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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.

Featured articles

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Argentina

Argentina approves tax regime for knowledge-based activities

Law No. 27,506, published on June 10, enacted a new regime promoting knowledge-based activities. The regime's main tax benefits include a reduced corporate income tax rate of 15% and a tax stability agreement. The new regime replaces the existing regime, which was limited to the software industry, and will be effective from January 1, 2020 through December 31, 2029.

The new regime aims to encourage the creation, design, production, and implementation/adaptation of products and services related to, among others, the following 'Promoted Activities':

- software, computing, and digital services
- audiovisual production and post-production activities
- certain scientific and engineering activities
- geological and prospecting services
- export of professional services
- activities related to the industrial sector using '4.0 technologies.'

Among others, the following tax benefits apply to the extent that taxpayers comply with certain requirements:

- 15% reduced corporate income tax rate applicable to fiscal years beginning on or after January 1, 2020
- executing tax stability agreements with federal tax authorities providing that the federal tax burden on income from Promoted Activities cannot increase until December 31, 2029
- ability to claim withholding taxes, VAT withholding exemptions, and reduction in social security contributions

Multinational entities engaged in Promoted Activities should revisit their Argentinian operations in order to benefit from the new regime. The regime promotes Argentina as a jurisdiction for establishing regional shared service centers.

For more information, see our **PwC Insight**.

PwC observation:

Expected regulations may provide additional guidance on the:

- types of activities that qualify as Promoted Activities
- registration process mechanism for making contributions to finance the regime (3% and 1.5% on tax savings obtained, as described above)

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France

France enacts DST and partially delays corporate tax rate reduction

The French Parliament on July 11 passed a tax on digital services by large internet and technology providers and partially postponed the corporate income tax rate reduction initially intended to apply as of January 1, 2019.

The law was published in the Official French legal Gazette on July 25, 2019. The new 3% digital tax applies to companies providing certain digital services in France with global annual revenue exceeding EUR 750M and revenue in France exceeding EUR 25M. The tax is based on the amount the taxpayer collects as consideration for taxable services provided in France as of January 1, 2019, excluding VAT. The law also includes a provision postponing the decrease of the corporate income tax rate from 33 1/3% to 31% for companies or tax groups with global revenue in excess of EUR 250M. The US and France, on August 27, agreed that once an OECD resolution is reached on taxing the digital economy, France would issue a tax credit to US corporations that are subject to the French DST.

Services within the tax's scope

The digital tax applies to the following services:

1. the provision of a digital interface by means of electronic communications, allowing users to contact and interact with other users, particularly for the purpose of selling goods or providing services directly among such users (such as online marketplaces, dating services, and app stores).
2. services to advertisers or their agents, aimed at placing targeted advertising messages on a digital interface based on the interface user's data collected or generated through the use of such interface. In particular, these services include the purchase, storage, and distribution of advertising messages, advertising control, and performance measurement, as well as services for managing and transmitting user data.

For more information, see our **PwC Insight**.

Technology and internet services providers operating in France and with French customers should immediately consider the impact of the digital tax, its reporting and filing requirements, and potential domestic and EU challenges.

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Hungary

Significant changes in the Hungarian corporate income tax legislation

A number of significant changes were enacted on July 23, 2019 to the Hungarian corporate income tax (CIT) legislation.

Introduction of exit taxation rules

The Hungarian corporate income tax (CIT) regime introduced exit taxation provisions that take effect beginning on January 1, 2020. The implementation of such rules complies with the EU's Anti-Tax Avoidance Directive (ATAD I) harmonization requirements. Accordingly, a Hungarian taxpayer is subject to a 9% CIT in certain cases at the time of exit of its assets at an amount equal to the positive difference between the fair market value of such assets (to be determined in line with the general transfer pricing guidelines) and the tax book value of those assets.

The exit tax per the above rule is only triggered if the underlying transaction would not otherwise be subject to the same tax burden in Hungary.

Implementation of hybrid mismatch rules and related anti-avoidance provisions

Also, effective January 1, 2020, ATAD II's (EU Directive 2017/952) hybrid mismatch provisions will be incorporated into the Hungarian CIT legislation.

Notably, the implemented provisions closely follow ATAD II's rules with respect to the scope of hybrid mismatch anti-avoidance provisions and tax residency mismatches. The new rules do not include provisions on reverse hybrid mismatches, as they are only expected to be incorporated into Hungarian legislation when the corresponding deadline of December 31, 2021 approaches.

Amendment of group taxation rules

Hungary introduced a group taxation regime for corporate income tax purposes as a new concept effective January 1, 2019. The current amendments aim to simplify the administration process and assure increased transparency in the application of respective provisions, with effect from July 24, 2019.

Currently, Hungarian taxpayers may opt to apply group taxation if (i) the level of direct or indirect voting rights is at least 75% (in which sense a common controlling company also has to be considered); (ii) they apply the same GAAP for statutory purposes; (iii) with the application of the same balance sheet date (or same tax year if the balance sheet date is not applicable); and (iv) they have the same functional currency.

Implementation of DAC6

Hungary implemented EU harmonization requirements as set out in EU Council Directive 2018/822 EU (DAC6).

The implemented provisions set forth the mandatory automatic exchange of information with respect to certain cross-border arrangements involving either more than one EU member state or a member state and a third country and aim to strengthen tax transparency in this respect and to fight against aggressive tax planning. In this respect, the new rules introduce an obligation for 'intermediaries' to disclose cross-border arrangements that feature the hallmarks set out by the Directive. The term 'intermediaries' generally includes persons that design, implement or manage the implementation of such cross-border arrangements or persons that provide aid, assistance or advice in this regard.

