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International Tax News

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Welcome

Keeping up with the constant flow of international tax developments worldwide can be a real challenge for multinational companies. International Tax News is a monthly publication that offers updates and analysis on developments taking place around the world, authored by specialists in PwC's global international tax network.

We hope that you will find this publication helpful, and look forward to your comments.

Featuered articles

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China

China expands scope of accelerated depreciation methods for CIT preferential treatments to all manufacturing sectors

In order to upgrade China's traditional industries and enhance technology innovation, beginning in 2014 China issued several policies to improve the fixed asset (FA) accelerated depreciation policy under the Corporate Income Tax (CIT) law. The policies provided that certain industry specific entities in (e.g., bio-pharmaceutical manufacturing, special equipment manufacturing, software and IT services, automobile industries, etc.), could have certain newly acquired FAs qualify for the CIT deduction in one lump sum in the acquisition year, or be depreciated by using the accelerated depreciation methods. The accelerated depreciation methods refer to depreciation over a shorter period (up to 60% of the minimum depreciation period) of FAs prescribed in the CIT law or, as an alternative, depreciation calculated using the 'double declining balance method' or 'sum-of-year-digits method.'

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Further to the above policies, China issued Public Notice [2019] No. 66, to substantially expand the industry sectors that are eligible to use FA accelerated depreciation methods for CIT purposes to all manufacturing sectors. The policy became effective January 1, 2019.

PwC observation:

Since more costs now may be deducted at earlier stages, companies' cash flow should improve and investments in certain industries should increase.

Italy

Italian government approves measures to boost national economic growth

Law Decree No. 34 of April 30, 2019 (the 'Growth Decree') introduced, among others, the following provisions:

- **Reduced CIT rate -** Instead of the ordinary 24% CIT rate, reduced CIT rate (22.5% for FY19, 21.5% for FY20, 21% for FY21, 20.5% for FY22) applies to the portion of taxable income that corresponds to the prior year profit allocated to available equity reserves and within the limit of the net equity increase.
- **Free tax step-up regime applicable up to FY22 -** Deficits, arising from mergers and demergers between unrelated non-dormant companies, allocated to goodwill and fixed assets in the financial statements are recognized for CIT purposes up to€ 5m; this same regime applies to contributions of business. Claw-back clauses apply.
- **Self-determination of the patent box benefit -** Beginning in FY19, taxpayers are no longer obliged to file an advance tax ruling with tax authorities in order to determine the patent box benefit, provided that 'adequate documentation' (including the criteria for the benefit's computation) is prepared. If there is a tax assessment of the patent box benefit, penalties will not apply, as long as certain requirements are met.
- **Super amortization -** The purchase cost of new tangible fixed assets (up to € 2.5 m) purchased (or leased) between April 1 and December 31, 2019 is effectively increased by 30% for tax amortization (or lease payment) purposes.

PwC observation:

Companies might consider the free tax step-up regime in implementing reorganizations and certain foreign investment structures. The self-determination of the patent box benefit could be combined with intangible property planning structures.

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Australia

ATO releases guidance regarding multiple entry consolidated groups avoiding capital gains tax through intra-group debt

The ATO released Taxpayer Alert TA 2019/1, on March 28, expressing the ATO's concerns about multiple entry consolidated (MEC) groups avoiding capital gains tax (CGT) through intra-group debt.

The ATO is reviewing arrangements where a MEC group sells a CGT asset with a large unrealized capital gain by way of moving the relevant asset into an 'eligible tier-1 company' (an 'ET-1 company') with significant (existing or newly created) intra-group debt and then selling the ET-1 company shares to a third party purchaser. As part of the arrangement, the purchaser undertakes to ensure the ET-1 company's intra-group debt is extinguished on the sale's completion, thereby avoiding CGT for the MEC and foreign shareholder. The arrangements are, in substance, a sale of the asset by the MEC group to the purchaser.

