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THE NETHERLANDS

2019 TAX BUDGET

On 18 September 2018 the Dutch government published its Tax Budget for 2019, containing no fewer than seven legislative bills. In this article we summarise some of the important changes in the fields of corporate income tax, dividend withholding tax, VAT and payroll taxes.

Corporate income tax

General

1. **Phased reduction in corporate income tax rates**

   From 1 January 2019, corporate income tax rates will be reduced in annual phases over a period of three years, in conjunction with a broadening of the tax base (*see below*). These changes will result in the following:

Taxable profit or taxable amount	Corporate income tax rate		
	2019	2020	2021
Up to EUR 200,000	19%	17.5%	16%
EUR 200,000 or more	24.3%	23.9%	22.25%

2. **Restriction on depreciating buildings in own use for corporate income tax purposes**

   At present, buildings in own use cannot be depreciated below 50% of their WOZ value (i.e. their value for property tax purposes), while other buildings (investment properties) cannot be depreciated below 100% of their WOZ value. From 1 January 2019, the restriction on depreciating buildings for corporate income tax purposes will be the same for all types of buildings. This means that buildings in own use will not be able to be depreciated below 100% of their WOZ value. This applies only to businesses liable for corporate income tax and so not to entrepreneurs liable for income tax. For the latter, the depreciation rules remain unchanged.

3. **Restriction on period for loss carry-forward in corporate tax**

   Currently a loss for corporate income tax purposes can be set off against taxable profit in the previous year (loss carry-back) or taxable profit in the next nine years (loss carry-forward). From 2019, the loss carry-forward will be restricted to six years, with transitional rules applying for losses incurred in previous years. This change will increase the importance of taking steps to prevent losses evaporating and becoming ineligible to be set off.

4. **Real estate held by FBIs (fiscal investment institutions for corporate income tax purposes)**

   Fiscal investment institutions for corporate income tax purposes (FBIs) are liable for corporate income tax at a rate of 0%, and have to distribute their profits to investors each year. While these profit distributions currently attract dividend withholding tax, the abolition of the dividend withholding tax with effect from 1 January 2020 (*see below*) means this will no longer apply. Along with the introduction of the above measures, FBIs will also no longer be able, from 1 January 2020, to invest directly in real estate in the Netherlands.

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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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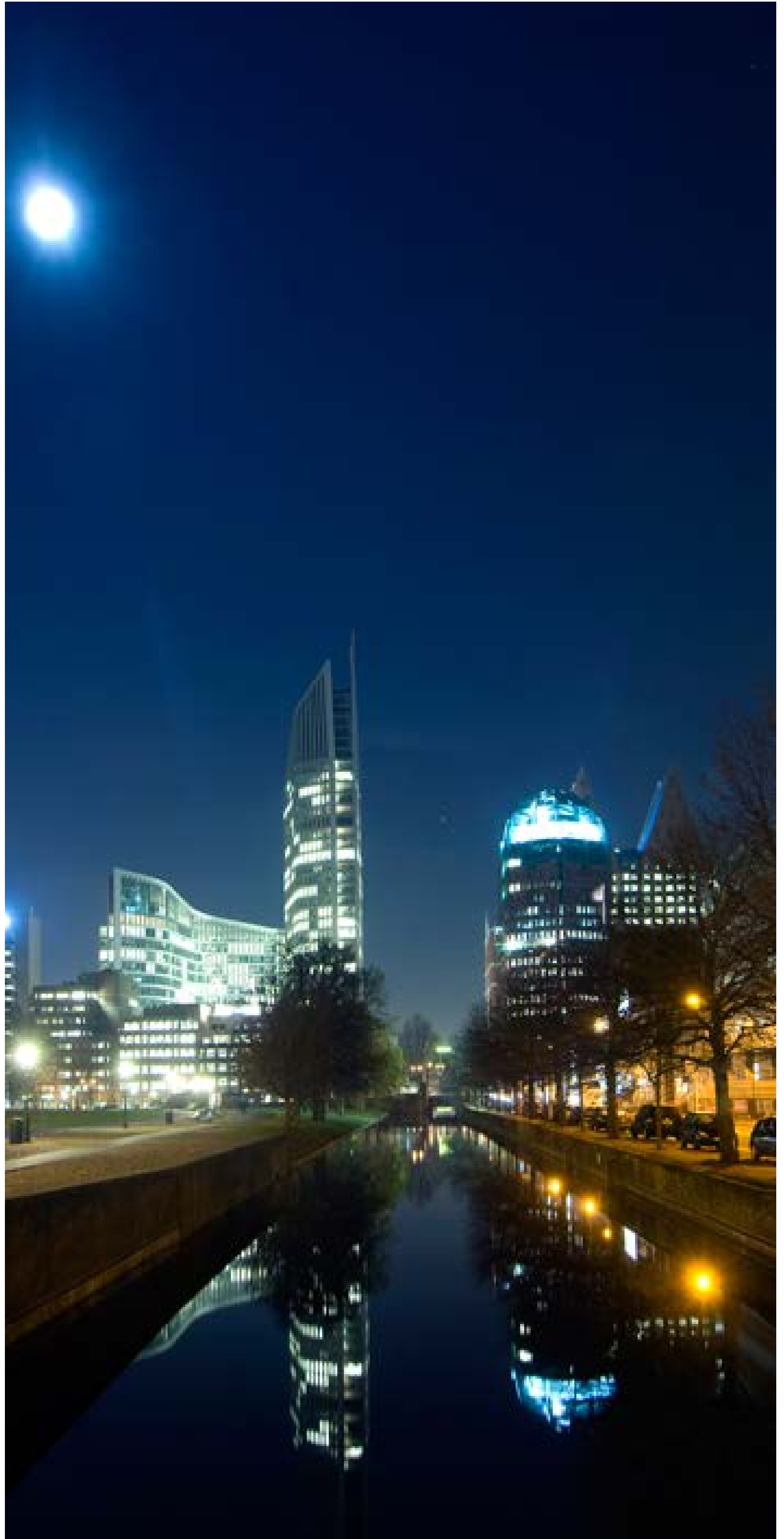

Implementation of Anti-Tax Avoidance Directive 1

In addition to the Tax Budget for 2019, the legislative proposal to implement Anti-Tax Avoidance Directive 1 (ATAD1) is published, and some accompanying measures are proposed in the 'Withholding Tax Act 2020'.

1. Controlled foreign companies ('CFC')

Taxpayers can avoid or defer taxation by shifting profits to a subsidiary or permanent establishment in a jurisdiction with a low corporate income tax rate (CFC). The new CFC rule as included in ATAD1 aims to immediately include certain 'tainted' categories of income of a CFC in the Dutch taxable base. The categories of income for example include interest, royalties and dividends.

A low taxed controlled foreign company (CFC) is considered to exist if:

- A taxpayer alone or together with an affiliated company or individual, (in) directly owns an interest of more than 50%; and
- That company or the permanent establishment is located in a jurisdiction with a statutory tax rate on profits of less than 7%, or is located in a jurisdiction that is included in the EU list of non-cooperative jurisdictions.

The CFC rule will not apply for CFCs that carry out real economic activities, as determined under the substance requirements that came into effect from 1 April 2018 in the Dutch Dividend Withholding Tax Act. These requirements include a minimum wage cost criterion of a minimum of EUR 100,000 and having an office space available for a minimum period of 24 months. Also, the CFC rule will not apply to CFCs whose income consists of 70% or more of other, non 'tainted', categories of income.

2. General interest deduction limitation rule

Specific interest deduction limitation rules in the Corporate Income Tax Act 1969 (CITA) are mostly replaced (*see below*) by a general interest deduction limitation rule: the earnings stripping rule.

The earnings stripping rule limits the deductibility of net interest payable on loans obtained from both related parties and unrelated third parties. This is the difference between interest payable and interest receivable from loans (net interest or the net amount). This part of the interest paid is no longer deductible in excess of:

- 30% of the tax based EBITDA (earnings before interest, tax, depreciation and amortization); or
- EUR 1 million, if this is higher than 30% of the tax based EBITDA.

The tax based EBITDA does not include exempt income items (e.g. dividends that are exempt under the participation exemption). When the taxpayer is part of a Dutch fiscal unity for corporate income tax purposes, the earnings stripping rule is applied on the level of the fiscal unity. The remaining net interest in a year which is not deductible based on the earnings stripping rule, can be carried forward indefinitely. With only one exception (*see below*).

3. Provision against trade in 'net interest bodies'

An accompanying measure is being introduced in order to prevent a 'trade' arising in taxpayers with interest being 'parked' and carried forward. If the ultimate interest in such a taxpayer changes by 30% or more, the 'parked' amount from before the change in ownership is in principle no longer eligible to be included when calculating the profit from after the change, so that the parked net amount is no longer eligible for deduction. However, exceptions to this primary rule may allow the parked net amount to be carried forward to future years, depending on how the earnings stripping rule applies in that future year.

4. Abolition of certain restrictions on the deductibility of interest and costs for corporate income tax purposes

The following existing restrictions on the deductibility of interest and costs in the CITA will end with effect from 1 January 2019:

- The restriction on the deductibility of excess interest and costs relating to the financing of participating interests (Article 13l CITA);
- The restriction on the deductibility of interest and costs relating to acquisition debt (Article 15ad CITA);
- The restriction on loss carry-forward in the case of holding and finance companies (Article 20(4)-(6) CITA).

The restriction on the deductibility of interest in situations involving base erosion (Article 10a CITA) and the restriction on the deductibility of interest in situations involving international mismatches (Article 10b CITA) will continue to apply.

Transitional arrangements will apply in respect of Article 15ad CITA. Acquisition interest that has not yet been set off can be added to the net amount of interest to which the earnings stripping rule applies. Transitional arrangements will also apply in respect of Article 20(4)-(6) CITA. Holding and finance losses incurred in financial years starting no later than the 2018 calendar year will subsequently only be able to be offset against holding or finance profits.

5. Exit taxation

If a taxpaying body resident in the Netherlands transfers assets or its tax residency to another state, corporate income tax is payable on the surplus value for tax purposes (e.g. on assets that are worth more than the amounts for which they are shown for tax purposes in the balance sheet), irrespective of whether that surplus value has actually been realised. In that case, the taxpayer can choose either to pay the tax immediately or to apply for a deferral, subject to compliance with certain conditions. If the taxpayer opts for the latter, any deferral granted will end if and when the relevant asset is disposed of. In that case, the taxpayer may request to be allowed to pay the tax due in ten equal annual instalments.

As a result of the implementation of ATAD1 in Dutch legislation the current ten year deferral period will be reduced to five years, for years starting on 1 January 2019 and later. The ten-year term will continue to apply to deferrals granted before 1 January 2019.

Dividend withholding tax

Withholding Tax Act 2020

Abolition of dividend withholding tax and introduction of new withholding tax on dividends and (at a later date) interest and royalties

The dividend withholding tax will be abolished with effect from 1 January 2020. In order to prevent the Netherlands acting as an access portal to countries that do not levy enough tax on profits, a new withholding tax on dividends will be introduced under the Withholding Tax Act 2020, which will enter into force on 1 January 2020.