Upon failure to comply with provisions related to reportable cross-border arrangements, the Hungarian tax authority may impose a default penalty of up to HUF 500,000, or up to HUF 5,000,000 for repeated failure to report. The first reportable arrangements are those where the first implementation step occurs between June 25, 2018 (the date when the Directive entered into force) and July 1, 2020, the date the disclosure requirements become applicable). Taxpayers will be required to file information in this respect by August 31, 2020.

PwC observation:

The latest legislative changes are of great significance, as they intend to meet EU law harmonization measures and provide more favorable conditions for existing entities operating under a group tax regime. Taxpayers should carefully review existing arrangements and new structures, as the new rules are not completely straightforward and allow for differing interpretations.

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Ireland

Ireland publishes Feedback Statement on Irish implementation of ATAD II's anti-hybrid rules

The Irish Department of Finance released a Feedback Statement on the Irish Implementation of Anti-Hybrid Rules under Council Directive (EU) 2016/1164 of July 12, 2016 (the Anti-Tax Avoidance Directive or ATAD), as amended by Council Directive (EU) 2017/952 of May 29, 2017 (ATAD II) (Feedback Statement). In late 2018, a public consultation was launched on implementing ATAD II's interest limitation and anti-hybrid rules. The Feedback Statement's purpose is to respond to the views expressed in response to the public consultation and to set out possible approaches to some of the technical aspects of anti-hybrid rules (it does not address the interest limitation rules). A common request in the submissions received was that the Department of Finance consult with stakeholders to the greatest extent possible while developing the anti-hybrid legislation and provide sufficient advance notice on technical details of the anti-hybrid rules in order to allow taxpayers to understand how the new rules will operate from January 1, 2020.

The Feedback Statement includes extracts of the proposed draft legislation as well as general commentary. The proposed legislation does not constitute final legislation, but rather it gives interested parties the opportunity to further engage with possible approaches to some of the technical aspects of anti-hybrid rules. Submissions on the Feedback Statement were due September 6, 2019. The final legislation is expected to be implemented in the Irish Finance Bill 2019 later this year, with the rules generally applying from January 1, 2020.

Based on the Feedback Statement, the outline of the rules suggests that Ireland's policy makers intend to transpose the anti-hybrid provisions in a business-friendly manner limited to ATAD II's minimum standard. Ireland seeks to provide certainty to taxpayers and put the various definitions on a statutory footing that is compatible with and can co-exist with existing Irish tax law. In this way, many of the definitions seek to leverage and interact with existing concepts in the Irish tax code.

PwC observation:

The Feedback Statement provides stakeholders with the opportunity to assess the potential impact of how the key legislative provisions relating to the anti-hybrid rules are likely to be transposed into the Irish tax code. In this context, all intercompany arrangements involving tax deductions claimed in Ireland should be considered carefully in advance of January 1, 2020, as the anti-hybrid concepts are complex and can result in tax deductions being denied in circumstances which are not obvious, such as under the 'imported mismatch' or 'double deduction' concepts.

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Japan

Consumption tax implications for foreign digital service providers

1. Japanese consumption tax implications on cross-border digital services

Under Japanese tax law, the provision of digital services in Japan by a foreign service provider is treated as a taxable transaction under the Japanese Consumption Tax (JCT). In general, 'digital service' is defined as the provision of copyrighted articles (including licensing of the copyrighted articles) and other services via telecommunication lines.

Whether the digital services are provided in Japan is determined based on the service recipient's location. As to the taxation method, if the service is mainly provided to businesses in Japan due to the nature of the service (i.e., B2B digital service), the business service recipients should be responsible for paying JCT (i.e., reverse charge mechanism). In contrast, where the digital service is provided to other customers in Japan (i.e., B2C digital service), the service provider needs to file its JCT return in Japan and pay JCT if it is subject to filing in Japan. For example, online digital services provided by a foreign corporation to Japanese customers would be subject to JCT in Japan. The foreign provider will be required to file the JCT return accordingly.

2. JCT return filing obligation

As of now, an invoicing system has not been adopted for JCT purposes in Japan. Rather, the JCT return filing obligation of a company is based solely on whether it is a taxable or tax-exempt enterprise. Below is a basic outline for determining the filing obligation, as a detailed discussion exceeds this article's scope:

* A company with taxable transactions for JCT purposes of less than JPY 10 million during the 'Base Period' for a fiscal year is generally treated as a tax-exempt enterprise ('Base Period Exemption'), subject to the rules described below. The Base Period is the two fiscal years prior to the current year.

* A newly-established company technically does not have a Base Period for its first two fiscal years. However, if the company is established with a paid-in capital of JPY 10 million or more, the Base Period Exemption cannot be applied, and it is automatically treated as a taxable enterprise for its initial two fiscal periods.

* The Base Period Exemption cannot be applied by a company if:

i. the company's taxable sales for the first six months of the 'Preceding Fiscal Period' are more than JPY 10 million (where the duration of the 'Preceding Fiscal Period' is more than seven months) and

ii. the company's salary expense for the first six months of the 'Preceding Fiscal Period' are more than JPY 10 million (where the duration of the 'Preceding Fiscal Period' is more than seven months)

Please note that an invoicing system will be introduced in Japan beginning October 1, 2023. Thus, the above criteria may be amended in the future.

