Briefing

International briefing for April

Speed read

In the UK, a new tax year has commenced but attention is focused on the snap general election called for next month. The OECD gave an update on progress in a recent webcast. Singapore is in the process of introducing a number of enhancements to its already competitive tax regime and China has published a major set of regulations clarifying aspects of its transfer pricing rules. The German CFC rules, as they apply to third countries, have been referred to the CJEU, and Australia has relaxed its rules on the carry forward of losses following a change in ownership.

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I started last month's article with some comments on the potentially wide ranging tax reforms expected in the US under President Trump. The press are now reporting that the timeline for these reforms to be ready for review (originally hoped to be by August 2017) is likely to be pushed back due to the setbacks suffered by the administration on healthcare reform. Given the very ambitious nature of the original timetable, this is not entirely surprising.

Here in the UK, the headlines are all focused on the surprise general election called for next month. It is difficult to predict what this could mean for tax policy going forward, but this is effectively the first manifesto for Theresa May and Philip Hammond, so it does create the opportunity for them to replace some old policies. Although less headline grabbing, it is also worth noting that a new fiscal year commenced this month and with it the corporate interest restriction regime, triggered by BEPS Action 4, came into effect. On 31 March, one day before the rules came into effect, HMRC published an initial tranche of draft guidance focused on the core rules, with further draft guidance expected in May. Draft regulations have also been published for consultation, which will introduce transitional rules to prevent unintended results occurring from mismatches between the tax and accounting treatment. At the time of writing, it is uncertain what impact the general election will have on the legislation in Finance Bill 2017; indeed, any predictions on our part may well be out of date within days.

Also on 31 March, HMRC published updated draft hybrid mismatch guidance. The new hybrids rules have been in place since 1 January this year. The amendments deal with key themes identified from representations received from stakeholders since the initial draft was released in December and attempt to correct any inconsistencies. HMRC acknowledges that the development of the guidance is an ongoing process and further engagement with respondents is required before it is finalised.

BEPS/OECD update

The OECD gave a 'Tax talks' webcast on 28 March, where its Centre for Tax Policy and Administration (CTPA) gave an update on progress on various international tax projects. The webcast mentioned the recent G20 finance ministers meeting (the first meeting attended by the new US Treasury Secretary Steven Mnuchin), where the attendees restated their commitment to the implementation of the BEPS project. It was mentioned that the inclusive framework on BEPS had grown to 94 members, with an expanded steering group of 20 members; and there was a promise of an annual report back to the G20. In relation to the multilateral instrument (MLI), there has been a 'speed matching' event with more than 300 meetings between pairs of countries to discuss their positions and the Secretariat is holding workshops and providing bilateral assistance. Many participating countries are on track to sign the MLI by 7 June 2017.

In relation to transfer pricing, a lot of work has been happening on BEPS Actions 7 and 8–10, with the OECD looking at the permanent establishment changes to ensure there will be no double tax implications, and preparing administrative guidance to minimise the compliance burden for taxpayers and tax administrations. Draft revised guidance on the use of profit split methodologies will be issued in the coming months, as will draft guidance for implementation for 'hard to value' intangibles and financial and funding transactions within multinationals.

Also of interest was further guidance on the implementation of country by country (CBC) reporting published by the OECD on 6 April (BEPS Action 13). Five issues were addressed in this guidance: the definition of 'revenues'; the accounting standards to be used for determining the existence of and membership of a group; the definition of 'total consolidated group revenue'; the treatment of major shareholdings; and the definition of 'related party' for the purposes of reporting related party revenues.

Global update

Singapore: enhancements to tax regime

Singapore is often mentioned as a business model to emulate in the Brexit debate, with its competitive tax regime cited as one of its main attractions. It is also regularly mentioned as one of the many jurisdictions which are likely to try and attract business away from the UK post-Brexit. The Singapore authorities have recently announced two further enhancements to increase its attractiveness to global business.

The first is in relation to the global trader programme (GTP), which offers concessionary tax rates of 5% or 10% to global trading companies undertaking qualifying transactions in qualifying commodities and products. The objective is to attract companies to use Singapore as a base to conduct their international physical trading activities. A number of changes to the rules were announced in the 2017 Budget, which will significantly alleviate the administrative and compliance burden for GTP companies. The substantive requirements for qualifying for the GTP regime are being increased, however, as a result of the OECD's BEPS recommendations and further details on this are expected to be released by May 2017.