The new withholding tax on dividends will only apply to dividend distributions (and similar income that is made available) to affiliated companies. It will therefore not apply to dividends distributed to natural persons. This arrangement will not be limited to letterbox companies, as companies with a real business presence would also be able to use the Dutch tax system as an access portal to countries that do not levy enough tax on profits. The scope of the new withholding tax will be limited to:

(i) Dividends (and similar income) distributed to affiliated companies based in a country that does not levy enough tax on profits; and

(ii) Abusive situations.

In specific cases, also capital gains (i.e. alienation of shares) are subject to the withholding tax.

i. Profits subject to tax rate of less than 7% or EU list of non-cooperative jurisdictions

A country that does not levy enough tax on profits is defined as follows: a state where entities are not liable to profits tax or that taxes the profits of entities at a rate of less than 7%, or a state that is included in the EU list of non-cooperative tax jurisdictions. The arrangement shuts the door on distributions to hybrid entities. Whether the Netherlands will actually be able to effect the withholding tax on dividends depends in part on the tax treaty between the Netherlands and the relevant country that does not levy enough tax on profits, where the company receiving the dividend is based. In order to amend tax treaties, the Netherlands will contact the relevant treaty partner. In such cases, the withholding tax will not apply until a period of three calendar years has passed.

ii. Abusive situations

An abusive situation is a situation in which an artificial structure is used to circumvent the new withholding tax on dividends. The classic example is a situation where the shares in the Dutch company that distributes the dividend are not directly held by the affiliated company that is based in a country that does not levy enough tax on profits, but are instead held through an intermediate holding company that is not registered in such a country. Whether a specific situation involves abuse will be determined on an individual basis.

Once the new withholding tax on dividends is applicable, the Dutch company that distributes the dividend will have to withhold the tax and remit it by filing a tax return. The applicable rate will be the highest corporate income tax rate. This will be 23.9% in 2020 and 22.25% as from 2021.

The Dutch company that distributes the dividend (withholding agent) and the taxpayer will have to provide the Dutch tax authorities with correct and complete information or data that could be of relevance for the levying of the new withholding tax. Failure to comply with the obligation to provide information owing to wilful misconduct or gross negligence constitutes an offence that carries a fine.

A withholding tax on interest and royalties, with details still to be decided, will also come into effect on 1 January 2021.

VAT

1. Reduced rate of VAT to increase from 6% to 9%

The reduced rate of VAT will increase from 6% to 9% from 1 January 2019. The reduced rate applies to a range of goods and services, such as food and drink, medicines and bandages, books, passenger transport, hotel and restaurant services, museums, amusement parks, cinemas and zoos. These goods and services will therefore become more expensive, with no transitional measures.

2. Electronic Commerce Directive (Implementation) Act

A number of simplifications related to the levying of VAT on telecommunication, broadcasting and electronic services will be implemented in Dutch VAT legislation by means of a separate bill. These services are taxed in the country where the customer lives or is registered, irrespective of whether the customer is a business or consumer. Businesses that perform these services for consumers are able to file a VAT return in their own EU Member State for the VAT that they owe in other member states. This is referred to as the Mini One Stop Shop (MOSS) scheme. The simplifications are as follows:

- With effect from 1 January 2019, businesses that are based in a member state and generate no more than EUR 10,000 in revenue from providing telecommunication, broadcasting or electronic services to consumers in other member states will be able to charge the VAT applying in their own member state. They may also opt to charge the VAT applying in the member state where the customer is based. In order to do this, they must first submit a request to the inspector.
- Businesses that are not based in the EU may file returns under the MOSS scheme in the member state of their choosing. This is currently not the case for businesses that are, or ought to be, registered in the EU for VAT, but they will also be able to do this with effect from 1 January 2019.
- At the moment, the invoicing rules in force in the customer's member state apply. With effect from 1 January 2019, if the service provider makes use of the MOSS scheme, the invoicing rules in force in that service provider's member state will apply. For Dutch businesses, this means it will no longer be necessary to issue an invoice if the customer is a private individual.

A second set of measures under the Electronic Commerce Directive due to come into effect on 1 January 2021 will have a major impact in practice.

Wage tax

Maximum term of 30% ruling reduced

With effect from 1 January 2019, the maximum term of the 30% ruling for foreign employees will be reduced by three years, from a maximum of eight years to no more than five years. This maximum will apply to existing cases as well as new cases. No substantive changes are envisaged for employees who are posted abroad, and no transitional provisions will be introduced for existing cases, but transitional provisions for tuition fees payable for international schools with effect from 1 January 2019.

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HONG KONG

ENHANCED TAX DEDUCTION FOR RESEARCH & DEVELOPMENT EXPENDITURE

A new law that grants enhanced tax deductions for qualifying research and development (R&D) activities carried out in Hong Kong, pursuant to the Inland Revenue (Amendment) (No. 3) Bill 2018 (Amendment Bill) passed its third reading in the Legislative Council on 24 October 2018 after one minor amendment (*see Note 1*). The new R&D tax deduction regime has retrospective effect for R&D expenditure incurred on or after 1 April 2018.

Key features

1. **Former regime**

   A deduction under the old Section 16B of the Inland Revenue Ordinance (IRO) was allowed for R&D expenditure incurred by a taxpayer in relation to trade, profession or business, subject to some specific conditions. The deductible R&D expenditure could be in the form of:

   (i) Payments to approved research institutes (*see Note 2*); or

   (ii) Expenditure incurred in-house by taxpayers themselves. R&D expenditure included capital expenditure, except expenditure on land or buildings.

2. **The new R&D deduction regime**

   The old Section 16B has been substituted by a new Section 16B and Schedule 45 which sets out the details of the deduction. Under the enhanced R&D deduction regime, R&D expenditure is classified into two types:

   – Type A expenditure qualifies for a basic 100% tax deduction, whereas Type B expenditure qualifies for the enhanced two-tiered tax deduction (300% tax deduction for the first HKD 2 million and 200% for the remaining amount), subject to meeting certain conditions.

   – The tax deduction for Type A expenditure is largely the same as the deduction under the old Section 16B, while Type B expenditure will qualify for the enhanced deduction. In simple terms, Type B expenditure refers to qualifying expenditure on qualifying R&D activities wholly undertaken and carried on in Hong Kong. This is further explained below.

3. **Enhanced R&D deductions**

   To qualify for Type B expenditure, the following conditions must be met:

   a) The expenditure arises from an activity that falls into the definition of a qualifying R&D activity and related to the trade, profession or business; and

   b) The expenditure incurred falls into the definition of R&D expenditure.

   A qualifying R&D activity refers to the R&D activity that is wholly undertaken and carried on in Hong Kong and falls within one of the following (*see Note 3*):

   a) An activity in the fields of natural or applied science to extend knowledge;

   b) An original and planned investigation carried on with the prospect of gaining new scientific or technological knowledge and understanding; or

   c) The application of research findings or other knowledge to a plan or design for producing or introducing new or substantially improved materials, devices, products, processes, systems or services before they are commercially produced or used.

   Qualifying R&D expenditure that enjoys the enhanced two-tiered deduction comprises:

   a) Payments made to a designated local research institution; or

   b) In-house expenditure in relation to:

      (i) An employee engaged directly and actively in a qualifying R&D activity; or

      (ii) A consumable item used directly in a qualifying R&D activity.

      Expenditure in relation to an employee means any salary, wages, contributions to a recognised occupational retirement scheme/mandatory provident fund scheme and any other benefit that constitutes a cash outlay paid by the employer. Director's remuneration is specifically excluded.

4. **Deemed taxable trading receipts**

   The following will be deemed as taxable trading receipts:

   a) Proceeds from the sale of plant and machinery for, or rights generated from, any R&D activity for which the expenditure has been allowed as a deduction under Section 16B (taxable amount limited to the amount of deduction previously allowed).

   b) Royalties received for the use or right to use outside Hong Kong of any intellectual property or know-how generated from any R&D activity for which the expenditure has been allowed as a deduction under Section 16B.

5. **Advice from Commissioner for Innovation & Technology (CIT)**

   Where an R&D claim under the new Section 16B or an advance ruling application is made by a taxpayer, the Commissioner of Inland Revenue may seek advice from the CIT to ascertain, among others, whether:

   (i) An activity is a qualifying R&D activity; and

   (ii) An R&D expenditure was incurred in relation to a qualifying R&D activity.

   The CIT may designate any local university or college or any other local institution that undertakes qualifying R&D activities in Hong Kong as a designated local research institution.

Our observations

1. We welcome the Government's effort to introduce tax measures to promote R&D activities being carried out in Hong Kong.
2. Apart from enhanced deductions for certain R&D expenditure, however, the conditions to be met in order to obtain deductions under the old Section 16B and the new Section 16B remain largely the same and are rather stringent. A taxpayer can only obtain deductions on part or all of the in-house expenditure incurred, payments to universities and colleges both in Hong Kong and overseas as well as payments to designated local research institutes. No deductions are allowed on expenditure incurred on outsourcing R&D activities to entities other than designated local research institutes.
3. Nowadays, it is not uncommon for multinational corporations to centralise the R&D functions in one constituent entity, as local designated research institutes may not have the industry expertise and knowledge to suit the requirements of taxpayers. While the group entity in Hong Kong would potentially derive taxable income from the benefits of the R&D work, it is not entitled to claim any R&D costs recharged as deductible expenses under either the old or the new regime. Unless there is a relaxation of the criteria in qualifying R&D expenditure, the effectiveness of the new measure would be undermined.

Notes

1. An amendment was made so that a payment by a taxpayer to a local institution qualifies as R&D expenditure if the local institution is designated as a designated local research institution within six months after the date of payment.
2. An approved institute means any university, college, institute, association or organisation which is approved in writing by the Commissioner of Inland Revenue as an institute, association or organisation for undertaking research and development which is or may prove to be of value to Hong Kong.
3. A qualifying R&D activity does not include:
   (a) Any efficiency survey, feasibility study, management study, market research or sales promotion;
   b) The application of any publicly available research findings or other knowledge to a plan or design, with an anticipated outcome and without any scientific or technological uncertainty;
   (c) An activity that does not seek to directly contribute to achieving an advance in science or technology by resolving scientific or technological uncertainty; or
   d) Any work to develop the non-scientific or non-technological aspect of a new or substantially improved material, device, product, process, system or service.

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INDIA

SERVICES FOR PROCESSING CARD PAYMENT TRANSACTIONS CREATE A PERMANENT ESTABLISHMENT

The taxpayer (a Singapore based subsidiary and regional headquarters of the MasterCard group) requested a ruling on the taxability of fees in respect of processing card payment transactions.

Under the licence agreement, the taxpayer receives transaction processing fees (relating to the authorisation, clearing and settlement of transactions between merchant and cardholder banks), assessment fees (for building and maintaining the processing network) and miscellaneous fees for ancillary services. The taxpayer's customers (banks and financial institutions) are provided with a MasterCard Interface Processor (MIP) – about the size of a computer – that in turn is connected to the network and processing centres. Such MIPs placed at a customer's location are owned and maintained by the Indian subsidiary of the taxpayer.