3. Consumption tax rate hike

While the JCT rate is currently 8%, it will increase to 10% beginning October 1, 2019, together with various related transitional measures. Since the JCT rate is determined based on when service is completed, service providers should properly identify when completion occurs.

PwC observation:

There could be foreign corporations that do not file the JCT returns, although they provide Digital Services and have a Japanese filing obligation. We have observed that the Japanese tax authorities became aware of several foreign corporations being non-compliant with filing requirements in this regard. In fact, the tax authorities have issued the notices to some foreign corporations that provide considerable digital services in Japan. Foreign digital service providers should file JCT returns to avoid non-filing status and penalties.

The consumption tax rate hike should affect all JCT payers, including foreign corporations providing digital services in Japan. Foreign corporations providing cross border digital services to Japanese consumers may be required to amend their collection and accounting systems in order to properly collect and pay the JCT beginning October 1, 2019. In this regard, if a platform company collects the JCT for a foreign digital service provider, the provider may need to communicate with the platform company.

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Kenya

Corporate tax highlights from Kenyan Finance Bill 2019

The Kenyan National Treasury introduced its latest Finance Bill into the National Assembly.

The domestic capital gains tax (CGT) rate will be increased from 5% to 12.5%. However, property and share transfers within a group by entities for internal restructuring purposes will be exempt from CGT, provided that the restructuring does not result in a transfer to a third party.

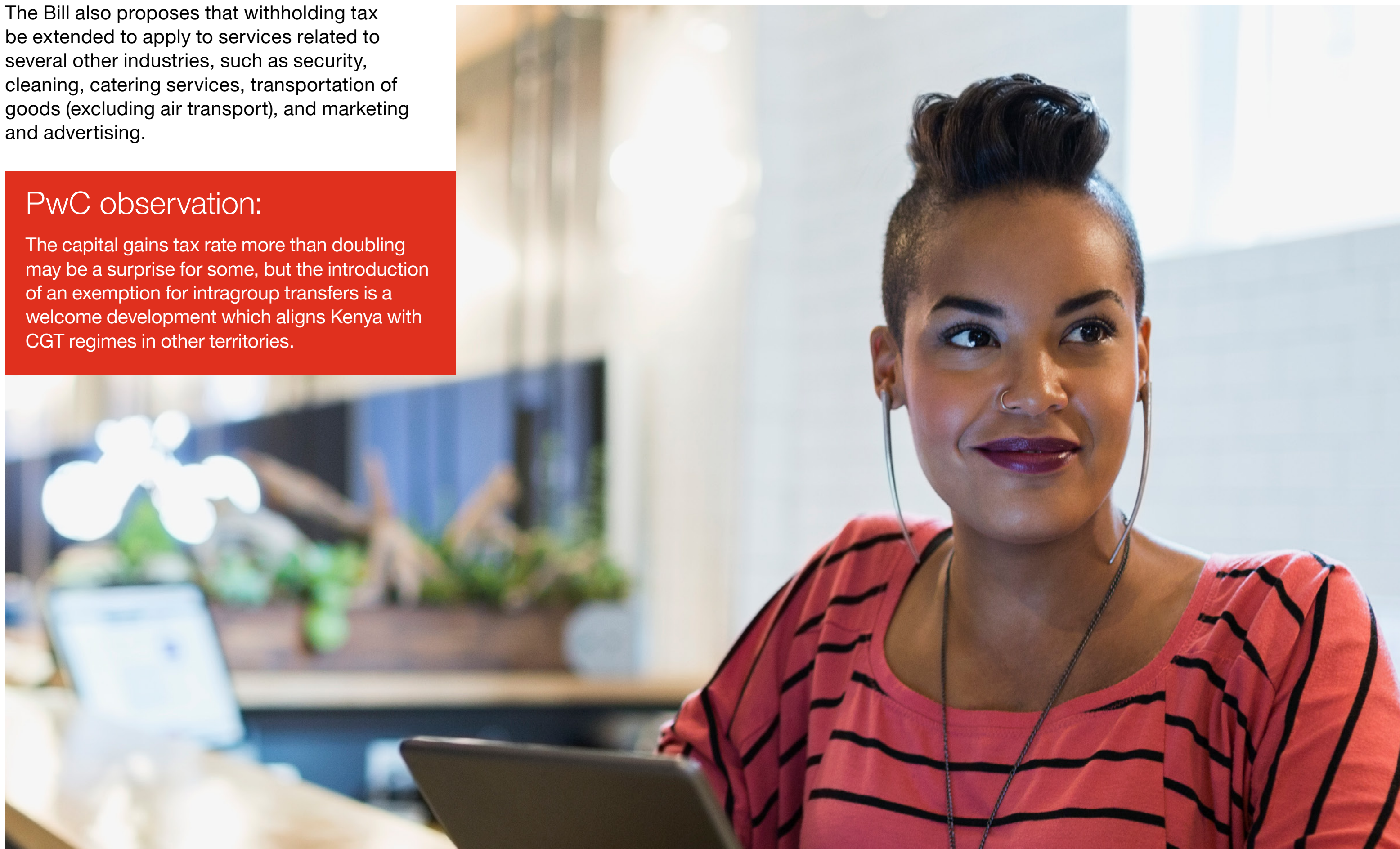
In a third amendment in as many years, the Bill proposes reintroducing a 3% turnover tax with respect to businesses with a turnover that is less than five million shillings. This comes after Treasury abolished the turnover tax in its previous budget because it was unsuccessful and instead replaced it with a presumptive tax. This existing 15% presumptive tax of the single business permit has been retained and can be offset as an advance tax credit against the turnover tax payable.

