Briefing

International briefing for May

Speed read

In the US, President Trump has published a list of tax reform principles; and here in the UK large swathes of legislation were dropped from the Finance Bill prior to the dissolution of parliament. President Macron of France included a few pieces of tax policy in his election campaign, and in Australia there has been a federal budget and an important transfer pricing case. A recent court decision in India on fixed place permanent establishments could have wider implications, and there have been patent box developments in Luxembourg and Italy.

Tim Sarson
KPMG
Tim Sarson is an international tax partner at KPMG in the UK. He has 17 years' experience as an international corporate tax specialist in 'big four' firms as well as in industry, where he was the group tax and treasury manager for an operational consulting practice. Email: tim.sarson@kpmg.co.uk; tel: 020 7694 4831.

Most of my recent articles have started with an update on the US and this month is no exception. At the end of April, the Trump administration released information on what was touted as 'The biggest individual and business tax cut in American history'. However, very few details were forthcoming and we just saw a short list of tax reform principles, including the previously announced intention to reduce the tax rate on business income (corporate and pass-through entities) to 15%, a reduction in individual income tax rates and a repeal of the alternative income tax. Also included were the so-called mandatory repatriation tax on unremitted earnings of US multinationals and moving to a territorial system for future overseas income.

Notably absent from the principles were any references to either the interest expense disallowance or the so-called 'border adjustable' proposal that are key elements of the House of Representatives Republican Blueprint for tax reform. Given that the immediate reaction from various sources was that the principles could result in an increase in the US federal budget deficit of several trillion dollars over the ten year period, it is unlikely that they will be acceptable to some Republican members of Congress. The content of the final package of proposals and the new corporate tax rate are therefore still very uncertain at this point, as is the timing of the legislative process.

President Trump also signed an executive order on 21 April directing the Department of the Treasury to examine recent Obama-era tax regulations to determine whether any excessively burden taxpayers. Again, the outcome of this review is currently unclear but it could apply to regulations such as the section 385 debt/equity rules released last year.

Here in the UK, the upcoming general election has continued to dominate the headlines and, at the time of writing, manifestos are appearing. Perhaps the most notable points so far are in the Labour manifesto with the planned staged increase in the CT rate to 26% by 2020 and the introduction of a so-called 'Robin Hood tax' (i.e. extending the scope of stamp duty reserve tax).

Also, since my last update the government announced a series of amendments to the Finance Bill, shortening it significantly to enable the enactment of Finance Act 2017 before parliament was dissolved. Significantly, a number of elements were dropped from the Bill, including the legislation on the new corporate interest restriction, major changes to CT loss relief rules, and amendments to the anti-hybrid rules and the substantial shareholding exemption (SSE). Whilst there is no certainty at this stage what will happen with these dropped plans, it is very likely they will be reintroduced in another Finance Bill at a later date, probably very quickly if the Conservatives are successful on 8 June. The government was quick to confirm there has been no change in policy, so it is quite likely that the proposals which were due to come into effect on 1 April 2017 will still commence from that date.

BEPS/OECD update

It has been a reasonably quiet month at the OECD with the main development being an announcement on 4 May of the activation of 'automatic exchange relationships' as part of the implementation of country by country (CBC) reporting in accordance with the BEPS Action 13 minimum standard. The OECD release commented that with over a year still to go before the first exchanges of CBC reports, more than 700 automatic exchange relationships have now been established among jurisdictions which are committed to exchanging CBC reports from 2018 (including those between EU member states). Also published was a full list of automatic exchange relationships that are now in place.

Global update

France: tax implications of the election

As has been widely reported, Emmanuel Macron won the recent presidential election in France and entered office on Sunday 14 May. There was little discussion of tax policy during his election campaign so we will have to wait for detailed plans. However, some of the tax reform measures he did put forward included:

- continuation of the decrease to the corporate income tax rate until it eventually reaches 25% (no implementation date was announced); N.B. a phased reduction of the corporate income tax rate to 28% is already in progress;
- repeal of the 3% tax on dividend distributions; and
- delay of one year to the planned implementation of a withholding system on salaries and revenues (similar to our PAYE system) so it will apply from 1 January 2019, not 1 January 2018.

It is not yet clear when these reforms would be introduced. In general, a 'rectified budget' for the current year is submitted to the French Parliament in June or at the beginning of the summer but parliamentary elections are planned to take place on 11 and 18 June. As the ease with which President Macron can bring in tax reforms will, to a certain extent, be dependent upon the outcome of those elections, this timing may be difficult to achieve. Alternatively, these measures could be included in a 'rectified budget' during the autumn or directly into the Finance Law for 2018.

Australia: federal budget 2017

On 9 May, the Australian federal budget for 2017 was delivered with the overall aim being to provide a fair and responsible plan to balance the budget by 2020/21. Given the very significant recent changes from prior budgets impacting the international tax framework, it was perhaps unsurprising that this budget represented a relatively 'light touch' for global multinationals. Some points of interest were:

There was some specific targeting of the multinational anti-avoidance legislation (MAAL), which is the first part of Australia's adoption of rules akin to the UK diverted profits tax. The changes are to be backdated to the commencement of the MAAL legislation (1 January 2016) and are aimed at structures involving the use of foreign trusts and partnerships that were perceived to be sidestepping its intent.

