Briefing

International briefing for March

Speed read

The challenges of taxing the digital economy are high on the agenda for many this month, with the UK anticipating updates from both the EU and the OECD. As anticipated last autumn, the Netherlands has enacted emergency retrospective legislation in response to two rulings from the EU. There have been budget announcements in Canada, Hong Kong and Singapore. China has provided guidance on its interpretation of beneficial ownership, and India has concluded two advance pricing agreements which may provide helpful insights for other taxpayers.

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The world of international tax sometimes moves fast, but it's not often I have to update my briefing twice between the copy deadline and going to press. First the British government and then the OECD decided to opine on the digital economy while the ink was still drying.

This month we start our article looking at the current debate over how digital businesses should be fairly taxed as countries anticipate the OECD's Task Force on Digital Economy (TFDE) interim report for G20 finance ministers, due to be published in April. In parallel, the EU and certain individual countries have already taken (or are proposing) their own approaches to both implement short term interim solutions and influence the longer term multilateral policy development.

Here in the UK, the Spring Statement saw the publication of an updated 'position paper' on the taxation of the digital economy. This paper sets out a clear, overriding message in favour of coordinated and multilateral action, and it states that the UK is waiting to see how the landscape evolves in light of the recommendations from the OECD and EU. However, the paper does also put down a marker that the UK will consider interim measures in the form of revenue-based taxes, although again, there is a preference for coordination with a critical mass of other like-minded countries, rather than moving alone. Overall, I believe this is a positive stance, as I know that businesses both here in the UK and overseas have stated a clear preference for multilateral action.

Looking more widely however, we have seen other countries implementing immediate and unilateral measures, such as Italy's 3% 'web based' tax, India's 6% equalisation levy, Australia's multinational anti-avoidance law and some countries such as India, Turkey, Israel, Saudi Arabia and Taiwan moving towards the concept of a digital permanent establishment (PE). Other countries have made changes to their indirect tax regimes to address the challenges of the digital economy, the most recent example being Singapore which has announced its intention to apply GST on imported services from 1 January 2020.

Meanwhile, at the EU level, discussion on the challenges of the digital economy continue. Last month saw EU Commissioner Moscovici speak on the subject and in particular on the challenges of identifying value in digital business models. The EU is pressing for a coordinated approach across the EU, and potentially more widely, although Moscovici expressed frustration at the pace and scope of digital tax reforms outside of Europe. Following the completion of last year's consultation, we now have a paper from the European Commission on their proposed approach for both interim and long term solutions. This also includes the previously reported proposal of a digital tax on revenues of between 1% and 5%, which would apply to businesses with global sales exceeding €750m per annum.

Finally, on a global scale, the OECD's TFDE has now published an interim report, in advance of the G20 finance ministers meeting in April. In 2015, the OECD concluded in its BEPS Action 1 recommendations that the digital economy should not be ring-fenced, and there should be a pause in considering specific measures for taxing the digital economy until the impact of the wider BEPS recommendations is known. At the time, this was widely considered to be on or around 2020. It is clear that many now feel that the political, business and tax environment has moved on since the publication of the BEPS recommendations in 2015, and as expected, the OECD is now revisiting its position.

It is, however, widely agreed that what would be helpful from the OECD would be a commentary on defining what value is derived from digital economy business models and how this value may be captured and quantified. Across all the different areas of action, whether local, regional or global, I do believe this is the significant missing piece of the jigsaw, and if agreement can be reached on this knotty issue, the details of the tax policy proposals will follow much more easily.

Canada

Finance Minister Bill Morneau delivered Canada's 2018 federal budget on 27 February. As expected, the headline measure of the budget was the introduction of a new taxation regime for the holding of passive investments by Canadian-controlled private corporations, originally contemplated in July 2017. Under these proposals, the benefits of the small business tax rate reduces if a Canadian-controlled private corporation and its associated corporations earn more than $50,000 of passive investment income in a year (and is eliminated once earnings reach $150,000 per year).

The budget did not make any direct response to the recent US federal tax reform programme, although an announcement was made that a detailed analysis of the impact for Canada will now be undertaken.

China

China's State Administration of Taxation issued guidance (Announcement 9) to clarify the 'beneficial ownership' requirement with respect to dividends, interest, and royalties under certain articles of double tax treaties. Readers familiar with doing business in China will be aware that beneficial ownership is a challenging area in Chinese tax law, not least because the Chinese interpretation requires consideration of both the familiar international 'degree of control' test, and in addition, consideration of the level of commercial substance demonstrated by the relief claimant.

Announcement 9 confirms conclusively that China will retain a commercial substance-focused approach to beneficial ownership, as originally set out in guidance issued in 2009. It also provides greater clarity on the substance requirements (offering detailed examples), expands a 'safe harbour' provision and introduces a form of a 'derivative benefits' test. The guidance is effective from April 2018.