PwC observation:

Taxpayers whose arrangements exhibit these features should ensure they are ready to provide evidence to the ATO in relation to the commercial non-tax reasons for the transfer of the assets and intra-group debt.

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Australia

ATO releases guidance on the arm's-length debt test

The ATO issued Draft Ruling TR 2019/D2 on April 5, 2019. The draft ruling provides guidance on applying the arm's-length debt test (ALDT) under the thin capitalization rules.

The ALDT requires the separate calculation of a debt amount under both the independent borrower test and the independent lender test. Given that the determined arm's-length debt amount (ALDA) needs to satisfy both independent tests, the applicable ALDA is determined based on the lesser amount of these two tests.

The draft ruling specifically covers key technical issues that arise when calculating the ALDA. Once finalized, the draft ruling will apply retroactively, and will replace the existing taxation ruling on the application of the ALDT (TR 2003/1).

PwC observation:

Taxpayers should evaluate their historic ALDT positions in light of the 'retroactive nature' of the draft ruling and understand how the result may play out under this guidance. Practically speaking, the ALDT is now a key focus area of the Commissioner and each case is likely to come down to an evidentiary exercise between taxpayers and the Commissioner as to whose view is more 'reasonable.'

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Australia

ATO guidance on low-tax lender rule in the anti-hybrid rules

On April 5, 2019, the Australian Taxation Office (ATO) issued a draft Law Companion Ruling (LCR 2019/D1) regarding particular aspects of Australia's low-tax lender rule.

The low-tax lender rule is designed to prevent multinational groups from interposing entities in a no or low-tax jurisdiction (10% or less) as an alternative to using hybrid entities or instruments. Where applicable, this rule will deny the borrower's entitlement to a deduction for interest and other financing costs for tax years commencing after December 31, 2018 (i.e., from January 1, 2019 for calendar-year taxpayers).

Whether payments are subject to foreign tax at a rate of 10% or less is a key element in identifying whether the rule applies. According to the draft LCR, where two countries impose tax on a payment, only the higher rate of tax can be taken into account (the cumulative tax cannot be taken into account). In addition, tax holidays, concessional rates of tax based on particular activities or status all need to be taken into account (i.e., a headline corporate tax rate of more than 10% is not sufficient). In addition, tax grouping or tax consolidation may activate the back-to-back look-through rule.

PwC observation:

The draft LCR clarifies a number of technical issues. However, uncertainties remain, and the practical application of the low-tax lender rule will continue to present challenges for taxpayers. Notably, the draft LCR does not address how this rule interacts with certain foreign tax regimes or ownership structures connected to foreign state-owned enterprises.

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Italy

IRA issues implementing regulation addressing PE self-disclosure procedure

The Italian Revenue Agency (IRA) issued, on April 16, the implementing regulation that addresses the self-disclosure procedure of a permanent establishment in Italy for foreign enterprises. This was endorsed in Article 1-bis of Law Decree No. 50 of April 4, 2017, converted by Law No. 96 of June 21, 2017. The self-disclosure procedure provides foreign multinational entities (MNEs) an opportunity to check with the IRA as to whether their operations and activities in Italy amount to a taxable presence for both corporate income tax (a permanent establishment, or 'PE') and VAT purposes (a fixed establishment, or 'FE'). If they do, the procedure allows MNEs, through an agreement with the IRA, to attribute an arm's-length profit to the PE and address any VAT ramifications.

Please see our **PwC Insight** for more information.

PwC observation:

The Italian self-disclosure procedure is a step towards Italian transparency and fair collaboration with foreign MNEs. It grants a beneficial regime in terms of applicable administrative and criminal penalties and the right to enter into the Italian cooperative compliance procedure. For the time being, the self-disclosure procedure is the only legal measure available to deal with the IRA in relation to activities already performed that might constitute a PE in Italy. The ruling procedure, through which a foreign MNE can ask the IRA to conclude whether a PE exists, is, in fact, subject to the 'preventive' requirement (is limited to cases where no activities have been performed in Italy at the time the ruling is filed).