In a step towards reforming the digital economy's taxation, the Bill introduces a definition of 'digital market place' and affirms that income arising from a digital market place is accrued from Kenya. However, it is not clear how this will effect change within the existing tax system, and additional measures (or further clarification) may be needed to achieve the desired reform.

The Bill also proposes that withholding tax be extended to apply to services related to several other industries, such as security, cleaning, catering services, transportation of goods (excluding air transport), and marketing and advertising.

PwC observation:

The capital gains tax rate more than doubling may be a surprise for some, but the introduction of an exemption for intragroup transfers is a welcome development which aligns Kenya with CGT regimes in other territories.



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Korea

Korea's 2019 tax reform proposals

The Ministry of Economy and Finance, on July 25, 2019, announced the Korean government's latest tax reform proposals. The main proposals of which Korean inbound investors should be aware include:

Changes to the taxation of payments for patents registered outside of Korea

Payments for the use of patents registered outside of Korea used in manufacturing or production activities in Korea would be treated as royalty payments for withholding tax purposes. Also, compensation payments made for infringement of patents registered outside of Korea would be treated as Korean-source other income subject to 16.5% withholding tax under domestic tax law.

Increased tax incentives for qualifying facility investment

Tax credit rates for qualifying investment in facilities to improve productivity and encourage corporate investment would increase. For large corporations, the tax credit would increase from the current 1% to 2% for investments made from January 1 to December 31, 2020.

Expansion of R&D tax credits

The existing R&D tax credit regime for qualifying new growth-engine and core technologies would be extended to include semiconductor system design/manufacturing technology and bio-beta clinical trial technology, and it would increase the carry forward period for unused credits from 5 years to 10 years.

Securities transaction tax rate cut for transfers of unlisted shares

The securities transaction tax rate on unlisted shares would decrease from 0.5% to 0.45%, effective April 1, 2020.

Allocation of burden of proof for tax abusive transactions

If an abusive transaction results in a taxpayer reducing their tax liability by more than a certain prescribed threshold (currently proposed at 50%) a new rule would impose the burden of proof on the taxpayer to substantiate that justifiable business reasons exist for the transactions without a tax avoidance intention. Failure to meet the requirements would result in the taxpayer being treated as unduly enjoying tax benefits, and substance-over-form rules would apply to the transaction.

PwC observation:

The proposals aim to help the Korean government achieve its objectives of encouraging corporate investment in innovative growth areas, expanding tax collection revenue and promoting social equality.

Any overseas companies receiving patent income or patent infringement compensation from sources in Korea will need to evaluate the Korean withholding tax position given these proposals, which were made following recent Supreme Court decisions that favored taxpayers and held that similar payments should not be subject to Korean withholding tax **(see International Tax News April 2019)**.

While some of the proposals may offer opportunities for companies to claim additional tax credits if they are planning to make investments in manufacturing or R&D facilities, any groups undertaking corporate transactions in Korea will need to carefully consider the proposed new burden of proof requirements.

The proposals may be subject to modifications before being finalized for submission to the National Assembly in September. If approved by the National Assembly, most of the proposed changes would take effect on January 1, 2020.

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Mauritius

Mauritius National Assembly approves Finance Bill 2019

Finance Act 2018 abolished the previous Deemed Foreign Tax Credit regime and introduced a new Partial Exemption Regime for Global Business License (GBL) companies, effective January 1, 2019.

Finance Bill 2019 builds on these reforms and introduces some additional measures aimed at aligning Mauritius with international tax best practices, while ensuring it remains an attractive location for international investment.

Highlights of the Bill from an international tax perspective include:

- Introduction of CFC rules, effective for years of assessment commencing on or after July 1, 2020. These rules will apply where the Mauritius Revenue Authority considers that the non-distributed income of the CFC arises from non-genuine arrangements designed for the purpose of obtaining tax benefits. The CFC rules will not apply where certain conditions are met.
- Eligibility for the partial exemption regime is made conditional upon satisfaction of enhanced substance requirements, details of which are expected to be set out later this year. The partial exemption regime is also extended to include several additional categories of income (subject to meeting prescribed conditions).
- A real estate investment trust (REIT) regime will be introduced for years of assessment commencing on or after July 1, 2020.
- Effective July 1, 2019, a company will not be considered a Mauritius tax resident if it is centrally managed and controlled outside of Mauritius.

PwC observation:

The introduction of CFC rules and substance requirements may add an additional layer of administration to the tax affairs of businesses holding investments in or via Mauritius. These rules and requirements are aimed at ensuring that Mauritius remains a sustainable location for future international investment.

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Singapore

Proposed tax treatment for variable capital companies

The Variable Capital Companies (Miscellaneous Amendments) Bill 2019, which seeks to amend the Variable Capital Companies Act 2018, Income Tax Act, Goods and Services Tax (GST) Act and Stamp Duties Act to introduce a tax framework for variable capital companies (VCCs), was published on August 5, 2019.

Key aspects of the proposed tax treatment for VCCs include:

- a single corporate tax filing for an umbrella VCC, regardless of the number of sub-funds, to ease its compliance burden.
- deductions and allowances for umbrella VCCs applied at the sub-fund level determining the respective sub-funds' chargeable or exempt income.
- tax residence to be determined at the umbrella level of the VCC. A VCC whose business is controlled and managed in Singapore will qualify as a tax resident.
- extension of tax incentives under sections 13R and 13X of the Income Tax Act to VCCs.
- Application of GST at the sub-fund level, as each sub-fund makes independent sale and purchase decisions based on its investment mandate.
- stamp duty applied at the sub-fund level because each sub-fund can, through its umbrella VCC, enter into transactions relating to immovable property and shares.

