Analysis
The international briefing for May

SPEED READ HMRC has published draft guidance on one of the CFC changes in the Finance Bill. The CJEU has rejected the UK government's legal challenge to the proposed financial transaction tax on procedural grounds and the political will to proceed with this initiative is continuing. The EC's proposed amendment to the EU Parent-Subsidiary Directive in relation to hybrid loans has been blocked by Sweden, but discussions are continuing with a view to obtaining agreement shortly. A recent case in India highlights the risk of creating a permanent establishment when sending employees to India on secondment. Draft guidance on the German corporate tax loss limitation rules has been published.

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For the last few months, I have started my article with an update on what has been going on with the OECD's action plan on base erosion and profit shifting (BEPS) and there is usually plenty to write about. Readers may be relieved to know that things have been a little quieter over the last month, not because the OECD has eased its breakneck pace, but because the deadlines have now passed for the submission of comments on the first batch of discussion drafts and the ball is back in the OECD's court. A series of public consultation meetings are being held to discuss the numerous comments submitted on the various discussion drafts. Final outputs on these first actions are expected in September this year.

Back in the UK, the 2014 Finance Bill, which contains two changes to the controlled foreign company (CFC) finance company exemption, is now going through the Committee stage. One of the CFC changes prevents the exemption from applying to a loan if it is connected with an arrangement that has a main purpose of artificially diverting into a CFC profits that are currently received by a UK group company. HMRC has now published draft guidance on this (see www.bit.ly/1gaDBet).

The draft guidance provides an overview of the draft legislation and then sets out HMRC's view on its application in 11 different examples. It clearly indicates that HMRC will be taking a facts and circumstances approach to applying the main purpose test in the draft legislation. The draft guidance suggests the specific facts of a case and the actual purpose of the arrangements may be established by discussion with the group; contentious cases, though, may require extensive record examination. Groups seeking to demonstrate that the rules should not apply in potentially contentious cases should therefore ensure they have supporting evidence in place to support their factual position.

HMRC notes that where there is no anticipated current or future reduction in UK tax liability and there is a clear non-UK tax rationale for the arrangements, then the rule should not apply. Where a clearance is requested, the draft guidance states this is likely to be given as a risk indication rather than as a definite view, creating a degree of uncertainty for taxpayers.

EU update

Financial transaction tax: On 30 April, the CJEU rejected the UK government's legal challenge to the EU Council's decision to authorise enhanced cooperation in relation to a financial transaction tax (FTT) (reported in 'Cases', *Tax Journal*, dated 9 May 2014). As a reminder, in 2013 11 EU member states made the decision to move ahead with the tax, and the Economic and Financial Affairs (ECOFIN) Council of the EU authorised this action under the enhanced cooperation procedures. The UK government then filed an action for annulment of the ECOFIN authorisation, on the grounds that it infringed provisions of the Treaty on the Functioning of the EU and that the decision was illegal because it authorised the adoption of an FTT that would have 'extraterritorial effects' and that would impose costs on non-participating member states.

The CJEU rejected the UK's arguments on the grounds that they were directed at the elements of a potential FTT and not at the authorisation to establish enhanced cooperation. Since the decision to authorise enhanced cooperation did not contain any substantive element on the FTT itself, the arguments were not accepted.

The FTT proposals were then discussed at an ECOFIN meeting on 6 May. Although the details of the proposal are still under discussion, it appears that participating member states would like to implement a scaled down version of the original proposal from 2016. The political will to proceed with this initiative is continuing and it now seems more likely that agreement will be reached on the broad design of the proposal. It will then be up to the EU Commission to draft a new proposal, taking into account the many technical issues that have been discussed between the participating member states. The form of this new proposal is likely to be a key factor in determining whether the UK government will launch a second legal challenge.

Parent-Subsidiary Directive: At the same ECOFIN meeting on 6 May, the European Commission's proposed amendments to the EU Parent-Subsidiary Directive were also discussed. These cover two areas: an amended anti-avoidance rule; and proposed changes to exclude payments on cross-border hybrid loans from a tax exemption (aimed at preventing double non-taxation).