MNEs should evaluate the potential benefits of the self-disclosure procedure, and consider that group activities in the Italian market are viewed in their entirety. Furthermore, MNEs should remember the importance placed on the support activities that present either a direct or an indirect link to the sale of goods and the provision of services in Italy.

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United States

Section 965 toll charge regulations could affect US inbound companies

Treasury and the IRS earlier this year released final regulations under amended Section 965 ('the toll charge'). The final Section 965 regulations provide guidance relating to the toll charge due upon the mandatory deemed repatriation of certain deferred foreign earnings. Section 965, enacted in December 2017 as part of the comprehensive US tax reform legislation (the Act), levies a transition tax on post-1986 untaxed foreign earnings of specified foreign corporations owned by United States shareholders by deeming those earnings to be repatriated.

While US inbound companies generally are not directly affected by Section 965, shareholders of US companies with non-US subsidiaries should consider the potential Section 965 tax liability, effects on certain tax attributes, and compliance obligations. US inbound companies that own US companies with non-US subsidiaries therefore should consider the potential impact of these rules upon their operations.

PwC observation:

US inbound companies with sandwich structures should review their business operations in light of the Section 965 final regulations. MNEs should consider potential transactions to determine whether a transfer agreement will need to be filed within 30 days of the transaction date.

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United States

Treasury and the IRS finalize and withdraw parts of the temporary Section 987 regulations

Treasury and the IRS released on May 10 final regulations under Section 987 that finalize certain anti-abuse provisions contained in previously issued temporary regulations and withdraw other temporary regulations. The Section 987 regulations generally provide guidance regarding the determination of income or loss and Section 987 gain or loss with respect to a Section 987 qualified business unit (QBU).

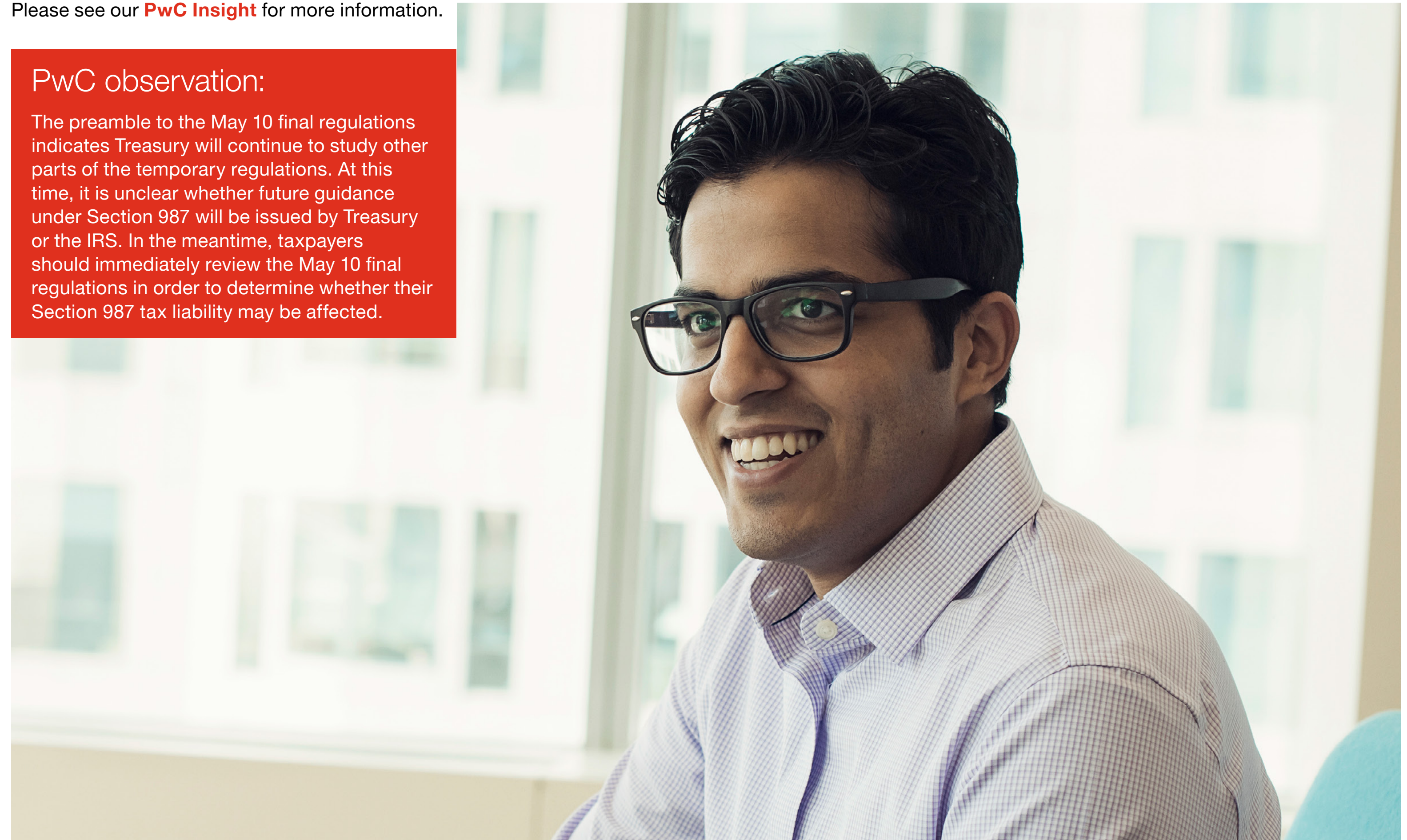
In December 2016, Treasury had issued a complex set of temporary Section 987 regulations, proposed regulations, and final but not effective regulations. The provisions of those December 2016 temporary regulations that were finalized on May 10 were due to expire in December 2019.