PwC observation:

The introduction of the VCC framework strengthens Singapore's position as a full-service international fund management center. The framework provides for both stand-alone and umbrella VCCs and is expected to become effective sometime in the later part of 2019. The proposed tax treatment for VCCs recognizes their unique characteristics, combining the advantage of a single legal entity at the VCC level but segregating assets and liabilities at the sub-fund level thereby allowing different investment strategies for investors in the particular sub-fund.

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United Kingdom

HMRC publishes draft regulations and guidance to implement EU mandatory disclosure rules in the UK

The UK tax authority (HMRC), on July 22, 2019, published a consultation document and draft regulations to implement the EU Directive on the mandatory disclosure and exchange of cross-border tax arrangements (DAC6) which was published last year. HMRC indicated that it expects to introduce these regulations by December 31, 2019, regardless of Brexit's outcome.

The draft UK regulations follow DAC6 closely and require disclosing to HMRC certain cross-border arrangements falling within broadly defined hallmarks. As such, many commercial transactions would fall within the scope of the rules. The disclosures would be shared on a quarterly basis with tax authorities of all EU Member States. The consultation document sets out the approach HMRC intends to take in interpreting DAC6 and elaborates on how the rules would operate in practice. HMRC will provide further guidance alongside the finalized regulations.

DAC6 would start in the United Kingdom on July 1, 2020, and from that date, arrangements would need to be reported within 30 days of certain triggers. Crucially however, disclosures for the transitional period (June 25, 2018 to June 30, 2020) would need to be made by August 31, 2020.

The obligation to disclose to HMRC falls on UK-based intermediaries (unless or to the extent that legal professional privilege applies). Where there are no UK-based intermediaries with a reporting obligation, the obligation to disclose may fall to UK-based relevant taxpayers. There are penalties for non-compliance with the rules.

PwC observation:

In broad terms, the draft regulations contain few surprises. They fall mainly in line with the original DAC6 Directive from the EU and avoid some of the more punitive obligations which certain territories have imposed on taxpayers. The consultation document also indicates that HMRC will take a pragmatic approach to the definition of 'tax advantage', limiting it to situations where the tax benefit doesn't fall in line with the principles or policy intention of the relevant legislation. Reasonably, small and medium enterprises would also be exempt from reporting transactions that fall under the transfer pricing hallmark (E), given that they are (broadly) exempt from these rules in the United Kingdom.

While this is positive news, businesses should act now to ensure compliance by the July 1, 2020 deadline. Businesses should assess the impact of the rules, engage with intermediaries on reporting, and put processes and technology in place to help manage their obligations.

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Venezuela

Venezuela introduces net wealth tax for companies and individuals

The Venezuelan Official Gazette No. 41,667, published on July 3, included a new law introducing an annual net wealth tax on individuals, corporations, and permanent establishments, which have qualified as 'special or major taxpayers' by the tax administration. It is unclear whether the tax will begin to apply in tax year 2019 or 2020. Forthcoming regulations expected later this year should clarify this point.

The new tax is imposed on an annual basis at the end of each 'taxable period', to 'special or major taxpayers', with a net wealth of at least:

- 36M tax units (approx. USD 252,000) in the case of individuals
- 100M tax units (approx. USD 700,000) in the case of companies and permanent establishments

Venezuelan residents are subject to the tax on their worldwide net worth. Nonresidents are subject to the tax on property located, or with rights enforceable in the country (including in rem rights on real estate and shares issued by Venezuelan companies). The tax basis is the value of the property at the end of the taxable year minus encumbrances on that property. Specific valuation rules apply depending on the type of asset.

The tax applies at a 0.25% rate on net wealth that exceeds the above thresholds. A higher rate or progressive rates can be imposed by the government (not to exceed 1.50%).

For more information, see our **PwC Insight**.

PwC observation:

Pursuant to administrative guidelines on the matter, the tax authority qualification of 'special or major taxpayer' would consider the amount of annual and monthly income reported in tax filings, domicile of the taxpayer in the country (capital or other region), and activity or industry developed by the taxpayer, among others.

The law does not define 'taxable period,' so it could refer to a calendar year or a fiscal year for corporate income tax purposes. The forthcoming regulations on the net wealth tax may provide clarity.

The law does not clarify the first 'taxable period' when the tax will apply. Per the Venezuelan General Tax Code, new annual taxes shall apply for taxable periods that begin on or after the law's entry into force. As such, the new law applies to tax years beginning after July 3, 2019. Therefore, for calendar-year taxpayers, it would apply on net wealth at December 31, 2020. For fiscal-year entities, it would apply on net wealth for tax years beginning on or after July 3, 2019.

Taxpayers should assess the tax's impact and monitor forthcoming regulations to comply with the new tax liabilities and filing obligations.

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Australia

ATO finalizes ruling on tax consolidation anti-churn measure

The Australian Tax Office (ATO) finalized Law Companion Ruling LCR 2019/2, providing guidance on the tax consolidation 'anti-churn' integrity measure. The anti-churn rules switch off entry tax cost setting rules when a non-land-rich entity joins a consolidated or multiple entry consolidated (MEC) group, when a foreign resident ceases to hold membership interests in the joining entity within the preceding twelve months and there has been no change in the joining entity's economic ownership.