On the question of whether the taxpayer has a Permanent Establishment (PE) in India for services to be rendered through the use of network and infrastructure for processing card payments, the Authority for Advance Ruling (AAR) ruled as follows:

A. The taxpayer has a fixed place of PE in India through:

   i. The MIP – Important and crucial functions such as preliminary examination for authorisation (PIN processing, name and address verification) are performed by the MIP. Without this authorisation element, the overall transaction processing function would not happen, and therefore it cannot be said to be preparatory or auxiliary. After examining the functions, assets and risks (FAR) profile, contracts with customers and third-party entities for updating and maintenance, cost charging arrangements within the group, and ownership of intangibles, the AAR noted that the MIPs are at the disposal of the taxpayer, though shown to be owned by the Indian subsidiary. This is in consideration of the fact that all risk mitigation functions are performed by the taxpayer and all decisions with respect to MIPs are taken by the taxpayer.

   ii. The MasterCard network – The network consisted of the MIP, transmission tower, leased lines and application software – Master Connect and Master Card File express. The AAR held that this network passes the test of permanency, fixed place and disposal. The transmission of data through the network is not preparatory or auxiliary, since the overall activity of MasterCard is the transmission of signals between merchants and banks. In fact, when the MIP is combined with the transmission tower and leased lines, the scope of activity increases. It was also observed that the revenue generating activity for the taxpayer takes place in India i.e. customer swipes card in India, data flows between banks in India and money also moves in India.

   iii. Premises of the Bank of India (BoI) – The settlement process involving movement of funds between banks is performed by BoI in its premises. Settlement activity is the function of the taxpayer, carried out by BoI on its behalf and with all responsibility for errors on the taxpayer. The employees of BoI carrying out this work are under the control and supervision of the taxpayer, and the space occupied by them in BoI is at the disposal of the taxpayer.

   iv. Indian subsidiary – Prior to Dec 2014 for ten years, the taxpayer disclosed income from processing services rendered in India at 100% attribution when it was operating through a liaison office (LO). Thereafter, the LO was shut down and all activities were transferred to a subsidiary, including employees. However, the Indian subsidiary has reflected these activities as only support functions in its FAR. It was observed that once the taxpayer had admitted income in its tax return with 100% attribution of profit to India, it means that legally it has accepted carrying out those operations in India through a PE. The AAR noted that the Indian subsidiary is carrying on work of the taxpayer through facilities, services, personnel and premises at the disposal of taxpayer, thus constituting a PE.

B. A service PE was created – Services performed by employees visiting India such as informing customers about new products and taking feedback form an integral part of the business and do not constitute steward activities. The employees are providing services to Indian clients and once the threshold of 90 days is crossed, a service PE is created.

C. Indian subsidiary is an agent PE – The Indian subsidiary is legally and economically dependent on the taxpayer, from whom it receives instructions and remuneration. On reviewing how agreements are executed with customers, the AAR noted that orders or agreements are routed through the Indian subsidiary, though finalised by the taxpayer outside India. The process satisfies the requirement of habitually securing orders, so the Indian subsidiary is an agency PE of taxpayer.

[MasterCard Asia Pacific Pte. Ltd., In re AAR No. 1573 of 2014].

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GERMANY

PLANS TO EXTEND TAXATION OF NON-RESIDENT CAPITAL GAINS RESULTING FROM THE SALE OF SHARES IN REAL ESTATE-RICH CORPORATIONS

Background

Until recently, the disposal of shares in foreign corporations with domestic real estate assets by shareholders with limited tax liability could only be taxed if the corporation had its company seat or place of management in Germany and if the shareholder held at least 1% of the company's share capital (pursuant to § 17 EStG – German Income Tax Act). A foreign corporation usually does not fulfill these company seat or place of management requirements. Although certain double taxation treaties (DTTs) already provide Germany with a right to taxation in this regard, at the moment there is no national taxation basis. The right of taxation remains theoretical, only. As a result, Germany's right to levy taxes, to which it is per se entitled based on several DTTs, has no impact.

The law 'to prevent VAT losses relating to trade of goods in the internet and concerning the amendment of other tax regulations' – formerly Annual Tax Act 2018 – is supposed to close this tax gap, according to the wording of the government draft bill published in early August 2018 (Bundesrat, Drucksache 372/18). § 49 EStG (income subject to limited tax liability) is to be amended in accordance with Article 13 (4) of the OECD Model Tax Convention, version 2017. Article 13 (4) of the OECD Model also forms the basis for negotiating new DTTs to be concluded or existing ones to be revised.

Tax structures concerned

The vast majority of structures concerned relate to companies which own real estate located in Germany, while the real estate company itself (as the owner) as well as its shareholders are solely tax resident abroad.

Draft legislation

§ 49 EStG is to be amended so that revenue related to the disposal of shares in domestic and foreign real estate companies will be considered German taxable income. Prerequisite for the tax liability is that:

- More than 50% of the value of the corporation's shares is based, directly or indirectly, on real estate located in Germany at any time during the 365 days preceding the disposal; **and**
- Pursuant to § 39 AO (German Tax Code), the shares in the corporation were attributed to the seller at that time.

Since the general prerequisites of § 17 EStG are also applicable, it is sufficient, if the seller held at least 1% of the share capital of the corporation within the last five years preceding the disposal. Therefore, it is not necessary for the seller to hold at least 1% of the shares in the corporation at the time of disposal.

Valuation of domestic company assets

The quota of 50% of domestic immovable assets as part of the total assets is to be calculated based on the book values of the company assets. If the assets of an indirect shareholding are to be included, the quota of 50% is to be calculated based on a consolidated view of the assets of the companies, to which the domestic immovable assets can be directly or indirectly attributed – according to the explanatory note of the draft legislation.

Effective date

The forthcoming revision will apply to capital gains from the disposal of shares taking place after 31 December 2018. Furthermore, only gains based on a change in market value occurring after this date are to be considered. Past value increases of shares continue to be exempt from taxation.

Impact – Practical implementation

The tax base gain in connection with the new legislation is likely to be rather small. Pursuant to § 8b KStG (German Corporation Tax Act), capital gains from the disposal of shares by foreign corporations remain fully tax-exempt (insofar, pursuant to the judgment in the BFH case on 31 May 2017 (case no. I R 37/15), the fiction of non-deductible operating expenses of 5% is not applicable).

In the absence of a domestic permanent establishment of the seller, trade tax is also not applicable. Therefore, investors who cannot claim § 8b KStG, i.e. natural persons – where the German partial income system pursuant to § 17 EStG applies – and certain finance and insurance companies would especially be materially affected.

Practical problems of application might arise concerning the method by which the existence of the required criteria can be determined or reviewed in the future. Non-resident shareholders of corporations – particularly those with micro shares – usually do not have the necessary information to derive and determine whether the share value of the corporation in the year preceding the disposal was based on more than 50% of real estate assets in Germany.

Moreover, the application of the 365-day period could be difficult, if e.g. a complete disposal of the real estate by the foreign corporation is followed by a sale of shares by a shareholder, and the 365-day-period has (formally) not expired yet. The capital gain arising from the sale of the real estate itself is already taxed at the level of the real estate owning corporation, see § 49 Sec. 1, No. 2, letter f), double letter bb).

Further developments

The finalisation of the legislative process is planned before the end of this year. Further developments and the specific version of the final legislation remain to be seen. Given that many related questions remain unanswered, changes cannot be ruled out.

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DEVELOPMENTS IN RELATION TO TAX COMPLIANCE MANAGEMENT SYSTEMS

The subject of tax compliance management is currently on the agenda of many German companies. The technical capabilities that tax authorities have for analysis are constantly improving, allowing inaccuracies and errors in taxpayers' returns to be identified more quickly. In addition, digital communications, automated processing and the introduction of an IT-based risk-management system for allocating taxpayers to particular risk groups are issues that have long been the subject of intensive work on the part of the German tax authorities. Furthermore, the tax authorities are increasingly expanding their opportunities for technical analysis by targeted requests for data from electronically generated financial statements, reporting processes and through international exchange of information and ongoing initiatives such as the BEPS project launched by the OECD and the G20 group of countries.

Whether errors or omissions are identified by the tax authorities or by the company itself, they must be promptly rectified. Under German law, rectification will result in penalties unless the original return was 'subjectively correct' at the time of filing (Article 153 of the Tax Code – *Abgabenordnung* (AO)) and the error is neither wilful nor careless. Determining whether wilful or careless conduct has taken place is difficult, as this is largely done by reference to subjective factors. Even conditional intent, i.e. a suspicion and a tacit acceptance, will be deemed to be wilful tax evasion.

On the part of the tax authorities, the significance of a Tax compliance management system (CMS) for determining whether wilful or careless conduct has taken place was clarified by a letter dated 23 May 2016 from the Federal Ministry of Finance concerning Article 153 AO. According to the letter, an 'internal control system' for ensuring tax compliance can serve as a defence against a presumption of wilfulness or carelessness. The effectiveness of a Tax CMS as a means of mitigating the level of penalties has, moreover, been emphasised in a judgment of 9 May 2017 of the Federal Supreme Court (*Bundesgerichtshof*).

Thus, the implementation of a properly designed and effective Tax CMS is extremely important for a business and its administrative bodies, in view of the introduction of more stringent regulations and the threat of sanctions. Only in this way can boards of directors and managing executives demonstrate in the worst-case scenario that they have not tacitly assented to incorrect or incomplete tax returns, but have, to the contrary, managed to establish clear processes and structures for the avoidance of errors.

Designing a Tax Compliance Management System (Tax CMS)

An internal control system for compliance with tax regulations should be designed as an integral part of a comprehensive compliance management system. A suitable basis for the design concept of such a system would be the generally recognised and proven Auditing Standard IDW 980 of the German Institute of Certified Public Accountants (*Institut der Wirtschaftsprüfer*) ('Principles for the Audit of Compliance Management Systems') and the Practice Direction 1/2016 ('Design and Audit of a Tax Compliance Management System under Standard IDW 980 of the [German] Institute of Certified Public Accountants') derived from it.

The model is based on the following seven principal elements:

1) Culture;
2) Objectives;
3) Risks;
4) Programme;
5) Organisation;
6) Communication; and
7) Monitoring and Improvement.

1) The **tax compliance culture**, on which the degree of seriousness that the employees place on observing tax regulations and properly complying with tax obligations has a decisive influence, has a special significance in this context. This culture is crucially dependent on the attitude and behaviour of management and how it communicates internally. The requisite values and desired behaviour can be communicated and documented, for example, by a code of conduct or written (tax) guidelines and tax strategies.

2) The systematic identification and evaluation of material areas and the setting of **tax compliance objectives** takes place in line with the overall objectives of the business.

3) **Tax compliance risks**, i.e. risks that breaches of the regulations may occur, can then be evaluated according to the likelihood of their occurrence and the possible consequences. Due to its fundamental nature, the analysis of objectives and risk is particularly important. For this reason, an appropriate time period should be set aside for this in planning the design phase. Tax risk often arises in the course of operating processes (e.g. processes of sales, human resources, IT-departments) that are not managed or supervised by the tax department. It is therefore also essential to take into consideration areas of the business other than the tax department.

4) Reaction to identified risks is laid down in the **tax compliance programme**. Documentation in so-called risk-control matrices has proved to be of great practical value in this regard. In the ideal case, the appropriate risk-management measures have a preventive, therefore error-minimising, effect here. Whereas absolute safety cannot be guaranteed even by this method, it is possible by taking the appropriate (detective) measures to ensure that breaches of the regulations will be detected promptly.