Generally, the May 10 Final Regulations finalize former temporary provisions relating to the recognition and deferral of Section 987 gain or loss and regarding combinations and separations of Section 987 QBUs. The May 10 Final Regulations also withdraw temporary guidance with respect to the liquidation value percentage methodology for allocating assets and liabilities in the context of Section 987 aggregate partnerships.

Please see our **PwC Insight** for more information.

PwC observation:

The preamble to the May 10 final regulations indicates Treasury will continue to study other parts of the temporary regulations. At this time, it is unclear whether future guidance under Section 987 will be issued by Treasury or the IRS. In the meantime, taxpayers should immediately review the May 10 final regulations in order to determine whether their Section 987 tax liability may be affected.



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Australia

Clarity for foreign fund investors in complex foreign resident fund case

The Full Federal Court of Australia, in Resource Capital Fund IV LP v Commissioner of Taxation [2019] FCAFC 51, comprehensively overturned the first instance decision, which held that certain gains made by a foreign resident fund on the sale of shares in an Australian company should not be taxable in Australia.

The judgments key takeaways are:

- Limited partnerships are taxable entities. Unpaid tax can be collected from individual partners in the event of LP non-payment.
- Gains made by the foreign resident fund on the sale of shares in an Australian company were sourced in Australia for tax purposes notwithstanding that significant activities in relation to the shares were undertaken overseas including most, if not all, of the key decisions made by the investment committee.
- The underlying partners were able to claim treaty protection, however the fund itself was not.
- The term 'mining' in this instance should capture downstream processing functions. Accordingly, the general purpose leases and miscellaneous licenses that were part of those downstream activities were taxable Australian real property.

PwC observation:

The decision addresses a number of complex international tax issues, and clarifies the tax treatment of limited partnerships. This case is important for foreign investors who are considering investing in Australia.

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United Kingdom

UK intra-group transfer rules found to violate EU law

A First Tier Tribunal (the UK's lowest-tier tax court) held that imposing an immediate corporate tax liability on capital gains from an asset transfer by a UK company to its Dutch parent company, denying the no gain / no loss treatment available to transfers within a UK group, is a disproportionate measure that violates the EU right to freedom of establishment.

