Briefing

International briefing for September

Speed read

Taxation of the digital economy is once again on the international agenda, with developments within the EU and a proposal for a unilateral measure in Chile. Australia has published draft legislation amending its significant global entity and country by country rules. Chile has published draft legislation for its tax reform programme. Ireland, Poland and Sweden have progressed with the implementation of the Anti-Tax Avoidance Directive into domestic law. Finally, whilst there has been little tangible movement in relation to Brexit, the UK has published a series of notices explaining the potential impacts of a 'no deal' Brexit scenario for businesses.

Tim Sarson
KPMG
Tim Sarson is a tax partner at KPMG in the UK. He has worked in the international tax and transfer pricing field since 1998, in both practice and industry. Email: tim.sarson@kpmg.co.uk; tel: 020 7694 4831.

After a busier than expected start to July, we did eventually settle into the traditional summer lull and indeed this column took its own summer break during August. Although not unexpected, there was little visible progress in the UK government's Brexit negotiations, aside from the publication of a number of 'no deal' Brexit scenario notices. Many of us are feeling Brexit fatigue, but we should not underestimate the distraction of the continually present Brexit background music. With the UK's exit date looming, the coming months should eventually provide us with some much needed certainty over the future UK/EU relationship.

In my view, the key to successfully navigating our way through the next year's tax agenda will be knowing when to leapfrog Brexit to the top of the list. This will of course vary, depending on the specifics of each business and the sector it is in. Act too soon and there is a risk that time and effort will be diverted away from the (many) other items on the international tax agenda. However, hold off for too long and there could be a really challenging impact on the smooth running of business operations as we close in on March 2019. My only caveat to this is 'no regrets' planning – so called because it either requires only minimal effort for a valuable (and normally reversible) result, or because it brings wider benefits to the business.

Another signal that we are back to business-as-usual are the announcements from the White House on US trade relationships: first, the agreement of a deal with Mexico but notably not Canada; and now, at the time of writing, an escalation of the US-China trade war.

Taxation of the digital economy

The European Commission (EC)'s proposals for taxation of the digital economy have once again been the subject of discussion, this time at an informal meeting of the Economic and Financial Affairs Council (ECOFIN) in Vienna on 7 and 8 September. In a statement following the meeting, the Austrian minister of finance indicated the EU will look to reach agreement on the EC's proposed interim measure, a 'digital services tax' (DST), as soon as possible, and that he believes it would not be unreasonable to achieve this by the end of the year. Many remain to be convinced on this: it is an ambitious timeline, especially given that a number of member states have continued to express reservations about the EC's proposals.

The agreement by the ECOFIN, supported by the EC, to include a 'sunset clause' in the DST proposal may, however, facilitate wider agreement on the DST. The 'sunset clause', suggested by France and Germany, would ensure that the DST would cease to have effect once there is international consensus on a permanent, long-term solution to the challenges of taxation of the digital economy. Following the ECOFIN meeting, the 27 member states reportedly agreed that there was a need to implement a short-term solution, such as the DST – perhaps indicating that some of the initial concerns had been addressed, at least in part.

Local country updates

Australia

Following the announcement in the Federal Budget in May this year that it would look to expand the significant global entity (SGE) definition, on 20 July the Australian Treasury released draft legislation introducing the concept of a 'notional listed company group' (NLCG) within the SGE definition. The SGE definition at present may exclude some entities, e.g. those headed by trusts, investment entities, partnerships or proprietary companies. The draft legislation expands the definition of an SGE to include any member of a NLCG that meets the A$1bn (c. £0.5bn) annual global income threshold. An NLCG is broadly defined as a group of companies that would be expected to consolidate as a single group for accounting purposes, assuming that one of the group members is a listed company and disregarding any exception to consolidation (including materiality). These changes would effectively bring the treatment of all members of multinationals with revenues exceeding A$1bn onto a level playing field, regardless of their consolidation position, for the purposes of Australia's unilateral SGE measures – including diverted profits tax, multinational anti-avoidance law, administrative and transfer pricing shortfall penalties, and general purpose financial statements.

The draft legislation also aims to harmonise the Australian country-by-country (CBC) reporting framework with the OECD requirements, in part through the introduction of a 'country by country reporting entity' (CBCRE). The result of this is that an entity could be an SGE, but not a CBCRE, as exceptions to accounting consolidation (other than materiality) will be respected under the CBCRE definition. This seems to be aimed at ensuring that foreign-owned taxpayers within groups with revenue exceeding A$1bn, which may previously have been excluded from CBC reporting requirements on the basis that the controlling shareholders did not consolidate the group for accounting purposes, will now have to consider whether they also have CBC reporting obligations. Both the introduction of a CBCRE and an NLCG are expected to have effect for financial years beginning on or after 1 July 2018.

Chile

Following swiftly on from an announcement by the Chilean president on 21 August of his intention to modernise and simplify the Chilean tax system, draft legislation for a tax reform bill was submitted to Chile's Congress on 23 August. One of the proposed measures aims to bring the treatment of treaty and non-treaty non-resident investors broadly in line for dividend withholding tax purposes, allowing all investors to claim a credit equal to 100% of the corporation tax paid by the company against the 35% non-resident dividend withholding tax. Eligibility for the reduced 4% rate of withholding tax on interest payments would be restricted to cases where the 'ultimate beneficiaries' of the interest are banks, financial entities, insurance companies or pension funds.