5) **Tax compliance organisation**, i.e. rules for organising development and operations, represents a particular challenge in practice. This can be tackled by integrating Tax CMS and the tax department as far as possible into the CMS of the business as a whole.

6) **Tax compliance communication** – The employees involved and also, where appropriate, third parties must moreover be informed of the requirements, duties and parts of the tax compliance programme that are respectively applicable to them and of the roles that have been assigned to them. Reporting channels – content, rotas and recipients – and, by no means least, the opportunities and instructions for reporting breaches of the regulations must also be defined.

7) **Tax compliance monitoring and improvement** – Against the background of current legislation, it is essential in this respect that the board and the management also convince themselves of the effectiveness of the CMS. This requires proper monitoring of compliance with measures forming part of the tax compliance programme, process workflows, awareness of necessary educational and advanced training measures and the interface with external service providers. In this connection, it can be successfully ensured that changes in the framework conditions or in processes can at the same time be recognised and the Tax CMS can be correspondingly optimised.

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HUNGARY

RECENT TAX CHANGES

On 20 July 2018 the Hungarian Parliament approved many amendments to the Hungarian tax legislation regarding corporate income tax, VAT, the innovation contribution and other taxes. Most of the changes will come into force from 1 January 2019, but we also highlight some important mid-year changes.

Changes to corporate income tax

The definition of 'notified share' and the corresponding tax base deduction have been modified in favour of the taxable person: under the accepted proposal, the preferential rules can be applied in the case of changes in the form of a company, mergers and divisions – without a new notification. The proposal comes into force on the 31st day after its publication, so it can be applied this year and – based on a transitional rule – also in the case of shares acquired after 31 December 2017, depending on the taxpayer's decision. Under the latter option, the taxpayer needs to notify the tax authority within 75 days after the law comes into force.

It is also beneficial for taxpayers that the maximum CIT base reduction per tax year due to creating so-called development reserves has been increased from HUF 500 million to HUF 10 billion (subject to a limit of 50% of the pre-tax profit).

The tax base deduction for research and development (R&D) costs has also been significantly amended: in connection with the research of own activity and the direct costs of experimental development, the customer and the service provider may share the tax base reducing item, according to their common agreement as agreed between themselves. However, this cannot be applied together with the division of R&D costs among related parties.

The definition of 'investments to comply with energy efficiency targets' is also expanded. As a result of the accepted modifications, the tax allowance can be requested not only for investments, but also for renovations.

Changes in value added tax

- In order to keep within the EU Guidelines, a new section appeared in the VAT Act, which includes regulations in relation to voucher supplies. There are two types of voucher: single-purpose vouchers and multi-purpose vouchers. The most significant difference between them is that in the case of single-purpose vouchers, the place of supply in connection with the voucher's subject is already known when issuing the voucher (as also is the payable VAT amount). However, this information is not available with multi-purpose vouchers. Every handover of single-purpose vouchers generates VAT payment obligation; however, in the case of multi-purpose vouchers no VAT payment obligation is generated when issuing, distributing or handing over the voucher; VAT is payable when the voucher is used.
- From 1 January 2019, long-lasting (and especially heat-treated, UHT and ESL) milks are added to the list of super-reduced rated products (5%), and from next year the VAT rate will decrease to 5% from 27%.
- The application of reverse-charge taxation is extended until 30 June 2022 in the case of grain and steel industrial products. Furthermore, from 1 January 2021 in the case of temporary agency work (placement of personnel) the reverse charge taxation will only be possible in relation to construction and other similar work, secondment and provision of staff.

Changes in personal income tax

The most significant change in relation to personal income tax is the transformation of the cafeteria system: the number of items which can be given to employees with preferential taxation are reduced.

It appears that from 2019 mainly the so-called SZÉP cards (available for hospitality, inland hotels and recreation) and a few other items can be provided at a favourable tax rate.

Changes in innovation contribution

From 1 January 2019 the previous provision which had been repealed a few years ago becomes effective again. This means that the classification of micro and small businesses will have to take into account the data of affiliated companies, rather than only taking the separate company's figures. As a result of the accepted change, the number of those who are subjected to innovation contribution may increase from 1 January.

Changes in local taxes

Due to the new provisions, from 1 January 2019 Local Authorities are entitled to assess tax or tax base allowances on the value of an investment of the entrepreneur (or on a part of the investment) that has been made in the tax year.

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NORWAY

NATIONAL BUDGET 2019

Proposed changes in the rules on corporate tax residency

The Norwegian Government has proposed amendments in the rules on corporate tax residency. The aim is to address tax avoidance strategies and to ensure that companies with sufficient connection to Norway are deemed resident and liable to pay taxes for their worldwide income in Norway.

Current rules

A foreign company is deemed tax resident in Norway if the company's actual management at board level takes place in Norway.

For companies incorporated in Norway, effective management at board level is just one of several factors in the overall assessment regarding tax residency. Location of the central administration/daily management, distribution of responsibilities between different bodies in Norway and abroad, location of the general assembly meetings and application of Norwegian company law are additional factors which may be relevant in the overall assessment.

The proposal

The proposal implies that companies incorporated in Norway will be deemed tax resident here. Foreign companies will be deemed resident in Norway if the effective management is performed in Norway.

Compared to the current rules, the proposal entails a broader assessment to decide where a foreign company is tax resident. The assessment will be similar to the assessment in OECD Model Convention Article 4 (3).

A company resident in another state under a tax treaty will not be deemed resident in Norway. Nevertheless, these companies are obliged to file tax papers in Norway.

The proposed rules will, if passed by the Parliament, take effect from 1 January 2019.

Proposed changes in the Norwegian interest limitation rules

Current rules – Restrictions on related party interest

In 2014 Norway introduced interest limitation rules restricting deductibility on interest on related party debt and debt secured by related parties. A related party loan is deemed to exist where an entity or individual party to a loan agreement directly or indirectly owns at least 50% or exercise at least 50% control over the other party to the same loan agreement. The rules apply if the single entity has net interest expenses in excess of NOK 5 million. If the net interest expenses exceed NOK 5 million interests on related party debt is only deductible within 25% of the company's taxable EBITDA, but also only if the 25% allowance is not consumed by interest on external debt. If interest on external debt exceeds 25% of the taxable EBITDA all of the related party interest costs will be restricted (but there is no limitation in the deductibility of the interest on the external debt). Restricted interest can be carried forward for a period of up to ten years. Carried forward restricted interest is deducted prior to current year interest once there is room for such deductions.

As related party interest expenses are limited by taxable EBITDA it means that dividend income will not provide room for interest deductions as these to a large degree are exempt under participation exemption rules. On the other hand, taxable group contributions from another Norwegian group entity will be included in the tax EBITDA. The latter aspect of the current rules has been deemed a restriction under the EEA agreement by ESA. As a response, the Norwegian government notified ESA that it was working with new rules that would address this issue, whilst at the same time stating its disagreement.

New rules – Extension to external interest expenses

After a public sounding in the spring/summer of 2017 the ministry stated that it was working with new rules that it intended to present in time for them to enter into force from 1 January 2019. The proposal for new rules was presented in the budget for 2019 on 8 October 2018.

The main change in the proposal is that the interest limitation rules for Norwegian companies that are part of a group will be extended to third party interest expenses. The new rules will apply only when the Norwegian companies that form part of a group have combined net interest expenses over NOK 25 million. For companies in a group with interest expenses above the threshold, both related party and external interest expenses will be subject to restrictions if they exceed 25% of the tax EBITDA.

A group is deemed to exist where the companies in question are consolidated on a line by line basis in a group consolidated account prepared under IFRS, Norwegian GAAP, US GAAP, any EEA GAAP or Japanese GAAP. In addition, it will also be a group if such consolidation should have been done under IFRS (if this was applicable). Only companies that are (or could be) consolidated on a line by line basis in the group consolidated accounts are included in the group for the purpose of the new rules. Please note that if consolidation is not mandatory or done under IFRS such as may be the case where a top parent company is an investment vehicle (a sub group may be deemed to exist underneath such an investment vehicle), the 'group' will be limited to the companies subject to mandatory consolidation grouping under IFRS.

Aimed at profit shifting – Escape clauses

The main objective behind the rules is to prevent profit shifting. Consequently, the new rules contain escape clauses that aim to shield third party debt that is not used for profit shifting based on a comparison of equity ratios. The rules contain two alternative escape clauses:

- Single entity level – If the company in question has an equity to assets ratio higher or similar to that of the consolidated group at top global level, all interest expenses are tax-deductible. (We note that 'similar' allows an equity ratio that is 2% lower than the ratio of the consolidated group.);
- The Norwegian part of the group – If the Norwegian part of the group has a consolidated equity to assets ratio higher or similar to that of the consolidated group at top global level, all interest expenses are tax deductible.

The comparison in both cases should be made with an actual consolidated balance sheet of the top group entity globally as at the end of the prior year. This means that the balance sheet as at 31.12.18 will be important in the assessment of the applicability of the escape clauses above. If the companies in Norway are not consolidated into an actual consolidated group balance sheet, but would have been under IFRS, a consolidated balance sheet must be prepared under IFRS to enable use of the escape clauses. If a company higher up the chain than the top company that applies accepted accounting principles applies other accounting principles, it must be clarified if this higher tier company would have been obliged to prepare consolidated accounts where the Norwegian entity would be consolidated on a line by line basis under IFRS. In that event, such consolidated accounts must also be prepared to enable use of the escape clause.

The single entity accounts and/or the Norwegian group consolidated accounts must be prepared based on the same principles as the top group consolidated accounts. Before computing the equity to assets ratio, the rules require that certain adjustments are made to the single entity accounts:

- Positive goodwill in the consolidated accounts attributable to the company should be added to both balance sheet total and equity. Badwill in the consolidated accounts attributable to the company should be deducted from the balance sheet total and equity.
- Excess values recognised in the consolidated accounts attributable to the company should be added to the balance sheet total and equity. If the values recognised in the consolidated accounts attributable to the company are lower, the difference should be deducted from the balance sheet total and equity.
- Deferred tax liabilities related to the excess values that are added to the balance sheet total and equity should be deducted from the equity. A deferred tax asset related to lower values that reduces the balance sheet total and equity should be added to the equity.
- If the debt of the company is booked at a higher value in the consolidated accounts than in the single entity accounts, the difference should be added to the balance sheet total and equity. If the debt is booked at a lower value in the consolidated accounts than in the single entity accounts, the difference should be deducted from the balance sheet total and equity.
- Shares in companies that are consolidated line by line in the consolidated accounts that the global group equity ratio is based upon are deducted from the balance sheet total and equity of the company.
- Receivables on companies that are consolidated line by line in the consolidated accounts that the global group equity ratio is based upon are deducted from the balance sheet total and equity of the company.

Similar adjustments must also be made to the Norwegian consolidated accounts under the second escape clause.

An important aspect of the escape clause is that Norwegian groups without subsidiaries or branches abroad will always meet the condition under the second alternative. As such, these group companies are not required to prepare the documentation that will otherwise have to be prepared and also signed off by the auditor.