The UK offers tax relief where there is a capital gain on the disposal of assets between members of a UK group. This is achieved by deeming the consideration for the transfer (in the hands of both the transferor and transferee) to be the sum that would result in no gain / no loss arising for tax purposes. A chargeable gain or allowable loss will therefore only arise when the asset is disposed outside the UK group, and that gain or loss will reflect the economic gain or loss throughout the group's period of ownership. However, these rules currently require that both transferee and transferor are subject to UK corporate income tax with respect to the asset concerned. In other words, they must either be UK tax resident or the asset must relate to their UK permanent establishment.

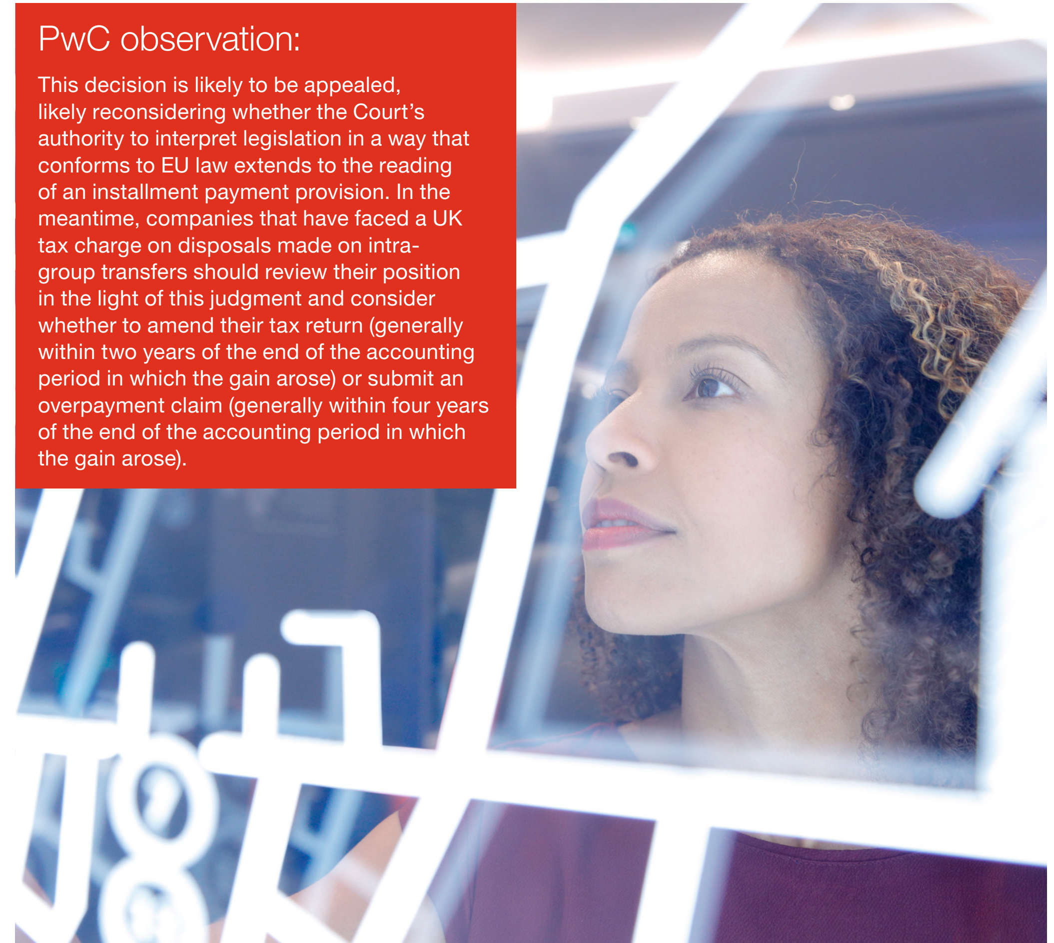
The case considered two disposals made within an international group. The first was a disposal of assets by a UK company to its Dutch parent and the second a disposal by a UK subsidiary of a Dutch parent to a sister subsidiary in Switzerland.