The anti-churn rules apply in relation to entities that became subsidiary members of a group under an arrangement commencing on or after 7:30pm (legal time in the Australian Capital Territory) on May 14, 2013. Where the rules apply, the head company of the joined consolidated group cannot 'reset' the tax cost of the assets of the joining entity. An exception applies for restructurings within 12 months of an entity acquisition.

The ruling provides examples of the relevant provisions' application and a warning on the potential application of the general anti-avoidance provisions in Part IVA of the Income Tax Assessment Act 1936 for contrived arrangements designed to exploit the 12-month test period.

PwC observation:

The anti-churn rules are complex and can have unexpected outcomes. Multinationals intending to restructure their Australian entities should exercise caution and seek advice to assess the impact of the rules.

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Australia

ATO finalizes views on cross-border debt issues

The Australian Taxation Office (ATO) has released TD 2019/10 and TD 2019/12, finalizing guidance on a previously released draft on cross-border financing.

TD 2019/10 clarifies that the debt and equity rules in Division 974 of the Income Tax Assessment Act 1997 do not limit the operation of the transfer pricing rules in Subdivision 815-B of the same Act. Ultimately, the determination concludes that the ATO may apply the transfer pricing provisions in a way that changes the debt-equity classification.

TD 2019/12 provides guidance on the type of costs that are 'debt deductions' for thin capitalization purposes. This classification impacts deductibility for two reasons: (i) amounts that are debt deductions may be denied where an entity breaches thin capitalization limits, and (ii) an entity must include all of its debt capital that gives rise to debt deductions in its adjusted average debt (for thin capitalization calculations). Relevant costs include tax advisory and legal services in connection with debt capital, establishment fees, transaction restructure fees, stamp duty, regulatory filing fees, costs to maintain the right to draw down funds and borrowing costs.

PwC observation:

Both determinations highlight the ATO's continued focus on cross-border related party financing. Taxpayers should be vigilant in assessing the arm's length nature of their cross-border related party financing conditions, and in determining available debt deductions.

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Australia

Australia and New Zealand release approach to dual resident entities

The Australian Taxation Office (ATO) and the New Zealand Inland Revenue released their joint administrative approach to interpreting the 'dual resident' provisions in the Multilateral Instrument (MLI).

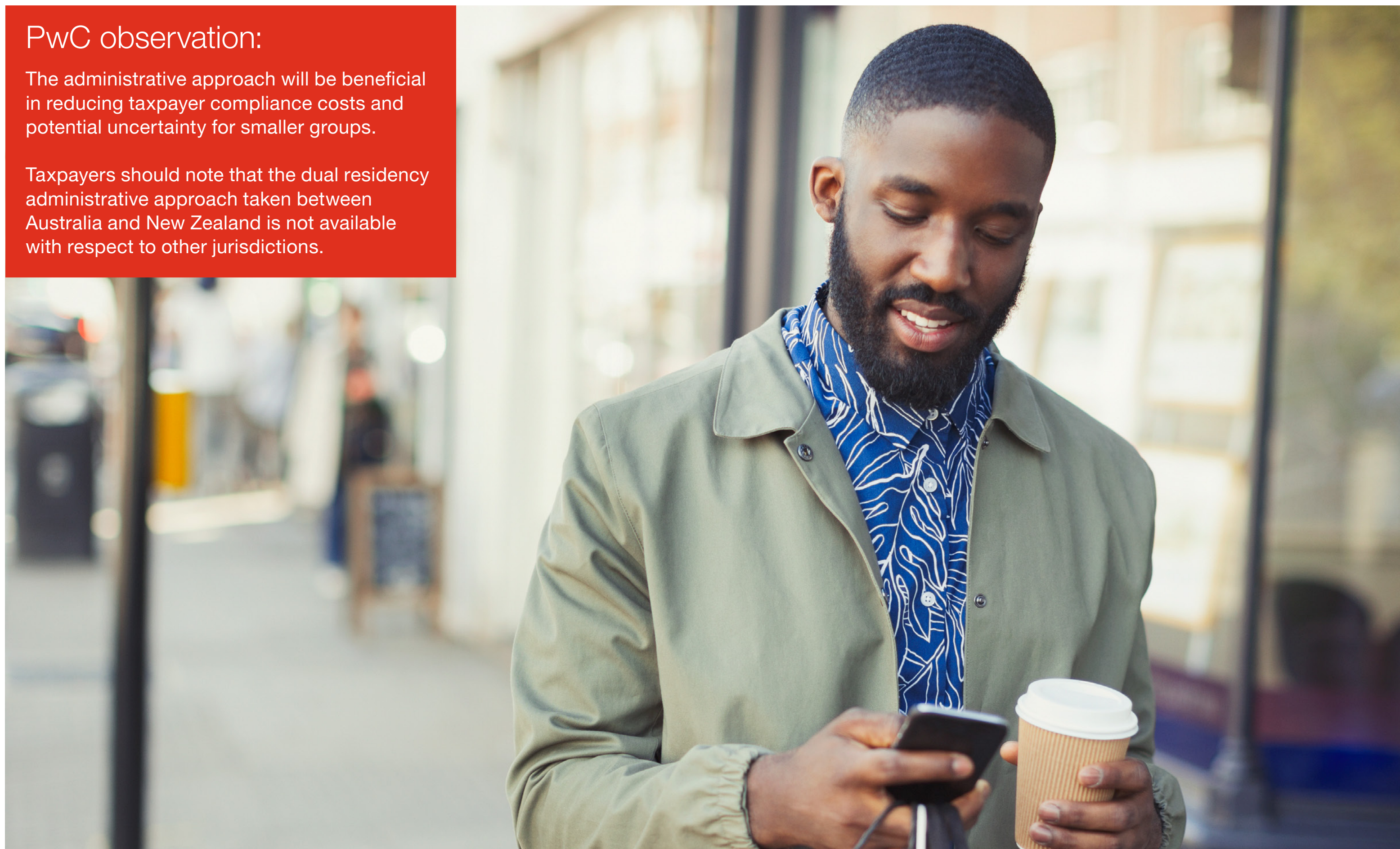
The MLI, which impacts the operation of many double tax treaties, has now been in effect from as early as January 1, 2019 for Australia and New Zealand. Article 4 of the MLI expands the criteria for determining a dual resident entity's tax residence and requires the competent authorities to agree on a single jurisdiction of residence. In the absence of such agreement, the entity will not be entitled to otherwise applicable tax treaty benefits.

