementation of FATCA through intergovernmental channels, the CRS is reciprocal and symmetric. The IGA Model 1 is reciprocal but asymmetric, since it is more information that the IRS receives than the information it transmits to foreign competent authorities.

In the Central American region, five countries participate in the CRS: Panama, Belize, Costa Rica, the Dominican Republic and Guatemala. Nicaragua, El Salvador and Honduras do not yet participate in the CRS. Of the countries that do participate, Panama, Belize and Costa Rica have committed themselves to the first exchange of information to take place in 2018; while the Dominican Republic and Guatemala have not yet formalised their commitment.

Conclusion

As we can see, Panama, as an international financial centre, leads the region in terms of automatic information exchange for the purposes of international fiscal transparency, under the three regimes: FATCA, QI, and CRS.

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EGYPT

INCOME TAX AND SOCIAL INSURANCE AMENDMENTS

On 22 May 2018, the Minister of Finance issued:

– Decree No. 221 for the year 2018 amending the executive regulations of the Income Tax Law;

– Articles No. 38, 39, and 40 relating to transfer pricing rules and methods; and

– Article No. 104 relating to electronic filing of corporate tax returns.

On 23 June 2018, Tax-Law No. 97 for the year 2018 was issued for further amendments to the Income Tax Law. The effective date of the Law No. 97/2018 is the next day from the date of publishing in the official gazette, which was on 23 June 2018.

In addition, under Law No. 120 of 2014, there is a new maximum limit of the basic salary which is subject to social insurance as of July 2018.

Further details of these amendments are given below.

Amendments to transfer pricing rules

The amendments outline the tax authority's right to verify the application of the arm's-length principal for commercial and financial transactions between associated persons, especially for the exchange of goods and services, as well as the distribution of common expenses, royalties, and interest, and other commercial or financial transactions carried out between themselves.

Also, two new methods of determining the arm's length prices between associated persons have been added – the Transactional Net Margin Method and the Profit Split method – in addition to the three existing methods, which are the Comparable Uncontrolled Price Method, Resale Price Method and Cost Plus Method.

The executive regulations prescribe that the taxpayer should select the appropriate method pursuant to the nature of the commercial or financial transaction and the particular circumstances. If none of the available methods can be applied, the taxpayer can choose any other appropriate method, and must retain the documents that support the method applied.

In addition, the amendments have removed the reference to OECD transfer pricing guidelines, and confirm that the Egyptian Tax Authority can enter into an Advanced Pricing Agreement (APA) with taxpayers.

Furthermore, the amendments to the executive regulations of the Income Tax Law state that the Minister of Finance will issue guidelines on the application of the arm's length price methods, and outline the rules to be followed on applying each method, and the books and documents to be kept. That guide will be the primary reference when the authority verifies the application of the neutral price, unless the taxpayer requests the application of other method, after approval of the Tax Authority's chairman.

Electronic filing of corporate tax returns

The amendments oblige the taxpayer (the juridical person) to file its corporate tax return through the Egyptian government's electronic portal (Income Tax Taxpayers Service) or through any other electronic channel to be determined by the Ministry of Finance.

However, individual taxpayers can choose between electronic or physical submission.

Social Insurance

Under Law No. 120 of 2014, indicating the maximum limit of the basic salary which is subject to the social insurance, the maximum limit increased to EGP 1,510 per month instead of EGP 1,370, with effect from 1 July 2018. The current maximum variable salary limit is EGP 3,360 per month.

Individuals' Income Tax

The amended Income tax brackets for individuals' income are as follows:

Taxable Income Bracket	Tax Rate
First EGP 8,000	0%
EGP 8,001 - EGP 30,000	10%
EGP 30,001 - EGP 45,000	15%
EGP 45,001 - EGP 200,000	20%
Over EGP 200,000	22.5%

The law has granted taxpayers who are subject to the following brackets a discount from the tax due as follows:

Taxable Income Bracket	Tax Discount
EGP 8,001 - EGP 30,000	85%
EGP 30,001 - EGP 45,000	45%
EGP 45,001 - EGP 200,000	7.5%

The discount mentioned above will be granted once for the bracket that applies to the taxpayer.

The above changes relating to individual income tax will be applied:

– From July 2018, for salary tax;

– From the fiscal period ending after 23 June 2018, for other individuals' income.

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UNITED STATES

TAX REFORM DEDUCTION – WHAT FOREIGN-DERIVED INTANGIBLE INCOME MEANS TO C-CORPORATIONS

What is FDII?

Enacted as part of the Tax Cuts and Job Act, the Foreign-Derived Intangible Income (FDII) deduction is a permanent deduction for domestic C-corporations that generate certain types of foreign income. It is effective for years beginning after 31 December 2017.

How does it work?

The name of the deduction is perhaps a bit of a misnomer, as the incentive is not necessarily tied to a specific revenue stream derived from a taxpayer's ownership of intangible property. Rather, the deduction generally applies to US taxpayers that generate income from export sales or services. For taxable years beginning after 31 December 2017, but before 1 January 2026, the deduction generally reduces a taxpayer's effective tax rate on FDII to 13.125%; for taxable years beginning after 31 December 2025, the effective tax rate on FDII is generally 16.406%.

What qualifies for the deduction?

At a high level, US taxpayers that generate gross receipts from the following activities may qualify for the deduction:

– Sale, lease, license, exchange or other disposition of property sold by a taxpayer to a non-US party for foreign use.

– Services provided by a taxpayer to any person, or with respect to property, not located in the US.

Special rules apply if the property or services are provided to foreign related parties.

What should companies do?

While taxpayers await further guidance from the IRS and Treasury providing specifics on the FDII deduction, it is prudent for corporations to begin assessing whether they may qualify for the benefit immediately for quarterly estimated payments and financial reporting purposes. At the same time, taxpayers should also determine whether they may be subject to the Global Intangible Low Tax Income (GILTI) provision, and undertake the proper planning procedures for estimating the potential impact of the income inclusion and corresponding deduction for certain taxpayers.

How can BDO help?

Calculating the FDII deduction involves a multi-step process with numerous data inputs. Further, determining whether certain transactions qualify for the deduction is highly nuanced and can factor in specifics related to intercompany transactions, what is deemed foreign use, as well as structure considerations. To address these complexities, BDO employs a collaborative team consisting of specialists from International Tax, R&D/199, Accounting Methods, and Corporate to help taxpayers maximise their benefit, while considering other ancillary tax matters as a result of tax reform changes. Additionally, BDO can assist with preparing detailed FDII calculations, along with any qualitative and quantitative support necessary to substantiate the benefit, as well as estimates for purposes of estimated tax payments and/or quarterly and annual financial statement disclosures.

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CURRENCY COMPARISON TABLE

The table below shows comparative exchange rates against the euro and the US dollar for the currencies mentioned in this issue, as at 12 July 2018.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
Hong Kong Dollar (HKD)	0.10878	0.12740
Euro (EUR)	1.00000	1.17103
Indian Rupee (INR)	0.01241	0.01453
Egyptian Pound (EGP)	0.04764	0.05579

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