For the first disposal, the Court held that the immediate charge to tax was a breach of the Dutch company's freedom of establishment. It considered that requiring tax payment by installments would be proportionate, but concluded that it didn't have the power to interpret the legislation as including such a provision. The Court therefore reluctantly felt obliged to remove the requirement that the transferee be subject to UK tax in order to qualify for the tax relief available to a UK group, with the result that this transfer would take place at no gain / no loss (notwithstanding the fact that there is no mechanism to impose a UK charge on the eventual disposal of the asset).

As for the second disposal, the Court concluded that since they were dealing with rules concerning group taxation, only freedom of establishment was at issue (and not free movement of capital). Therefore, the Court concluded that there was no restriction on the Dutch company's freedom to establish its UK subsidiary in this scenario because the same result would have arisen had the parent in fact been a UK resident, rather than a Dutch resident.

PwC observation:

This decision is likely to be appealed, likely reconsidering whether the Court's authority to interpret legislation in a way that conforms to EU law extends to the reading of an installment payment provision. In the meantime, companies that have faced a UK tax charge on disposals made on intra-group transfers should review their position in the light of this judgment and consider whether to amend their tax return (generally within two years of the end of the accounting period in which the gain arose) or submit an overpayment claim (generally within four years of the end of the accounting period in which the gain arose).



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Luxembourg

EC published opening decision on Luxembourg interest-free loans

The European Commission (EC) on May 3 published the non-confidential version of its opening decision in its State aid investigation into certain tax rulings granted by the Luxembourg tax authorities. These rulings related to that country's treatment of interest-free loans granted by an Irish group company to a Luxembourg group company. According to the opening decision, the EC expressed doubts that the treatment endorsed by the rulings in question can be justified, based on the following arguments:

Similar to the 'Belgian excess profits' State aid case, the EC considers that the reference system against which to assess selective treatment is the general Luxembourg tax system that subjects companies to taxation on their accounting profits, not the domestic transfer pricing provisions.

Against this general system, the EC considers that the unilateral downward adjustment applied on the interest-free loans represents a selective advantage, because in the EC's view it derogates from the principle of starting with accounting profit in assessing tax.

Furthermore, the EC considers that the Luxembourg income tax law provisions invoked by the Luxembourg tax administration that allow a downwards as well as an upwards adjustment of company profits cannot support a downwards adjustment in the situation where there is no corresponding income inclusion in the counter-party jurisdiction.

Please see our **PwC Insight** for more information

PwC observation:

The decision represents the EC's preliminary arguments for opening a State aid investigation. The final decision to be issued pursuant to a detailed investigation will be important for properly assessing this case's implications.

The decision is the latest in a number of high-profile cases concerning State aid and taxation. However, it is the first case that addresses the treatment of interest-free loans.

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China

China and Italy sign a new tax treaty and accompanying protocol

China and Italy entered into a new tax treaty on March 23, 2019. The treaty will enter into force on the 30th day following the day on which the respective legal procedures are completed by both sides. The key changes from the old tax treaty concluded in 1986 include:

Permanent establishment (PE)

- The time threshold for constituting a construction PE increases from 6 months to 12 months.
- The time threshold for constituting a service PE is changed from 6 months to 183 days within any twelve-month period.
- The situations that constitute agency PE are extended.

Dividends

The reduction of WHT rate from 10% to 5% in case of dividend paid to shareholders who owns directly at least 25% of the capital of the payer for a period of at least 12 months;

Interest

- The reduction of WHT rate on interest payments from the ordinary 10% to 8% on loans – granted by financial institutions - with a duration of at least 3 years for the financing of investment projects;
- The exemption from WHT both in case of interest payment by (or to) the Government or in case of interest payment to the Central Bank and any entity whose capital is wholly owned by the Government of the other State (provision already included in the tax treaty currently in force);
- The exemption from WHT for Italian-sourced interest payments in case the issuer is the Bank of Italy, Cassa Depositi e Prestiti, SACE or Simest.