The administrative approach allows a company that is a resident of both Australia and New Zealand that meets strict eligibility criteria, to reasonably self-assess its 'place of effective management' and access treaty benefits without needing to apply for competent authority approval. One of the key criteria to access this concession is that the taxpayer's group annual accounting income must be less than AUD 250 million (or NZD 260 million).

PwC observation:

The administrative approach will be beneficial in reducing taxpayer compliance costs and potential uncertainty for smaller groups.

Taxpayers should note that the dual residency administrative approach taken between Australia and New Zealand is not available with respect to other jurisdictions.



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Hong Kong

Revised guidance sheds light on practice of deducting foreign taxes

The Inland Revenue Department (IRD), on July 19, 2019, issued a revised Departmental Interpretation and Practice Notes No. 28 – Deduction of Foreign Taxes (revised DIPN 28) to share its positions on a change in the law on the deduction for foreign taxes affected by the Inland Revenue (Amendment) (No. 6) Ordinance 2018 (i.e., the BEPS and TP Ordinance), which was enacted in July 2018.

Pursuant to the BEPS and TP Ordinance, the revised DIPN 28 clarified that under section 16(1)(c) of the Inland Revenue Ordinance (IRO), a tax deduction on foreign income taxes paid on certain interest income and gains which are deemed to be taxable in Hong Kong is now restricted to taxes paid in territories not having a double tax agreement with Hong Kong (non-tax treaty territories). For foreign income taxes paid on captioned incomes derived from a tax treaty territory, Hong Kong taxpayers can only claim a foreign tax credit under section 50 of the IRO if the conditions are met.

The revised DIPN 28 also indicates the IRD's practice on deducting foreign taxes related to other specified incomes. Deduction under section 16(1) is allowable for "a tax charged on earnings (rather than on profits) that is payable regardless of whether or not a profit is made". It added a list of examples of taxes and duties that will be considered for deduction, including (1) rates levied on properties; (2) vehicle license fees; (3) duties on commodities or (4) foreign taxes and duties not levied by reference to profits.

PwC observation:

The new restriction on foreign taxes paid on certain interest income may affect the Hong Kong tax position of the Hong Kong branch of a foreign bank, as the branch unlikely will qualify as a Hong Kong tax resident. Consequently, the branch can neither receive a tax credit nor tax deduction for Hong Kong profits tax purposes on the foreign withholding tax paid on interest income it derives from tax treaty territories.

A withholding on royalties and services fees likely are no longer deductible under section 16(1). If these withholding taxes are paid in a tax treaty territory, they may be treated as creditable against the Hong Kong profits tax. However, this change will have a significant impact on business groups receiving substantial amounts of royalties or service fees from non-tax treaty territories. Withholding tax on such income may be neither deductible as an expense nor creditable.

Business groups should assess the potential impact of the above changes and consider whether any restructuring of current business models, fee charging arrangements or intellectual property holding structures is necessary while awaiting possible IRD clarification.

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United States

Highlights of proposed Section 861 regulations – cloud computing and digital content transactions

Treasury and the IRS on August 9, released **44-page proposed regulations** (under Section 861, regarding the classification of cloud transactions and transactions involving digital content. The regulations generally are proposed to apply to tax years beginning on or after the date final regulations are published. Comments on the Proposed Regulations are due by November 12, 2019.

Specifically, the Proposed Regulations (i) include Prop. Reg. sec. 1.861-19, which provides guidance under certain (but not all) provisions of the Code on the treatment of income from transactions involving on-demand network access to computing and other similar resources; and (ii) extend the computer program classification rules of Treas. Reg. sec. 1.861-18 (the Existing Regulations) to apply also to transfers of digital content other than computer programs. This expands the number of provisions to which the computer program (now digital content) rules apply.