Interest on related party loans from companies that are not part of the consolidated group

Please note that if the escape clauses are applied, interest expenses on debt from related parties that is not part of the consolidated group will continue to be subject to the current interest limitation rules that will continue to exist together with the group extension. I.e. the interest is only deductible within 25% of the tax EBITDA if the net interest expenses of the company are above NOK 5 million. These rules will also apply to Norwegian companies that are not part of a consolidated group.

In addition, if the first escape clause is applied, group contributions from such companies may not be included in the tax EBITDA of companies that do not apply an escape clause.

Carry forward of restricted interest

Restricted interest deductions can be carried forward for up to ten years. However, as the oldest interest is deducted prior to current year interest expenses, the carry forward period is for practical purposes often longer.

For a company that is part of a group which is subject to the interest limitation rules any prior year restricted interest can be deducted within 25% of the EBITDA (together with current year interest.) If the company makes use of the escape clause, prior year restricted interest can also be deducted, but only within the current year interest expenses. As such, if 25% of the tax EBITDA of a group company is higher than current year interest expenses, it may be more beneficial not to claim use of the escape clause.

For a company that is part of a group that is not comprised by the interest limitation rules, the higher of current year interest and 25% of the tax EBITDA should also be available for use of restricted interest carried forward. However, this needs further clarification.

End note

The new rules are highly complex and will require both tax and IFRS expertise to ensure correct compliance and to benefit from the escape clauses. There are no exemptions for real estate or public infrastructure industry, and these industries may be adversely affected by the new rules if the Norwegian companies are part of multinational consolidated group.

Certain aspects of the proposal are unclear, and clarification may be provided that will differ from our assumptions. The ministry of Finance will also present technical details in regulations that may impact our understanding and assumptions. Finally, this is a proposal and has not yet been approved by parliament.

This article is therefore for information only, and no tax planning should be based on it.

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POLAND

INNOVATION BOX – 5% TAX RATE ON INTELLECTUAL PROPERTY RIGHTS INCOME AND OTHER PREFERENCES

In 2019, a new tax incentive for investors will be introduced in Poland – the so-called 'Innovation box', also known as a 'Patent box'. This incentive will apply a preferential 5% tax rate to income generated from intellectual property rights. It places Poland as one of the most advantageous tax regimes of this type in Europe.

Criteria for the use of a reduced tax rate

The condition for using the preferential tax rate is that the Polish taxpayer carries out its own research and development (R&D) activity in relation to the development, creation or improvement of the intellectual property component. In such a situation, the income from the following intellectual property rights may be subject to a preferential tax rate:

- Patents;
- Protective laws for a utility model;
- Rights from the registration of an industrial design;
- Rights from registration of the integrated circuit topography;
- Additional protection rights for a patent for a medicinal product or a plant protection product;
- Rights of registration of a medicinal and veterinary product authorised for marketing;
- Computer program copyrights;
- Specific plant protection laws.

An additional condition for benefiting from the preferential tax rate will be an obligation to separate the qualified income in the accounting books.

Qualifying income

The amount of income covered by the preferential rate will be determined on the basis of the proportion based on the costs incurred in connection with the R&D activity associated with these rights. **Significantly, the acquisition of the results of R&D work, as well as the acquisition of intellectual property rights itself, are also considered to be such a cost.**

The spectrum of income covered by the preferential rate will be fairly wide, including:

- Fees or charges arising from a license agreement relating to the qualifying intellectual property right;
- The sale of qualifying intellectual property rights;
- The qualifying intellectual property right included in the selling price of the product or service;
- Compensation for infringement of rights resulting from a qualifying intellectual property, if it has been obtained in litigation, including court proceedings or arbitration.

Administrative requirements

Taxpayers benefiting from this preferential rate will be subject to additional formal obligations, which should not be too burdensome. They will be obliged to:

- Identify each qualifying intellectual property right in their accounting records;
- Keep accounting records in a manner that ensures determination of revenues, tax deductible costs, and income/loss attributable to each qualifying intellectual property right;
- Isolate the costs in relation to each qualifying intellectual property right, in such a way that ensures the determination of qualifying income;
- Make entries in their accounting records in a way that ensures the determination of the total income from these qualifying intellectual property rights;
- Make entries in their accounting records in a manner ensuring the determination of income from qualifying intellectual property rights in respect of each product or service, if the taxpayer uses one or more qualifying intellectual property rights in a product or service or in products or services.

Innovation box as an element of broader tax incentives for innovative activity

Since the beginning of 2017, the so-called 'R&D relief' has been available in Poland. This enables a deduction from the tax base of the tax-deductible costs incurred in carrying out R&D. This tax relief is based on the fact that eligible R&D expenses affect the amount of the tax base twice: firstly, such expenses constitute a tax cost at the income determination stage – they reduce revenues; then, the income so determined, which is in general the tax base, is reduced again by the same expenses, but up to a maximum of 50% of these expenses. Ultimately, the taxpayer, after fulfilling certain conditions, may therefore include 150% of R&D costs in tax costs. The fairly wide list of expenses that can benefit from this incentive includes:

- Expenditure on staff employed to carry out R&D activities, including insurance premiums;
- Acquisition of materials and raw materials directly related to the R&D activity carried out;
- Expert opinions, opinions, advisory services and equivalent services, as well as the acquisition of scientific research results, provided or performed on the basis of a contract by a research unit within the meaning of the Act on the principles of financing science for the needs of R&D;
- Acquisition of non-fixed equipment for specialist equipment used directly in R&D activities, in particular laboratory utensils and accessories as well as measuring devices;
- Paid use of scientific and research equipment used exclusively in R&D activities, if this use does not result from the contract concluded with an entity related to the taxpayer within the meaning of Art. 11 Para. 1 and 4 CIT;
- Specific costs of obtaining and maintaining a patent, protection rights for a utility model, and rights from registration of an industrial design.

However, the above costs on preferential terms can only be settled in relation to tax revenues from sources other than capital gains.

In addition, this incentive applies only to the stage of developing new solutions. In contrast, the innovation box introduced from 2019 concerns the stage at which the effects of these works are already generating income. Thus, both tax reliefs significantly complement each other and constitute significant tax incentives, in particular for entities from economic sectors in which R&D constitutes a significant part of their activity, e.g. in the electronics, pharmaceutical, machinery or IT sectors. Therefore, it may be particularly beneficial to locate R&D activity and intellectual property rights themselves, which generate income, in Poland. These tax reliefs may be applied simultaneously, so tax benefits can be significant.

9% corporate income tax rate for smaller entrepreneurs

However, these are not the only tax incentives in Poland. In 2019, a preferential CIT rate of 9% will be available. Once certain conditions are met, it will be available to taxpayers whose revenues will not exceed EUR 1.2 million in the tax year. This rate cannot be applied only to capital gains. These provisions are also subject to anti-abusive conditions, in order to counteract artificial transfers of property to entities that have the right to apply such a rate. However, if the assets are transferred to such a company, the right to apply the 9% CIT rate will be excluded only in the tax year in which the contribution was made and in the following year.

Example

PolCo's first tax period lasted from 30.6.2018 to 31.12.2018. During this period, an organised part of the DutchCo company was brought into PolCo. Therefore, PolCo will apply a 19% CIT rate only in its first tax year and the tax year from 1 January 2019 to 31 December 2019. From 2020, PolCo will be able to apply a preferential 9% CIT rate.

The taxpayer will, therefore, be subject to tax on income from intellectual property rights at a 5% tax rate. However, if it also receives income that is not subject to this tax rate, that will be taxed at the 9% rate. If, at the same time, it carries out R&D activities, it will be entitled to deduct 150% of expenses for tax purposes. Therefore, tax benefits may be significant for entities with an appropriate profile.

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UNITED KINGDOM

2018 BUDGET

The Chancellor delivered the 2018 Budget on 29 October 2018, with the positive message that austerity is ending as a result of the hard work of the British people and the Government's balanced approach to public finances. However, facing funding constraints which include a commitment to an additional GBP 20 billion for the National Health Service and the need to maintain a Brexit contingency fund, he warned that fiscal discipline would continue. He also warned that there might still be a need to upgrade the Spring Statement to a full Budget event, depending on the Brexit outcome.

The tax changes and consultations that were announced include tax savings for business focused towards investment and innovation. For individuals, the promised increases in personal allowances and the higher rate threshold will take effect one year earlier than planned.

In this article we highlight the main tax proposals.

International corporate taxes

- A Digital Services Tax in the form of a 2% tax on turnover derived from certain business activities will be introduced from 1 April 2020. Subject to consultation, the in-scope business activities are search engines, social media platforms and online marketplaces, where those activities are linked to the participation of UK users. There will be a GBP 25 million allowance, and the tax will only apply to businesses that generate revenues from in-scope activities of more than GBP 500 million per annum. The proposed measures include a safe harbour to protect loss-making businesses or businesses with very low profit margins from the scope of the tax. The tax is very likely to be outside the scope of existing tax treaties.
- The Diverted Profits Tax (DPT) rules will be amended to clarify that diverted profits will be taxed under either DPT or corporation tax provisions, but not both. The changes will also stop a planning opportunity from amendments being made to a company's corporation tax return after the review period has ended and the DPT time limit has expired. In addition, changes will be made to:
  - Extend the 'review period' in which HMRC and the taxpayer work together to determine the extent of diverted profits, from twelve months to fifteen months;
  - Extend a company's right to amend their corporation tax return to include diverted profits to the first 12 months of the review period;
  - Make clear that diverted profits liable to DPT can be reduced by amendment to the company's corporation tax return during the first twelve months of the review period.
- The UK definition of permanent establishment (PE) will be changed in line with OECD and G20 BEPS Report recommendations. An anti-fragmentation rule will be adopted in UK tax treaties through the Multi-Lateral Instrument signed in June 2017. This rule aims to prevent a foreign business from fragmenting complementary functions, otherwise forming part of a cohesive business operation, between locations or among related companies. This was previously used by companies to claim that each of the fragmented operations were preparatory or auxiliary and did not create a PE in the UK. The new rule will require the activities to be considered together to determine whether a PE exists.

Business taxes

- The Annual Investment Allowance, which provides a 100% deduction for the cost of purchasing eligible plant and machinery, will be temporarily increased from GBP 200,000 to GBP 1 million for two years from 1 January 2019.
- A new Structures and Buildings Allowance will be introduced for qualifying construction or renovation costs of new non-residential structures and buildings incurred on or after 29 October 2018 under contracts entered into on or after that date. Relief will be given on the original construction or renovation cost of the property across a fixed 50-year period at the rate of 2% per annum on a straight-line basis. Structures and buildings include offices, retail and wholesale premises, walls, bridges, tunnels, factories and warehouses. Expenditure on land or acquiring rights over land and the associated legal and stamp duty costs will not qualify.
- The writing down allowance for plant and machinery that qualifies for capital allowances at the special rate will reduce from 8% to 6% from April 2019. Special rate expenditure includes that on qualifying long-life assets, thermal insulation, integral features and cars with CO_2 emissions of more than 110 g/km.
- The Enhanced Capital Allowance (ECA) for energy- and water-efficient plant and machinery will end from April 2020.
- Subject to consultation, the payable tax credit available to loss-making SMEs carrying out qualifying research and development activities will be restricted to three times the company's total PAYE and NIC liability on employee costs, for accounting periods beginning on or after 1 April 2020.
- Subject to consultation, tax relief will be available for the amortisation of goodwill on the acquisition of businesses with eligible intellectual property with effect from 1 April 2019.
- Income derived from intangible property held in low-tax jurisdictions to the extent that it relates to UK sales will be taxable from 1 April 2019. The tax will be collected via a direct assessment on the owner of the intangible property.
- Subject to consultation, the proportion of annual corporate capital gains that can be relieved by brought forward capital losses will be restricted to 50% from 1 April 2020, in line with the treatment for income losses. The restriction will not apply to the first GBP 5 million of carry forward loss utilisation (whether capital or income-type losses). However, capital losses will continue to be streamed against chargeable gains, and a mechanism for transferring gains/losses intragroup will be retained.
- UK Real Estate Investment Trusts (REITs) will, subject to certain exemptions, from April 2019 be able to sell special purpose UK property owning companies without triggering a UK tax charge. Previously UK REITs generally would sell the property to fall within the REIT exemption for gains. However, from April 2019 non-resident investors in UK REITs who are not taxable only by virtue of non-residence may, if treated as investing in a UK property rich collective investment vehicle, be subject to UK taxation on the disposal of their shares.