Tightening of the foreign resident capital gains tax exemption was aimed at preventing foreign residents disaggregating indirect interests in taxable Australian real property to access the exemption. Some changes are also being made to the foreign-resident capital gains withholding regime.

In relation to implementation of the OECD's anti-hybrid mismatch measures, the government made it clear that there will be no special accommodation for banks and financial institutions in relation to additional tier 1 regulatory capital. A new bank levy is also to be introduced.

Australia: *Chevron* transfer pricing case

The full Federal Court in Australia has given the tax authorities a significant win in this widely reported case, *Chevron Australia Holdings Pty Ltd* [2017] FCAFC 62, which has potentially significant implications for other taxpayers. Of particular interest was the different approach taken by the court in relation to the characteristics of the 'hypothetical independent parties' that need to be taken into account when determining arm's length consideration. The evidence revealed that the borrower was part of a group that had a policy to borrow externally at the lowest cost and the parent would generally provide a third party guarantee for a subsidiary borrowing externally.

Chevron has potentially significant implications for other taxpayers

The court concluded that there is no reason to ignore those essential facts in order to assess the hypothetical consideration to be given. It also concluded that the 'independence' hypothesis does not necessarily require the detachment of the taxpayer, as one of the independent parties, from the group which it is part of, or the elimination of all the commercial and financial attributes of the taxpayer.

The implications of this approach are potentially significant for taxpayers as it would enable features of the taxpayer, in the context of the group of which it forms a part, to be taken into account.

India: PE decision

A recent Supreme Court decision in India, *Formula One World Championship Ltd* [2017] Civil appeal No. 3849, considered the determination of a fixed place permanent establishment (PE) involving Formula One racing. The broad facts of the case are that the UK resident taxpayer is the commercial rights holder in respect of the championship. An Indian company, Jaypee Sports International Ltd, entered into an agreement with the taxpayer to host, stage and promote the Indian Grand Prix and also to use certain marks and IP belonging to the taxpayer.

After entering into this agreement, the taxpayer and Jaypee approached the tax authorities for an advance ruling (AAR), which held that the consideration received by the taxpayer under this agreement should be treated as a royalty under the UK/India double tax treaty and tax should be withheld at source. It also held that the taxpayer did not have a PE in India. The Delhi High Court then reversed the decision of the AAR, holding that the consideration was not a royalty and there was a PE of the taxpayer in India.

This decision was appealed before the Supreme Court, which held that the international circuit constitutes a fixed place of business under the UK/India double tax treaty, since the circuit was under the control and at the disposal of the taxpayer and the entire income had been generated from the conduct of an event in India. This was decided notwithstanding the fact that the race event's duration was only three days, which some courts around the world have considered as important when determining whether a place is 'fixed' and 'permanent'. The Supreme Court therefore agreed with the High Court that the taxpayer had a PE in India.

The precedent set by this decision could have wide reaching consequences for the sports and entertainment sector, as well as any business with short duration operations in India.

Luxembourg: patent box

At the end of April, Prime Minister Xavier Bettel of Luxembourg delivered a speech in which he presented the government's policy plans. Most notably, from a tax perspective, he announced the introduction of a new intellectual property (IP) tax regime from 2018. As with other IP regimes, the aim is to increase and strengthen research and development (R&D) activities in Luxembourg and to attract foreign investors undertaking R&D. No details on the regime have been released; however, it is expected to be in line with the OECD recommendations on BEPS Action 5 (modified nexus approach).

Italy: patent box

Italy already has a patent box regime in place but on 24 April an amendment was published to exclude trademarks from the list of qualifying intangible assets that may be eligible for tax benefits. Under Italy's patent box regime, which was introduced in 2015, a percentage of income attributable to the use of 'qualifying IP' is excluded from the tax base.

The removal of trademarks from the list leaves the following as qualifying IP eligible for patent box treatment: software protected by copyright; patents; legally protectable designs and models; and legally protectable processes, secret formulas, and industrial, commercial or scientific knowledge, including know-how. The amendment applies to elections made to opt into the patent box regime after 31 December 2016 and, where an election had been made before this date, patent box benefits will still be available for trademarks until 30 June 2021.

This amendment removes one inconsistency between the regime and the OECD's BEPS recommendations, but some still remain so further changes are possible. ■

For related reading visit www.taxjournal.com

- Is the US tax reform effort in trouble? Donald L Korb & Andrew Solomon (4.5.17)
- News: Labour's tax proposals (17.5.17)
- Shortened Finance Bill enacted (Claire Hooper & Chris Sanger, 4.5.17)
- 30 questions on BEPS (Jill Gatehouse & Susie Brain, 29.10.15)
- Country by country reporting: practical issues (Julie Hughff & Andy Baillie, 6.10.16)