The tax reform bill proposes new rules for non-Chilean mergers, spin-offs involving assets located or registered in Chile, and cross-border mergers involving a Chilean entity (provided that the entity survives the reorganisation). Where the legal consequences of such transactions are similar to a purely domestic reorganisation, it is proposed that these international restructurings will be eligible for tax-free treatment.

Continuing the trend for unilateral measures aimed at the digital economy, the draft bill introduces a 10% tax on digital services provided by a non-resident to Chilean resident individuals. This will not alter the rules for digital services provided to resident entities by non-residents.

The draft legislation also contains provisions to bring the domestic definition of permanent establishment (PE) broadly in line with the OECD definition, with a few minor differences. The proposals clarify that only a dependent agent could give rise to a PE and prevent preparatory and auxiliary activities from constituting a PE.

Ireland

On 5 September, Ireland published its *Corporation Tax Roadmap*, which included details of Ireland's adoption of measures under the EU Anti-Tax Avoidance Directive (ATAD), the updating of Ireland's transfer pricing regime to current international best practice standards, and its commitment to continuing to implement EU and OECD wide transparency related initiatives. Ireland's roadmap restates its commitment to the 12.5% rate of corporation tax.

The roadmap measures include proposals (subject to a consultation) for updating Ireland's transfer pricing regime to current international best practice standards under OECD transfer pricing guidelines from 1 January 2020.

As expected, Ireland intends to adopt ATAD measures in line with the Directive but not to go beyond its requirements. Details of Ireland's proposed controlled foreign corporation (CFC) regime were released for consultation on 7 September, confirming that Ireland will adopt 'option B' of the two approaches set out in the ATAD, i.e. applying the CFC regime to undistributed profits that have been diverted to a 'low-taxed' CFC through non-genuine arrangements.

The regime would tax an Irish parent on an amount of profit which is estimated using arm's length transfer pricing principles. Where the exercise in Ireland of significant people functions of the Irish parent or a group member has been instrumental in generating the income of the CFC, the amount of the attributable income is taxed under the CFC regime at either 12.5% (trading income) or 25% (non-trading income).

The outline for the Irish CFC regime indicates that a number of other permitted measures under the ATAD, primarily aimed at easing the administrative burden and minimising double taxation, may also be implemented by Ireland. These include: removing from scope CFCs that pass a 'low-tax test requirement'; excluding from scope CFCs that have low profits or undertake low profit margin activities; temporarily excluding from scope (for a 12 month period) CFCs acquired from third parties; excluding undistributed profits priced on an arm's length basis or subject to Irish transfer pricing rules; and allowing 'creditable' foreign tax to be offset against the CFC's profits subject to Irish corporation tax. The proposals are expected to take effect from 1 January 2019.

Poland

In an effort to harmonise its domestic law with the requirements under the ATAD, on 24 August Poland's Ministry of Finance set out its proposal for an 'exit tax' in Poland on unrealised capital gains. The exit tax would be imposed on the transfer of an asset outside of Poland (with 'transfer' broadly defined, but with the asset remaining the property of the same person) and on a change of taxpayer residence if, as a result of the transfer or change in residence, Poland would lose the right to impose tax (either wholly or in part) on a future sale either of the asset or an asset owned by the taxpayer.

Interestingly, going beyond the strict requirements of the ATAD, Poland also proposes to impose the exit tax on individuals transferring assets during a one year period with a cumulative market value in excess of PLN 2m (c. £0.4m), mainly charged at 3%. In contrast, corporate taxpayers, and individual taxpayers in certain circumstances, would be liable to tax on their unrealised gains at a rate of 19%. The exit tax is expected to come into effect for both companies and individuals as of 1 January 2019.

Separately, the Polish Ministry of Finance set out a proposal for an 'IP box' regime, a preferential regime for income generated from certain intellectual property (IP) rights. Under the proposed IP box measures, income from IP rights created, developed or improved by the taxpayer through research and development activities carried on in Poland would be taxed at a 5% rate.

Sweden

The Swedish government published a legislative proposal to amend the CFC rules in Sweden, in order to align them with the requirements of the ATAD. The draft legislation will tighten the CFC rules in Sweden by removing a number of countries (including Malta) from the 'white list' of exempt territories, amending the rules relating to 'contingency reserves' of insurance companies and, going beyond the requirements of the ATAD, applying the rules both to corporate shareholders and to individuals. The changes are proposed to become effective on 1 January 2019.

Brexit

Following the publication of the UK government's white paper, the summer months were relatively quiet on the Brexit front. Negotiations are continuing, but in the absence of an agreed final deal, the UK government has ramped up its preparations for a potential 'no deal' Brexit – issuing a series of 'no deal' notices to help businesses understand the implications of, and prepare for, the scenario where the UK leaves the EU without a deal. Rounds 1 and 2 of these notices have now been published on the government's website, with a further round expected later this month. These cover a broad range of matters, many touching on tax – for example, the impact of Brexit on importing and exporting, VAT and state aid. In addition to these no deal notices, we understand that HMRC is starting to contact taxpayers highlighting the practical implications of a no deal exit; for example, for those UK traders who have not, to date, exported outside the EU. ■

For related reading visit www.taxjournal.com

- Tax reform in the digital economy: recent OECD and EC activity (Murray Clayson, 4.4.18)
- Examining the revised EC Anti-Tax Avoidance Directive (Tom Wesel & Zoe Wyatt, 7.7.16)
- VAT and a 'no deal' Brexit (Charishma Juddoo, 30.8.18)