Personal taxes

- The income tax personal allowance will go up to GBP 12,500 (from GBP 11,850) and the basic rate band will be increased to GBP 37,500 (from GBP 34,500) from 6 April 2019 – a year earlier than previously announced – so taxpayers with incomes of less than GBP 50,000 a year will only pay 20% income tax. However, the reduction in income tax liabilities will be partly clawed back by an increase in National Insurance contributions.
- Two additional tests will need to be satisfied before capital gains tax Entrepreneurs Relief (ER) is available on disposals of shares in a 'personal company' from 29 October 2018. The existing condition that an individual must hold at least 5% of the ordinary share capital and votes will be extended to:
  - 5% of distributable profits (dividends); and
  - 5% of assets available on a winding up of the company.

The holding period for business assets and shares held by individuals to qualify for ER will be increased from twelve months to two years, for disposals made on or after 6 April 2019.

Employment taxes

- The 'IR35' rules for public sector bodies engaging workers through Personal Service Companies (PSCs) will be extended to large and medium sized private sector organisations from April 2020. If the organisation engaging the worker thinks IR35 applies, it will be responsible for operating PAYE income tax and National Insurance contributions on the payment it makes to the PSC.
- Eligibility for the special PAYE arrangements for Short-Term Business Visitors to the UK will be widened, and the deadlines for reporting and paying tax will be extended, from April 2020. This should reduce the administrative burden on employers.

Indirect taxes

- The VAT registration and deregistration thresholds will be frozen at GBP 85,000 and GBP 83,000 respectively until 31 March 2022.
- An individual or a partnership will be allowed to join a VAT group from 1 April 2019, provided it controls the companies it is grouped with and is entitled to register for VAT in its own right.
- A domestic reverse charge on the supply of certain construction services made in the UK will be introduced with effect from 1 October 2019.
- The VAT treatment of vouchers issued on or after 1 January 2019 will be changed so that:
  - Many more vouchers will become Single Purpose Vouchers (SPVs), where the VAT rate applicable and the place of supply of the goods or services is known when the voucher is sold, and the VAT is accounted for when the voucher is sold, not when the goods or services are purchased using the voucher. The issue and sale of such a voucher will be treated as a supply of the underlying goods or services, with VAT due as appropriate.
  - A voucher which is not an SPV will be called a Multi-Purpose Voucher (MPV), where the place of supply or the rate applicable to the goods or services purchased is not known at the time that the voucher is issued. VAT will only be due when the MPV voucher is actually used, from the person who redeemed the voucher on the price that the last person paid for the voucher and not the price for which it was first sold. If that price paid by the final person is not available, VAT would be due on the face value of the voucher.
  - The issue and sale of an MPV is defined not to be a supply for VAT purposes. No VAT will therefore be due on the issue or sale of an MPV, and VAT will not be recoverable in respect of the issue or the sale of such vouchers.

Other taxes

- A new tax on the production and import of plastic packaging containing less than 30% recycled content will be introduced from 1 April 2022. Details of how the new tax will work will be the subject of consultation.
- A surcharge of 1% to Stamp Duty Land Tax rates is proposed for the purchase of residential property in England and Northern Ireland by non-residents. This proposal will be subject to a consultation to be published in January 2019.

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ARGENTINA

BUDGET BILL 2019 – FISCAL AMENDMENTS

The Budget Bill for the year 2019 raised by the Executive Power for consideration by the National Congress contains numerous and significant changes to the different taxes that apply in the country. We summarise the main proposals below.

Income tax

Elimination of exemptions

As from 2019 provisions which establish total or partial exemptions or deductions for public and other employees, retired individuals and pensioners, among others, will cease to apply.

In addition, the saving, credit, financial, insurance and reinsurance activities of cooperative and mutual associations will no longer be exempt, regardless of the way in which they are carried on, except for Occupational Risk Insurers and mutual associations that act as pension funds for their associates.

Value added tax

The following changes are proposed with effect from 1 January 2019:

Construction of Social Housing

Work on the construction of social housing will be exempt from Value Added Tax, and businesses that carry out the work will be able to deduct the tax invoiced for goods or services that have been effectively applied to that work against the tax arising from other taxable operations. If this is not possible or if it is only partially deductible, the balance will be credited against other taxes or otherwise refunded.

Books, brochures, and similar printed matter

The same treatment mentioned above will apply to businesses engaged in printing books, brochures and similar printed matter, even in instalments or loose sheets.

Capital goods

Manufacturers or importers of capital goods may request the reimbursement of input tax related to the trade of such goods.

Customs duties

The following changes are proposed with effect from 1 January 2019:

Exemptions

The import of goods for use in the passenger and cargo railway transport network will be exempt from import duties and Value Added Tax.

Export duties

The Executive Power may impose export duties at a rate of up to 33% of the FOB value of the goods until 31 December 2020.

Export of Services

The supply of services performed in the country, whose use or effective exploitation is carried out abroad, will be included within the scope of the Customs Code. This implies that from 1 January 2019 export duties may be applied on these operations.

Tax procedure

Tax secrecy

The tax secrecy conditions imposed on Foreign Tax Authorities in relation to the disclosure of information in the context of the International Cooperation Agreement entered into by the Tax Authority will be eased.

Tax Value Unit

The period in which the Executive Power can raise the bill which creates the Tax Value Unit, for the purposes of determining fixed amounts, scales, sanctions and any other monetary parameter referred to in the tax regulations, is extended until 15 September 2019.

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BRAZIL

IMPLEMENTATION OF OWNERSHIP DISCLOSURE REQUIREMENTS FOR BRAZILIAN CORPORATE TAXPAYERS

In 2016 the Brazilian Tax Authorities published Normative Instruction (NI) 1,634/2016, followed by NI 1,684/2016 and NI 1,729/2017, which introduced significant changes to the regulatory rules in relation to a Brazilian corporate taxpayer's ID (known as the 'CNPJ') held by foreign investors in Brazil. The effective dates for the changes, in 2017 and 2018, are set out below.

Main modifications

The modifications introduced by the NI include the obligation, with certain exceptions, for Brazilian resident entities to disclose their respective foreign chain of ownership to indicate their ultimate beneficial owner. The new disclosure requirements are in line with international guidelines to improve transparency and facilitate a more effective battle against corruption and money laundering.

The concept of ultimate beneficiary includes:

a) Individuals who directly or indirectly ultimately own or exercise significant influence or control over the Brazilian entity;

b) Individuals on whose behalf a transaction is carried out.

Significant influence, in turn, can be understood as:

a) Direct or indirect ownership of more than 25% of the Brazilian company; or

b) The right to hold or to exercise the power to make corporate resolutions as well as the power to elect a majority of the entity's management, even without controlling it.

The NI also introduced the requirement to disclose the Legal Entity Identifier (LEI) for companies that possess this identifier, which is part of an international registry which aims to increase the safety of international financial transactions.

Practical consequences

If an entity does not comply with the new requirements, its CNPJ will be suspended and the company's transactions with financial institutions will be completely blocked. Furthermore, without a valid CNPJ, a Brazilian resident company will be unable to issue invoices or make purchases.

Effective date

The NI entered in force on 1 June 2016, but the deadline for disclosing the ultimate beneficial owner depends on the circumstances, as described below:

(a) As from 1 July 2017, for entities that were formed on or after that date;

(b) From 1 July 2017 to 31 December 2018, for entities registered in the CNPJ before 1 July 2017, and which:

  i. Carry out any amendment in its registration; or

  ii. Advise the absence of an ultimate beneficial owner, as from 1 July 2017.

BDO in Brazil can provide any clarification on this matter and assist on the regularisation of a company's CNPJ registration to comply with the relevant legislation.

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CHILE

AUTOMATIC EXCHANGE OF INFORMATION FOR FINANCIAL INSTITUTIONS IN CHILE: FROM FACTA TO GATCA

Background

In 2013, Chile and Latin American countries received the Foreign Account Tax Compliance Act (FATCA) with many questions and complaints – it was a massive game-changing development for banks and financial institutions. Compliance officers and executives had complaints regarding the new regulation and the high costs for the new internal law from the USA with international and global effects. At the time there were discussions regarding whether Chile was able to fulfil and comply with the requests from the Internal Revenue Service (IRS) due to banking secrecy. However, OECD rules and guidelines were also pushing to lift banking secrecy.

Current position

The Common Reporting Standard (CRS, or informally also called GATCA – the global version of FATCA) is now in place, and Chile has already signed the Multilateral Agreement on its implementation. The Multilateral Competent Authority Agreement (MCAA) is a multilateral framework agreement that provides a standardised and efficient mechanism to facilitate the automatic exchange of information in accordance with the Standard for Automatic Exchange of Financial Information in Tax Matters (the Standard). This is very similar to the Intergovernmental Agreements (IGAs), and in fact the Standards are based on and influenced by the agreements from FACTA.

It is important to bear in mind that Chile has signed a number of Conventions for Avoiding Double Taxation as well as The Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MAAT). All these treaties contain articles that regulate and promote the exchange of information between the countries.

Therefore, for complying with these international agreements for the exchange of information from financial institutions, Chile recently added a new Article 62 Ter to the Tax Code in November 2017 which is now in force (Law 21047). The ruling that comes together with the new legislation sets out the procedures for fulfilling the above-mentioned international agreement (Resolucion 48, 2018).

Information that the Chile IRS can now request

The Chile IRS can now therefore request any reserved and undisclosed information that meets the requirements of the law. The information requested must:

a) Relate to the holders of financial accounts or controllers of those owners who are natural persons, legal entities or entities that are tax resident in another jurisdiction. This includes details of any wealth held on the death of a person who at the time of dying was a resident of any other jurisdiction, or legal entities that do not have a tax residence in Chile and whose effective administration is carried out in another jurisdiction;

b) Be related to the balance, value of the accounts or financial instruments belonging to the owners or controllers indicated in Paragraph a) above, as of 31 December of each year or at the closing date of the accounts. It also includes details of any payment made to those owners or controllers; and

c) Be held by qualified financial institutions in accordance with a current international agreement that provides for the exchange of information on financial accounts.

