Briefing

International update for April -

Speed read

Both China and America have initiated complaints to the World Trade Organisation in response to the customs duty war taking place between the two countries. On 1 July 2018, the OECD's multilateral instrument will enter into force in five European jurisdictions. In Europe, Luxembourg has introduced a new IP regime, Sweden has presented its proposed new legislation on corporate interest deductions, and Austria has drafted several changes to Austrian tax law. Further afield, both Australia and New Zealand report potential tax changes relating to R&D, and Thailand is the latest country to consider unilateral action in response to the digital economy.

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Even though I don't usually write in detail about indirect tax developments, it would be difficult to not include a comment on the developing political situation involving US and Chinese customs duties. President Trump has proposed $50bn worth of US tariffs on hundreds of Chinese imports; and China has subsequently announced proposed tariffs on an additional 106 US products. The US has stated that this is to address China's policies concerning technology transfers and intellectual property. The row started with US import taxes on steel being set at 25% and 10% for aluminium, which went into effect on 23 March 2018. China believed these would adversely affect its trade.

It is not yet certain how far this 'tit-for-tat' trade war will go but at the time of writing neither President Trump nor President Xi seems willing to back down. Both countries have initiated complaints with the World Trade Organisation, which may suggest there is no end in sight for this conflict. This has unsettled global markets in recent weeks and is likely to continue to for the foreseeable future.

This is a further example of the continuing influence of geopolitics on the international tax and regulatory landscape. Protectionism takes many forms. This trade war falls at the 'traditional' end of the spectrum, but there are also plenty of examples – both multilateral and unilateral – at the opposite end of the scale. Increasingly, corporate taxes, and the wide range of new 'anti-abuse' provisions springing up around the world, arguably have a trade protectionist element to them.

OECD update

The OECD announced this month that its multilateral instrument (the MLI) will enter into force in five European jurisdictions on 1 July 2018. This follows the deposit of the fifth instrument of ratification with the OECD by Slovenia on 22 March 2018 (following in the footsteps of Austria, Isle of Man, Jersey and Poland).

The entry into force of the MLI on 1 July 2018 will bring it into legal existence in these five jurisdictions. In accordance with the rules of the MLI, its contents will start to have effect for existing tax treaties as from 2019.

As previously discussed, the MLI is the first multilateral treaty of its kind, allowing jurisdictions to transpose results from the OECD/G20 BEPS project into their existing bilateral income tax treaties. The MLI thus will transform the way tax treaties are modified, without the need for bilateral treaty renegotiations.

It will, however, mean that interpretation of double tax agreements will be more complex for those companies wanting to rely on treaties, as they will have to analyse the impact of the MLI on each specific bilateral tax treaty. This will be particularly true in the next couple of years, as we start to see more and more ratifications being deposited with the MLI. Affected taxpayers will need to consider a complex matrix of covered tax agreements, notifications, reservations and the staggered timings of the MLI commencement schedule.

Luxembourg

Luxembourg has introduced a new IP regime, which came into effect on 1 January 2018. The new IP regime makes Luxembourg compliant with the 'modified nexus approach' set out in the OECD's final BEPS Action 5 report. Broadly speaking, the regime provides an 80% tax exemption on income derived from patents (including IP assets functionally equivalent to patents) and copyrighted software, as well as a full net wealth tax exemption of these assets.

This new IP regime is similar to other European IP regimes with certain exceptions: the partial exemption of capital gains on disposals of qualifying IP assets; and the option to include R&D expenditure of foreign branches (located in the EEA) as qualifying R&D expenditure.

As far as timing is concerned, this new IP regime will co-exist with the repealed 'old' IP regime, which is still applicable during the grandfathering period (subject to certain conditions), until 30 June 2021.

For those groups with IP activity in Luxembourg, now is a good time to review their R&D activity strategies, implement appropriate and efficient tracking of R&D income and expenditures, and prepare supporting documentation (according to transfer pricing guidelines) in order to determine the R&D income benefiting from the 80% exemption.

Sweden

The Swedish government has presented its proposal on new tax legislation regarding corporate interest deductions.

The proposed corporate interest restrictions are broadly comparable to those both set out in the BEPS report and recently introduced in the UK:

- A general EBITDA based interest deduction limitation is introduced in the corporate sector, with the cap calculated as 30% of EBITDA.
- Unutilised interest deduction capacity can be carried forward for up to six years, but is lost in the event of a change of ownership.
- Net interest expenses of up to SEK 5m (c. £400,000) per group may be deducted without applying the EBITDA rule.
- There is an amendment to the current interest deduction limitation rules for certain intra-group loans. Interest deductions will now be available if the beneficial owner of the interest income within the group: (i) is resident within the EEA; (ii) is resident of a state with which

Sweden has a tax treaty not limited to certain income; or (iii) is subject to a corporate tax of at least 10%. However, no tax deduction would be granted if the underlying purpose of the loan is exclusively (or as good as exclusively, i.e. greater than 90%) to obtain a significant tax benefit for the group.