The second is in relation to the Finance and Treasury Centre (FTC) incentive, which aims to encourage corporations to use Singapore as a base for conducting treasury management activities for themselves or for their affiliates in the region, offering an 8% concessionary tax rate as one of the key benefits. Again, some changes were announced in the 2017 Budget to significantly reduce the FTC's administrative and compliance burden; for example, qualifying activities such as 'transacting or investment in stocks and shares of companies which are neither incorporated nor resident in Singapore' has been revised to 'transacting or investment in stocks and shares of any company'.

The GTP enhancements apply to qualifying income derived on or after 21 February 2017 and the FTC enhancements apply to new or renewed FTC incentive awards approved from 21 February 2017.

The 2017 Budget also announced a new intellectual property development incentive, which is expected to be similar to the revised (BEPS compliant) UK patent box regime. This new incentive will take effect from 1 July 2017 and details, including the tax rate which will apply, are expected to be published in May 2017.

China: major transfer pricing regulations published

The State Administration of Taxation (SAT) in China published the long awaited 'Announcement 6' on 28 March. It covers the following main topics:

- The scope of special tax adjustment investigations are established, with clear confirmation that these can include transfer pricing, thin capitalisation, controlled foreign companies and general anti-avoidance rules. It also unequivocally states that foreign tax residents can be subject to investigation and sets out the types of characteristics it will focus on when deciding which enterprises to audit. There are numerous specific provisions on transfer pricing investigations, most of which are likely to increase the rigour of such investigations going forward, although there are a number of positive changes too.
- The SAT's transfer pricing approach to intangible assets is formalised. This is driven by the view that certain upstream and downstream value chain activities have been overemphasised in the transfer pricing practices developed in Western countries. The SAT approach emphasises that intangible assets, such as technical know-how and marketing intangibles, are created by Chinese subsidiaries of MNE groups in the course of manufacturing and selling and may be regarded as 'economically' owned by the Chinese subsidiaries. Alternatively, the efforts of the Chinese subsidiaries in selling and manufacturing may be viewed as enhancing the intangible assets owned by overseas group entities.
- There is a significant section on comparability factors and transfer pricing methods. Specific provisions are set out for determining whether and to what extent related party service transactions are arm's length.
- There are specific provisions and clarification around mutual agreement procedures.

The introduction of Announcement 6 is a significant piece of regulation in the development of the Chinese transfer pricing regime. As a result, taxpayers should be able to better understand the focus points and the rationale of the tax authorities when conducting transfer pricing investigations. There are likely to be more standardised practices in the future. Also, Announcement 6 regulates both outbound payments and inbound receipts of royalty and service fees, whereas prior Chinese transfer pricing regulations focused mainly on outbound payments. It therefore appears that the first steps are being taken by the tax authorities to regulate the transfer pricing practices of Chinese multinationals investing overseas.

Germany: CFC rules referred to CJEU

The German courts have asked the CJEU to determine whether the German controlled foreign company (CFC) rules, as they apply to CFCs domiciled in a third country generating passive income with an investment character, are compatible with the freedom of capital.

Most readers will remember the landmark *Cadbury Schweppes* case (Case C-196/04), which resulted in a change in legislation in Germany such that the CFC rules do not apply where it can be proved that the CFC pursues a genuine and actual business activity in its state of residence (the motive test). However, this relaxation was only introduced for CFCs resident in EU/EEA member states and there is no such motive test for CFCs based in third countries. It is this application of the CFC rules to third countries which is the subject of the reference to the CJEU.

EU law permits a restriction on the freedom of capital with regard to third countries in cases where the domestic rules were already in place in December 1993 and have not been substantially amended since (the so-called 'standstill clause'). However, the German courts are uncertain whether this grandfathering would be allowed here, as the rules have been extended since 1993. The CJEU has therefore been asked to opine on this point too.

Australia: relaxation of rules for carried forward losses

On 30 March, following earlier consultation, legislation was introduced into Parliament for a new 'similar business' test in the context of carrying forward losses and bad debt write-offs when there is a change in ownership. Australian legislation previously only allowed such carry forward when the 'same business' test was met. For losses or debt write-offs incurred after 1 July 2015, the taxpayer has a choice to apply either test, collectively the 'business continuity test'.

There are four factors to take into account when determining whether a 'similar business' is carried on (only three were in the previous exposure draft, with the fourth added in the final Bill):

- the extent to which assets (including goodwill) used in the current business to generate assessable income throughout the business continuity test period were also used in the former business to generate assessable income;
- the extent to which activities and operations from which the current business generates assessable income throughout the business continuity test period were also activities and operations from which its former business generated assessable income;
- the identity of the current business and the identity of the former business; and
- the extent to which any changes to the former business result from development or commercialisation of assets, products, processes, services or marketing or organisational methods of the former business.

While there are still fundamental differences, the changes bring Australia's rules more into line with those in the UK, Canada and the US. ■

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