In addition, financial institutions must deliver to the Chile IRS the information indicated in the previous paragraph no later than 30 June each year, by the means established by the Service.

For this purpose, financial institutions must keep a record of the review procedures made to identify the accounts information that must be communicated to the Chilean IRS. These records, together with backup information, must be kept for seven years from the date on which the financial institution received and recorded the information required to comply with the procedures to which the present article refers. In any case, the Service may not request information that exceeds that period.

Any failure to comply with the obligation to carry out the account identification and financial information procedures, to deliver the information in a timely and complete manner, and to keep the necessary records, will be sanctioned with fines. In addition, the delivery of false or untruthful information by the account holder or their controllers (including from abroad as mentioned) to the financial institution will be sanctioned with fines.

Finally, information obtained by the Chile IRS may not be disclosed in any way and may only be used to comply and fulfil the purposes of information exchange regulated by the current international agreements that allow the exchange of information between tax authorities. Moreover, in Chile the provisions of this new legislation will be applied and interpreted following the recommendations of the OECD and the United Nations.

It is important to mention that the Chile IRS has implemented a link for uploading any information required (the 'CRS XML schema'). This platform allows the Chilean tax authority to share the information automatically with 91 countries worldwide.

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PANAMA

BEPS-RELATED CHANGES TO PANAMA'S SPECIAL TAX REGIMES

Since the OECD included Panama in its blacklist of non-compliant jurisdictions in 2000, the government of Panama has made great efforts in cleaning its name and improving its image. Building a large treaty network was the first step; however, the OECD/G20 Base Erosion Profit Shifting (BEPS) fifteen action plans came along to tackle tax avoidance and demanded more efforts from Panama to keep its reputation in place. This was the case particularly after November 2016, when Panama was listed again as a non-compliant jurisdiction in the Phase 2 peer review conducted by the Global Forum on Transparency and Exchange of Information for Tax Purposes.

Since then Panama has doubled its efforts to comply with international standards both in the domestic and international arena by approving domestic laws regarding 'deemed inactive' companies in Panama, accounting records for offshore entities, signing of the Common Reporting Standard Multilateral Competent Authority Agreement, BEPS Inclusive Framework and Multilateral Instrument. Because of this Panama was provisionally listed as a largely compliant jurisdiction in June 2017 and will be reviewed again in the last trimester of 2018.

The Harmful Tax Practices – 2017 Progress Report on Preferential Regimes conducted in connection with BEPS Action 5 included five of Panama's preferential regimes:

- Panama Colon Free Zone – Listed as out of scope;
- Panama Shipping regime – Considered as not harmful;
- City of Knowledge technical zone, Panamá Pacífico zone (APP) and Panama Multinational headquarters (also known as SEM) – Given an 'in the process of being amended' status.

Amendments to these regimes (except for the City of Knowledge technical zone) are currently being discussed in the National Assembly, and are primarily focused on providing more substance to the regimes. A common amendment in all three regimes mentioned below is the implementation of local transfer pricing regulations.

Amendments to the Call Centres Regime

There are no significant changes to the labour, migratory, and fiscal benefits that this regime initially had. The amendments are focused on providing more substance to the regime, hence additional requirements have been suggested to maintain the income tax exemption:

- Keep at least an average of five full time employees,
- Require that operational expenses incurred in Panama must be ≥ 70% of the expenses directly related to such services,
- File a report to the Authority of Public Services (ASEP) specifying income, expenses and employees related to the generation of income within Panamanian territory, audit financial statements, and any other information required by ASEP.

Amendments to the SEM Regime

Currently, multinationals registered in the SEM Regime are not subject to income and dividend taxes and can negotiate tax agreements with the Ministry of Economy and Finance. The amendments to the SEM Regime eliminate most of these tax benefits and include much needed clarifications to the SEM Regime law.

Amongst the tax amendments we can mention:

- Automatic juridical stability;
- Income tax of a minimum 2% and maximum 5% on net taxable income generated within the Panamanian territory;
- Income tax credit may not be considered as loss or requested as a refund;
- Dividend, advance dividend and branch taxes are exempted;
- SEM Visa employees may opt for permanent residency after five years;
- Elimination of tax agreements. Tax agreements already in force must be ended by 30 June 2021.

The SEM Regime law lacks guidance on several topics, therefore the amendments include clarifications such as exemption from having a Notice of Operation and its tax, payment of capital gains tax whenever there is a capital gain at a reduced rate of 2%, withholding tax reduced to 5%, and SEM Visa personnel exempted from income tax, social security and educational tax on their salaries.

The amendments to the SEM Regime include similar suggestions to those proposed in the Call Centre Regime, such as:

- Have at least five full time employees;
- Incur in Panama a minimum of PAB 500,000 of annual operational expenses, as per IFR standards.

Rather than exempting the income generated in Panama, these substance requirements will be requested from multinational entities for the purpose of obtaining and keeping the SEM license granted to operate within this regime.

Amendments to the APP Regime

This regime is one of the most attractive preferential regimes that Panama offers to multinational enterprises (MNEs). If the MNE performs any of the activities mentioned in Article 60 of the APP Regime Law, income, dividend, local VAT and withholding taxes are exempt.

However, these tax benefits may change with the amendments being proposed to change this regime's law, such as:

- Income tax of a minimum 2% and maximum 5% on its net taxable income to MNEs registered to perform administrative services for other offices of the MNE group, and 5% withholding tax rate. Call centre services and logistic and multimodal services companies are exempted;
- Keep in Panama accounting records and documents that clearly reflect their exempt and non-exempt operations;
- File a report to the General Directorate of Income (DGI) specifying income, expenses and employees related to the generation of income within Panamanian territory, audit financial statements, and any other information required by DGI.

Eventually (possibly by July 2021), all MNEs registered in this regime will be subject to these amendments. The rates mentioned above will apply so long as the companies had maintained an adequate amount of qualified full-time employees and had incurred an adequate amount of operational expenses in Panama that are directly related to the activities they perform within this regime.

Other amendments to this regime are exemption from immovable property taxes until 1 January 2029 for MNEs and elimination of local VAT on services provided to companies outside this regime.

Conclusion

Adding substance to each of these regimes is the main amendment to comply with international OECD standards. These amendments are still under discussion and may be subject to change until the moment of approval by the National Assembly.

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UNITED STATES

PROPOSED REMOVAL OF SECTION 385 DOCUMENTATION REGULATIONS

On 21 September 2018, the Department of the Treasury and the Internal Revenue Service (collectively, Treasury) issued proposed regulations (REG-130244-17, hereinafter, the Proposed Regulations) that propose the removal of final regulations under Section 385 setting forth minimum documentation requirements that ordinarily must be satisfied for certain related-party interests in a corporation to be treated as indebtedness for federal tax purposes (the Documentation Regulations). The Proposed Regulations include conforming amendments to other final regulations to reflect the proposed removal of the Documentation Regulations. The final regulations to be amended and removed generally affect corporations that issue purported indebtedness to related corporations or partnerships.

Details

Section 385 of the Code authorises the Secretary of the Treasury to prescribe rules to determine whether an interest in a corporation is treated for purposes of the Code as stock or indebtedness (or as in part stock and in part indebtedness) by setting forth factors to be taken into account with respect to particular factual situations.

On 21 October 2016, Treasury published final and temporary regulations under Section 385. TD 9790 (I.R.B. 2016-46, 81 FR 72858 (21 October 2016)). These are primarily comprised of:

i. The Documentation Regulations; and
ii. Rules that treat as stock certain debt that is issued by a corporation to a controlling shareholder in a distribution or in another related-party transaction that achieves an economically similar result (together, the Section 385 Regulations). For a discussion of the Section 385 Regulations, see our **October 2016 Tax Alert**.

Executive Order 13789, issued on 21 April 2017 (E.O. 13789), instructs the Secretary to review all significant tax regulations issued on or after 1 January 2016, and to take concrete action to alleviate the burdens of regulations that:

i. Impose an undue financial burden on US taxpayers;
ii. Add undue complexity to the federal tax laws; or
iii. Exceed the statutory authority of the IRS.

E.O. 13789 further instructs the Secretary to submit to the President within 60 days a report (First Report) that identifies regulations that meet these criteria. Notice 2017-38 (2017-30 I.R.B. 147 (24 July 2017)) included the Section 385 Regulations in a list of eight regulations identified by the Secretary in the First Report as meeting at least one of the first two criteria specified in E.O. 13789.
E.O. 13789 also instructs the Secretary to submit to the President a second report (Second Report) that recommends specific actions to mitigate the burden imposed by regulations identified in the First Report.
For a discussion of Notice 2017-38, see our **August 2017 Tax Alert**.

The final Documentation Regulations were originally promulgated to be applicable with respect to interests issued or deemed issued on or after 1 January 2018. However, in response to continued taxpayer concern with the application of the Documentation Regulations, and in light of contemplated further actions concerning the Section 385 Regulations in connection with the review of those regulations under E.O. 13789, Treasury determined that a further delay in the application of the Documentation Regulations would be appropriate. Accordingly, in Notice 2017-36 (2017-33 I.R.B. 208 (14 August 2017)), Treasury announced the intent to amend the Documentation Regulations to delay the applicability of the regulations for twelve months, making the regulations applicable only to interests issued or deemed issued on or after 1 January 2019.

On 16 October 2017, the Secretary published the Second Report in the Federal Register (82 FR 48013 (16 October 2017)) stating that Treasury is considering revoking the Documentation Regulations and is actively considering developing and proposing streamlined regulations. After careful consideration of the comments received on the Documentation Regulations in connection with E.O. 13789, including with respect to Notice 2017-36 and Notice 2017-38, the Proposed Regulations propose the removal of the Documentation Regulations.

The Preamble to the Proposed Regulations further provides that Treasury will continue to study the issues addressed by the Documentation Regulations and when that study is complete, Treasury may propose a modified version of the Documentation Regulations. Any such regulations would be substantially simplified and streamlined to reduce the burden on US corporations and yet would still require sufficient documentation and other information for tax administration purposes. Further, they would include a prospective effective date to allow sufficient lead-time for taxpayers to design and implement systems to comply with those regulations.

The removal of the Documentation Regulations and conforming modifications are proposed to be applicable as of the date of publication in the Federal Register of a Treasury Decision adopting these Proposed Regulations as final regulations. However, taxpayers may rely on the Proposed Regulations, in their entirety, until the date a Treasury Decision adopting the Proposed Regulations as final regulations is published in the Federal Register.

BDO comment

The proposed withdrawal of the Documentation Regulations may be welcome news for many taxpayers as the costs to comply with such requirements could be substantial. Until further guidance is provided, US multinationals should continue to employ strong documentation measures as a matter of best practice to support the bona fide debt characterisation of such instruments for US tax purposes.

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MAURITIUS

CHANGES TO GLOBAL BUSINESS REGIME

Category 1 Global Business regime

Regulations are to be published which will abolish the Deemed Foreign Tax Credit regime applicable to companies holding a Category 1 Global Business Licence from 31 December 2018 and replace it with a partial exemption regime whereby 80% of the income mentioned below will be exempted from income tax.