When presenting the proposal, the minister of finance stated that they will monitor the proposed adjustments and, if necessary, return with new revised rules. This could include how the amended current interest deduction limitation rules work, the time limit to utilise net interest expenses carry forward, and potentially an exemption for public infrastructure projects.

In addition to the changes to the corporate interest regime, the government also proposes a two-step reduction of the corporate tax rate, from the present 22% to 21.4% for financial years commencing after 31 December 2018; and to 20.6% for financial years commencing after 31 December 2020. Finally, the previously proposed limitation on the utilisation of tax losses carry forward is abandoned.

It is proposed that the above changes will enter into force on 1 January 2019, applying to financial years commencing after 31 December 2018.

Austria

On 11 April, the Austrian Ministry of Finance published a ministerial draft setting out several changes to Austrian tax law. The draft includes a proposal to introduce controlled foreign corporation (CFC) rules, for tax years starting after 30 September 2018.

The proposed CFC rules aims to implement the EU anti-tax avoidance directive into Austrian domestic law by allowing for the reallocation of income of subsidiaries in 'low tax' jurisdictions to the Austrian parent company. Any foreign taxes paid would be creditable against Austrian taxation.

The CFC rules would apply to Austrian corporations holding a 'controlling interest' (more than 50% of voting rights, capital or dividend rights, either alone or together with associated enterprises) in an entity, and would reallocate passive income to the extent it represents more than one-third of the foreign subsidiary's total income and the effective tax rate of the foreign entity is 12.5% or less. 'Passive income' includes dividends, interest, royalties and financial leasing fees; capital gains from the sale of participations; income from insurance, banking or financial activities; and income from 'invoicing companies'.

The proposed CFC rules would not apply if the controlled foreign company conducts 'substantial economic activity' supported by staff, equipment, assets and premises (as evidenced by relevant facts and circumstances).

In addition to the proposed CFC taxation rules, the 'switch-over provision' would continue to apply but with certain modifications. For example, dividends and capital gains from 'low tax' passive participations of at least 5% would not be tax-exempt in Austria, but would be taxable with a tax credit allowed for any foreign taxes paid, provided that certain conditions are met.

Australia

Australia's treasurer has indicated there may be significant changes to the R&D tax incentive in the Federal Budget. Key changes could be the introduction of a 1% or 2% intensity threshold (requiring companies to spend at least that percentage of their total expenditure on R&D), a A$4m cap (c. £2m) on the annual refundable amount and a potential A$40m lifetime cap on the refundable amount. It is also possible that a collaboration premium will be introduced that will provide a non-refundable tax offset for expenditure spent by the private sector on collaborating with Australian research institutions. How these changes may be implemented is yet to be seen, but it is clear that the government intends to rein in the overall cost of the programme.

New Zealand

On a similar theme, the new government in New Zealand has committed to the re-introduction of a 12.5% R&D tax credit, with a possible effective date for the R&D tax credit of 1 April 2019. It is anticipated that with this re-introduction of the R&D tax credit, the current 'Callaghan innovation R&D growth grant' could be wound down.

Given it could be another year before any new legislation would take effect, and provided the current R&D funding continues to be available, businesses need to reconsider their eligibility for assistance and internal processes for documenting R&D activities.

Thailand

Again, while not strictly a direct tax update, it is worth noting Thailand's response to the deliberations regarding taxing the digital economy that I discussed in my previous article. It has attempted to resolve the problem of taxing the digital economy through the use of VAT.

The Thai Revenue Department (TRD) has now issued its comments addressing key issues raised by potentially impacted foreign e-commerce operators at a second public hearing (conducted in early February 2018, on the second draft of the proposed e-commerce law).

Briefly, the second draft of the e-commerce legislative amendments proposed that a foreign company providing services through electronic media to a non-VAT registered person, where such services are used in Thailand, must register and be subject to 7% VAT in Thailand if its annual VAT-able income exceeds Thai Baht 1.8m (c£40,000).

Although some important clarifications released by the TRD undoubtedly provide some further clarity on the possible outcomes from the future implementation of an e-commerce tax in Thailand, the administration of the proposed e-commerce tax will, however, not be an easy one. We understand that stakeholders would welcome further consultation with the Thai government; for example, an open forum with potentially impacted e-commerce foreign operators, or an assessment of how other countries have implemented their e-commerce levies. This would help with a fuller understanding of the challenges that may arise from enacting a tax on e-commerce, and the broader consequential impact on the Thai economy.

This development demonstrates two important points: firstly how, despite the OECD's attempts to prevent this, the subject of taxation of the digital economy continues to press ahead and convert into tangible (unilateral) tax policy; and secondly, this is arguably another example of protectionism in action. ■

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- Interpreting double tax treaties in light of the BEPS multilateral instrument (Jeremy Webster & Jamie Robson, 31.8.17)
- The multilateral convention to implement tax treaty related measures to prevent BEPS (Sandy Bhogal & Kitty Swanson, 19.1.17)