Multinational businesses are likely to welcome the increased guidance as one of the challenges facing international taxpayers has been the great diversity in interpretation of the substance test by the local Chinese tax authorities. Whilst this is unlikely to completely iron out the difficulties, it should go some way to improving consistency and predictability.

Hong Kong

The finance secretary on 28 February offered certain tax proposals in making the 2018/19 budget speech, including business tax measures to:

- introduce a regional headquarters tax regime (to enhance Hong Kong's competitiveness in the region, and complement the recently introduced Corporate Treasury Centre incentive). The RHQ regime will provide a 50% reduction in profit taxes in exchange for certain commitments to local investment;
- extend the scope of the profits tax exemption on debt securities (to attract corporate bond issuance); and
- expand trade, investment, and tax treaty networks (to open up new markets).

Businesses looking to benefit most from the broader announcements are those in the innovation and technology sector, with investments totally HK$50 billion announced for sector specific R&D.

In addition to these proposed measures, effective from 1 March 2018, all companies incorporated in Hong Kong (except listed companies) are required to obtain and maintain up-to-date beneficial ownership information through a significant controllers register. This is primarily a bid for Hong Kong to combat money laundering and terrorist financing by enhancing the transparency of corporate beneficial ownership. However, from a Hong Kong tax perspective, these changes potentially provide the Hong Kong Inland Revenue Department with more transparency about the beneficial owner(s) of a company when issuing Hong Kong tax residency certificates to taxpayers. In addition, this information could also be accessed by other tax authorities who are increasingly looking through holding companies to the ultimate owners when determining whether tax treaty benefits apply.

India

The Central Board of Direct Taxes (CBDT) in India announced two advance pricing agreements (APAs) have been concluded which address for the first time the treatment of advertising, marketing, and promotion expenses. They also involved resolution of issues concerning marketing royalties and technical royalties.

The treatment of advertising, marketing, and promotion expenses is one of the most litigated transfer pricing issue in India, and it is therefore hoped that these APAs bode well for other taxpayers that may currently be in litigation concerning these expenses (even though an APA is specific to a taxpayer, and provides a unique resolution for the taxpayer). With several bilateral and numerous unilateral APAs being concluded at a fast pace, APAs seem to have become a viable option for taxpayers that want to obtain tax certainty on complex issues.

The Netherlands

The Dutch government has introduced emergency changes to certain aspects of their tax law in response to a ruling by CJEU, on a combined case with important consequences for the Netherlands.

The cases, *X BV* (Case C-398/16) and *X NV* (Case C 399/16), considered whether taxpayers, despite being unable to enter into a fiscal unity with subsidiaries established elsewhere in the EU, are nevertheless eligible for benefits from certain separate elements of the fiscal unity regime as if they were able to enter into a fiscal unity with foreign subsidiaries (the 'per element' approach). Each case considered separate elements of the fiscal unity regime, with one considering the interest deduction limitation.

The opinion of the advocate general (AG) was released on 25 October 2017, and readers may recall that we reported on this in our December 2017 briefing. As the CJEU has now agreed with the AG's opinion, the Dutch government has confirmed it will introduce the previously announced emergency remedial measures with retrospective effect from 25 October 2017.

These emergency measures stipulate that certain corporate income tax provisions relating to the interest deduction limitation will need to be applied as if there is no fiscal unity. In addition, these changes will impact, amongst other things, the application of the carry-forward loss provisions in cases of change of control and the participation exemption to the extent these rules are affected by the current fiscal unity regime. Although legislation has not yet been published (it is expected in the second quarter of 2018), it is already clear that there may be a substantial impact for businesses with Dutch companies that are included in a fiscal unity for Dutch corporate income tax purposes.

Singapore

The finance minister on 19 February, delivered a budget for 2018 that includes certain tax-related measures. As noted above, this includes the extension of GST to services imported on or after 1 January 2020. For business taxpayers, the budget also includes the following measures:

- corporate income tax rebate enhancement and extension;
- reduced thresholds for start-up tax exemption scheme;
- funding support of up to 70% for adopting pre-scoped, off-the-shelf solutions to improve productivity;
- funding support of up to 70% for firms to build a range of capabilities (such as innovation);
- enhanced tax deduction for qualifying intellectual property licensing costs or registration costs; and
- increased tax deduction for staff costs and consumables incurred with respect to qualifying research and development costs. ■

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- Spring Statement 2018: corporate tax and the digital economy (Heather Self, 14.3.18)
- International briefing for November 2017 (Tim Sarson, 30.11.17)
- Dutch withholding tax (Miles Dean, 14.3.18)