As expected, there was broad support for the hybrid loan aspect of the proposals. However, the amendments were not approved because Sweden requested further assurance on certain technical aspects. The Commission has committed to working closely with Sweden to tackle any issues they currently have with the proposed wording, in order for the amendments to be approved at the next ECOFIN meeting in June.

Equally expected was the lack of agreement to the proposed amendment to the existing anti-avoidance provision in the Directive. In particular, there were concerns that due to its general formulation, this could lead to different interpretations in different member states and would create uncertainty for businesses. Discussions on this are expected to continue, with agreement unlikely in the near future.

The EU seems intent on pressing forward quickly with the proposals on hybrid loans, at the same time that the OECD is pressing forward with its own different proposals on hybrids as part of the BEPS project. It is to be hoped the two parties work together to ensure no disconnect.

Global update

India – Centrica case: In a recent case *(Centrica India Offshore Pvt Ltd v CIT* [WP(C) No. 6807/2012]) heard at the Delhi High Court, employees seconded to India from group companies in the UK and Canada were deemed to constitute permanent establishments (PE) of those companies in India.

A wholly owned subsidiary of the UK company, Centrica PLC, resident in India provided back office services to overseas group companies, charging cost plus 15% for those services. To help support the establishment of the Indian back office services in the first year of their operation, some overseas employees with managerial and technical expertise were seconded to India. The court decided that under the terms of the India-UK and India-Canada tax treaties, these secondees constituted a PE in India that was providing technical services.

The decision arose because of the way the secondments themselves were structured. The court distinguished between the concepts of economic employer and legal employer. It also referred to the OECD commentary which says that the foreign company will not constitute a service PE if the seconded employees work exclusively for the Indian enterprise and are released for the period in question by the foreign enterprise – that was not the case here. The court further observed that there was no purported employment relationship between the Indian company and the secondees and, notably, that the company had no right to terminate the employment contract and the employees had no right to sue the company for non-payment of salary.

This case highlights the need to ensure that secondment arrangements are very carefully managed to avoid the risk of PE exposure when employees are seconded to India, but could also have wider implications.

Germany – draft guidance amending corporate tax loss limitation rules: Draft guidance was issued on 15 April 2014 by Germany's Federal Ministry of Finance in relation to the German corporate tax loss limitation rules. Under those rules, loss carry-forwards and losses not used by a corporation are partially forfeited if, within a period of five years, more than 25% of the share capital in a corporation is transferred to an acquirer or a 'group of acquirers'. When more than 50% of the shares is transferred, the loss deduction is denied in full.

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The draft guidance is intended to replace existing guidance written in 2008 and it covers the following new areas:

- Mid-year changes in ownership: The guidance explains that the results of the accounting period need to be apportioned where the change in ownership occurs part way through the year. This can be done by way of an interim financial statement or by estimation. Losses brought forward can then be used against profits arising in the period up to the change in ownership (subject to rules on minimum taxation of profits), but only where the results for the entire period are positive. If the apportionment has resulted in profits before the change in ownership and losses afterwards, then these first have to be netted.
- Group exemption provision: This exemption applies where 'the same person' directly or indirectly holds 100% of the shares in the transferring and the acquiring entities. The guidance confirms that the exemption will not apply where an individual, foundation, local authority or similar is the transferring or acquiring entity. It will also not apply where there is more than one shareholder in the transferring or acquiring entity (e.g. a listed company or certain partnerships). This potentially means that the group exemption will not apply when shares are transferred to and from the group holding company.
- Hidden reserves provision: There is an exemption where losses carried forward are less than taxable hidden reserves of the domestic business assets of the company (only those taxable in Germany). There is new guidance on quantifying those hidden reserves both in terms of what is and is not included and the appropriate methods for valuing the reserves.

This draft guidance is open for consultation until 27 May 2014.

For related reading, visit www.taxjournal.com

The UK's premature legal challenge on the EU FTT (Vimal Tilakapala & Anne Powell, 16.5.14)

Cases: *United Kingdom v Council of the EU* (6.5.14)

Special report: OECD's action plan on BEPS (26.7.13)