Royalties

The reduction of withholding taxes on royalties relating to the use of, or the right to use industrial, commercial, or scientific equipment from 10% to 5%.

New provisions are added to the 'capital gains' article to provide clarity

- The term 'more than 50%' has replaced the word 'principally' in the immovable property paragraph to provide more clarity in the determination of 'immovable property holding company'.
- A 12-month holding period and indirect participation are added to the paragraph on the alienation of shares, other than 'immovable holding company shares.'
- The taxing right on gains from the alienation of any property, other than that referred to in paragraph 1 to 5 of the capital gains article, is now clearly granted to the state of residence, while under the old tax treaty, the source state may tax such gain if the gain arises from the source state.

Methods for eliminating double taxation

Double taxation shall be eliminated in China where the income derived from Italy is a dividend paid by a company that is a resident of Italy to a company that is a resident of China and that owns not less than 20% of the shares of the company paying the dividend. The credit shall take into account the tax paid to Italy by the company paying the dividend with respect to its income. This is on par with China domestic CIT Law.

Mutual agreement procedure

The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the agreement.

Other

The Italian government also approved tax treaties with Jamaica and Colombia that will enter into force only once the ratification process is finalized.

PwC observation:

Clauses in the new China-Italy tax treaty are relatively relaxed as compared with the treaty concluded in 1986, especially in terms of withholding tax rates for dividends and certain royalties, and the time threshold for constituting a Construction PE. Moreover, the taxing right allocation for alienation of property is explicit, so as to put it on par with other tax treaties concluded or re-negotiated by China in recent years.

The new tax treaty provisions are expected to encourage cross-border investments.

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France

Demark and France are negotiating a new tax treaty

The Danish government, on 10 June 2008, informed its French counterpart of its decision to terminate the 1957 tax treaty between the two countries. At the same time, the Danish government terminated the tax treaty concluded between Denmark and Spain.

The reason for terminating the Denmark-France tax treaty was a dispute regarding the allocation of the power to tax pensions paid to individuals who had left Denmark to settle in France. Article 13 of this treaty provided for an exclusive taxation in the country of residence, i.e., France. This termination became effective on January 1, 2009 and Denmark is currently the only European Member State with which France has no tax treaty.

Since the termination, domestic tax laws of both countries have applied without limitation, subject to applicable EU directives. Cross-border payments and operations between the two countries, including Danish pension payments, may be subject to double taxation. However, French tax authority guideline provide for a unilateral elimination of double taxation for cross-border transactions, under certain conditions.

In April 2019, Denmark and France concluded a principle agreement on the taxation of pensions in a new double taxation agreement.

PwC observation:

A positive outcome is expected soon, since the taxation of pensions constituted the main stumbling block to concluding a new tax treaty. Although Denmark has not yet ratified the OECD multilateral instrument, the new tax treaty may include some of its provisions, as was the case for the tax treaty entered into between France and Luxembourg on March 20, 2018.

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Glossary

Acronym	Definition
ALDT	arm's-length debt test
ATO	Australian Taxation Office
BEPS	Base Erosion and Profit Shifting
CFC	controlled foreign corporation
CGT	capital gains tax
CIT	corporate income tax
DTT	double tax treaty
EC	European Commission
EU	European Union
FA	fixed asset
FE	fixed establishment
FY	fiscal year
LCR	law companion ruling
IRA	Italian Revenue Authority
MLI	Multilateral Instrument
MNE	Multinational enterprises
OECD	Organisation for Economic Co-operation and Development
PE	Permanent Establishment
PPT	Principal Purpose Test
QBU	Qualified Business Unit
WHT	withholding tax

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