The income exemption will be granted to all companies on the following income, subject to complying with conditions which the regulations will prescribe in relation to the substance of their activities:

- Foreign source dividends, provided the dividend has not been allowed as deduction in the country of source;
- Foreign source interest derived by a company other than a bank;
- Profit attributable to a permanent establishment which a resident company has in a foreign company;
- Income derived from overseas by a collective investment scheme (CIS), closed end fund, CIS manager, CIS administrator, investment adviser or asset manager licensed or approved by the Financial Services Commission (FSC);
- Income derived from overseas by a company engaged in ship and aircraft leasing.

Foreign tax credit will not be allowed where a company has claimed the 80% partial exemption on its foreign source income.

Foreign source income of companies holding a Category 1 Global Business License issued prior to 17 October 2017 will, up to 30 June 2021, include income derived from its transactions with non-residents or corporations holding a Global Business Licence.

The ten year tax exemption applicable to a licensee under the Captive Insurance Act 2015 is subject to the person satisfying such conditions relating to the substance of its activities as the FSC may impose (regulations not yet published).

Category 2 Global Business regime

The Category 2 Global Business regime will be abolished from 1 January 2019. However, companies which have been issued a licence prior to 17 October 2017 will benefit from the current regime until 30 June 2021 except for income derived from:

- Intellectual property assets acquired from a related party after 16 October 2017;
- Intellectual property assets acquired from an unrelated party or newly created intellectual property assets after 30 June 2018;
- Specific assets acquired or projects started after 31 December 2018.

From 1 October 2018, a company incorporated in Mauritius and which has its place of effective management outside Mauritius, such as an Authorised Company approved by the FSC, is treated as non-resident for tax purposes but is required to submit a return of income. Such a company is only required to pay tax on its income derived in Mauritius.

Global Business Licences from 1 January 2019

From 1 January 2019, the FSC will no longer issue Category 1 or Category 2 Global Business Licences. From that date, new rules will apply where a corporation resident in Mauritius proposes to conduct or conducts business principally outside Mauritius or with such category of persons as may be specified in the FSC Rules (not yet published). If the majority of shares or voting rights or the legal or beneficial interest in that corporation is controlled by a person who is not a citizen of Mauritius or a corporation which is not incorporated in Mauritius and which is held or ultimately held by a person who is not a citizen of Mauritius, the corporation will have to:

- Apply to the FSC for a Global Business Licence; and
- Obtain the relevant licence, authorisation, registration or approval from the appropriate body where the proposed business is regulated before commencing business.

A 'corporation resident in Mauritius' means a company incorporated or registered under the Companies Act, a societe or partnership registered in Mauritius, a trust or any other body of persons established under the laws of Mauritius.

The conditions attached to the Global Business Licence are that the corporation whilst carrying out its core income generating activities in or from Mauritius should:

(i) Directly or indirectly employ a reasonable number of suitably qualified persons to carry out such activities;

(ii) Have a minimum level of expenditure which is proportionate to its level of activities;

(iii) Be managed and controlled from Mauritius;

(iv) Be administered by a management company.

The criteria the FSC will take into account to determine whether a corporation holding a Global Business Licence is managed and controlled from Mauritius include:

(i) The corporation has at least two directors of sufficient calibre to exercise independence of mind and judgment who are resident in Mauritius;

(ii) The principal bank account of the corporation is in Mauritius;

(iii) The accounting records are kept and maintained at the registered office of the corporation in Mauritius;

(iv) The statutory financial statements are prepared and audited in Mauritius; and

(v) The meetings of the directors include at least two directors from Mauritius.

Authorised company rules from 1 October 2018

As from 1 October 2018, new rules will apply where a company having its place of effective management outside Mauritius but incorporated under the Companies Act in Mauritius proposes to conduct or conducts business principally outside Mauritius or with such category of persons as may be specified in the FSC Rules (not yet published). If the majority of shares or voting rights or the legal or beneficial interest in that company is controlled by a person who is not a citizen of Mauritius or a corporation which is not incorporated in Mauritius and which is held or ultimately held by a person who is not a citizen of Mauritius, the company will have to apply to the FSC for an authorisation to be an 'Authorised Company'. An application for authorisation must be made through a management company which is also its registered agent in Mauritius.

If required, a registered agent has to provide to an Authorised Company the following services:

(i) Filing of any return or document required under the Financial Services Act, Income Tax Act or Companies Act;

(ii) Receiving and forwarding of any communication from and to the FSC, Mauritius Revenue Authority or Registrar of Companies;

(iii) Undertaking measures on combating money laundering and the financing of terrorism and related offences;

(iv) Keeping of records, board minutes and resolutions.

An Authorised Company:

– Has to file an unaudited annual financial summary as provided in the Ninth Schedule of the Companies Act to the FSC as well as any other return that may be required by the FSC Rules (not yet published). It may be required to furnish information to the Mauritius Revenue Authority under the Income Tax Act and may also be investigated under the Financial Intelligence and Anti-Money Laundering Act;
– Is allowed to invest in any securities listed on a securities exchange licensed by the FSC, open a foreign currency account with a local bank, hold any share, debenture, security or any interest in or dealing or transacting with a Global Business Corporation and enter into a business relationship with a Management Licence company, law practitioner, legal consultant, law firm or qualified auditor in Mauritius;
– Cannot carry out the business of banking, financial services, holding or managing or dealing with collective investment funds as a professional functionary, providing registered office facilities, nominee services, directorship services, secretarial services, other services for corporations and providing trusteeship services by way of business unless allowed in the FSC Rules (not yet published).

Transitional provisions for Category 1 Global Business Licences

A corporation holding a valid Category 1 Global Business Licence issued before 17 October 2017 continues to be governed by the existing provisions of the Financial Services Act until 30 June 2021. Thereafter it will be deemed to be a Global Business Corporation.

A corporation holding a valid Category 1 Global Business Licence issued after 16 October 2017 continues to be governed by the existing provisions of the Financial Services Act until 31 December 2018. Thereafter it will be deemed to be a Global Business Corporation.

Transitional provisions for Category 2 Global Business Licences

A holder of a valid Category 2 Global Business Licence issued before 17 October 2017 continues to be governed by the existing provisions of the Financial Services Act until 30 June 2021. Thereafter it can either apply to be an Authorised Company or a Global Business Corporation or migrate to another jurisdiction or be dissolved.

A holder of a valid Category 2 Global Business Licence issued after 16 October 2017 continues to be governed by the existing provisions of the Financial Services Act until 31 December 2018. Thereafter it can either apply to be an Authorised Company or a Global Business Corporation or migrate to another jurisdiction (the FSC must be informed before 31 December 2018) or be dissolved.

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UGANDA

LIMITATION ON INTEREST DEDUCTIONS AND OTHER PAYMENTS

Uganda has implemented the Base Erosion and Profit Shifting (BEPS) Action 4 recommendations with effect from 1 July 2018 by applying the fixed ratio rule to every taxpayer that is a member of a group. A provision has been introduced in the Income Tax Act of Uganda (Cap 340) where the amount of deductible interest in respect of all debts owed by a taxpayer who is a member of a group must not exceed 30% of the tax earnings before interest, tax, depreciation and amortisation (EBITDA).

Interest paid to third parties, related parties and group entities is deductible up to this fixed ratio. A taxpayer whose interest exceeds 30% of EBITDA may carry forward the excess interest for not more than three years, and the excess interest will be treated as incurred during the next year of income. Interest as defined by the Income Tax Act includes:

i. Any payment, including a discount or premium, made under a debt obligation which is not a return of capital;
ii. Any swap or other payment functionally equivalent to interest;
iii. Any commitment, guarantee, or service fee paid in respect of a debt obligation or swap agreement; or
iv. A distribution by a building society.

The rule applies only if the company is part of a group of companies with common underlying ownership, and it covers related party loans or other third party debt, including bank loans. The Income Tax Act allows a deduction for interest incurred during the year of income in respect of a debt obligation to the extent that the debt obligation has been incurred by the person in the production of income included in gross income.

The premise underlying the fixed ratio rule is that an entity should be able to deduct interest expense up to 30% of EBITDA, which helps to ensure that a portion of an entity's profit remains subject to tax in a country. Interest, taxes, depreciation and amortisation are all non-operating activities, therefore their exclusion from the calculation of deductible interest helps ascertain the real income earned from the borrowed funds. Depreciation and amortisation are non-cash expenses, so omitting them makes EBITDA more cash-flow based.

The introduction of the provision to limit deductions of interest and other financial payments saw the removal of thin capitalisation rules which looked at the ratio of debt to equity and sought to disallow interest deductions on an amount of debt capital thought to be in excess of a commercial level of debt for the company concerned. These rules were used on all foreign-controlled resident companies with the exception of banking institutions because of the special nature of their industry.

Calculation of EBITDA

EBITDA is a guide to the ability of an entity to meet its obligations to pay interest.

Step 1 – Calculating the measure of earnings

An entity's EBITDA should be calculated by adding back to its taxable income other than exempt income, the values for:

i. Net interest expense and net payments equivalent to interest payments;
ii. Depreciation and amortisation. Tax exempt income should not form part of the entity's EBITDA figure.

Step 2 – Applying the statutory benchmark fixed ratio to earnings

Following the calculation of the entity's EBITDA, the statutory benchmark fixed ratio will be applied to the EBITDA figure. The result determines the maximum amount of interest expense that the entity is allowed to deduct for tax purposes.

Step 3 – Comparing maximum deductible interest expense with actual interest expense

In the last step, the maximum amount that the entity is allowed to deduct for tax purposes is then compared with the entity's actual net interest expense. Net interest expense in excess of the maximum allowable amount is disallowed.

Observations

The amendment in its current state does not make an exception for companies in banking and insurance as was recommended under BEPS.

The rule applies consistently to all groups operating in different sectors, and no form of threshold was issued in terms of size of entities or level of debt to remove low risk entities. The main policy goal of this rule is to address base erosion and profit shifting using interest deductions. It is recognised that certain entities may pose a sufficiently low risk that excluding them from a fixed ratio rule would be appropriate and would reduce the compliance and administrative burden on these entities and the Uganda Revenue Authority respectively.

In most cases group companies have a central treasury department to access credit for non-tax reasons such as credit ratings, and low interest rates. The fixed ratio rule limits interest deductions regardless of whether the debt is actually at arm's length and does not pause a threat of BEPS. However, the loss carry forward option adopted by Uganda makes it possible for the company to deduct between 70%-95% of the interest by the end of the three years.

However, interest paid on debentures issued by a company outside Uganda to a company resident in Uganda for the purposes of raising a loan outside Uganda, widely issued debentures, or interest paid to a financial institution of a public character is generally exempt from tax and would not be curbed by the fixed ratio rule.

Conclusion

The fixed ratio rule is in line with the best practice approach in dealing with BEPS. It is reasonably straightforward for groups and tax authorities to apply. The carry forward option allows the group company to deduct most of the interest expense within three years.

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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 13 November 2018.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
Euro (EUR)	1.00000	1.12701
Hong Kong Dollar (HKD)	0.11325	0.12765
Hungarian Forint (HUF)	0.00311	0.00350
Norwegian Kroner (NOK)	0.10475	0.11806
British Pound (GBP)	1.14276	1.28801
Panamanian Balboa (PAB)	0.88720	1.00000

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