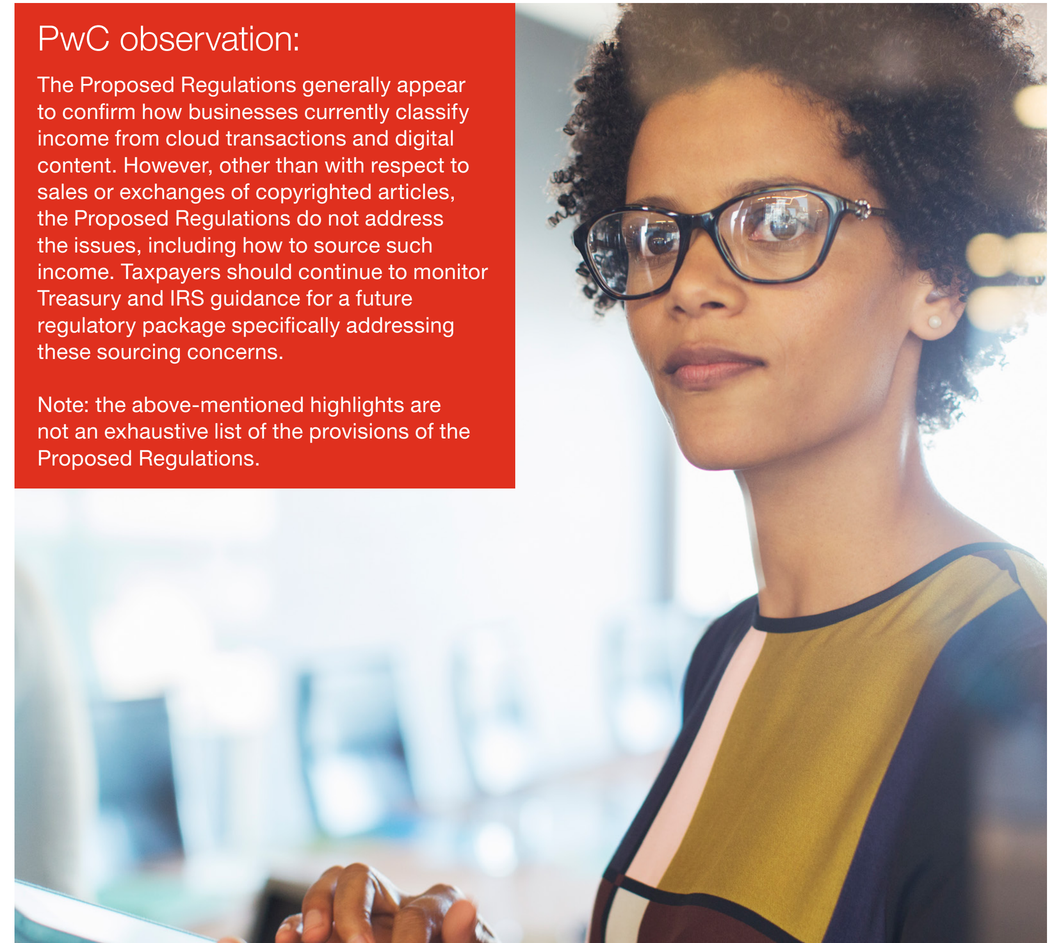
Prop. Reg. sec. 1.861-19 suggests that on-demand access (i.e., cloud) transactions generally give rise to service income based on a multifactor analysis based on Section 7701(e) principles and other factors, although rental income could arise in some situations. These proposed rules also result in all service or all rental income for a single transaction, in lieu of a bifurcation approach, although a single business arrangement could involve multiple transactions, each of which would have to be characterized separately. In addition, Prop. Reg. sec. 1.861-18 amends the rule for determining the 'place of sale' or 'title passage' with respect to downloaded software and digital content (i.e., copyrighted articles transferred through an electronic medium).

For more information, see our **PwC Insight**.

PwC observation:

The Proposed Regulations generally appear to confirm how businesses currently classify income from cloud transactions and digital content. However, other than with respect to sales or exchanges of copyrighted articles, the Proposed Regulations do not address the issues, including how to source such income. Taxpayers should continue to monitor Treasury and IRS guidance for a future regulatory package specifically addressing these sourcing concerns.

Note: the above-mentioned highlights are not an exhaustive list of the provisions of the Proposed Regulations.



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Netherlands

South African Tax Court rules for taxpayer on applying 'most favored nation' clause in South Africa-Netherlands tax treaty

The 'most favored nation clause' ('MFN clause') in the double taxation agreement between South Africa and the Netherlands was the subject of a recent South African Tax Court decision.

A South African resident company requested a refund from the Commissioner for dividend tax it withheld and paid on the basis that the MFN clause should entirely exempt dividends paid to its Dutch shareholder from the tax. The case came before the South African Tax Court, as the Commissioner refused the refund request. On June 12, 2019, the Court found in the taxpayer's favor. The decision was not surprising, considering a January 18, 2019 decision by the Dutch Supreme Court that the MFN clause applied in the reverse scenario (holding that the MFN clause effectively exempts South African residents from the Dutch dividend tax paid by a Dutch resident company). The South African Tax Court's decision reduces any lingering uncertainty related to the MFN clause's applicability to the South African dividend tax. Further, given the time that has now elapsed since the judgment was issued, our understanding is that the South African Revenue Service does not intend to appeal this judgment.

PwC observation:

Where relevant, South African resident companies that paid dividends to Dutch shareholders are encouraged to consider submitting refund claims for any dividend tax paid. Further, given the recent decision, taxpayers will not be required to withhold dividend tax from such future dividends (provided that all necessary treaty and local legislative requirements have been met).

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Luxembourg

Release of the Luxembourg bill for ATAD 2 implementation

The Luxembourg government, on August 8, 2019, tabled a Bill (n°7466) before the Luxembourg Parliament with draft legislation (the 'Draft Law') that will implement the EU Anti-Tax Avoidance Directive regarding hybrid mismatches with third countries ('ATAD 2') as Luxembourg domestic law.

The Draft Law generally closely follows the text of ATAD 2, mainly adapting it to integrate with the Luxembourg income tax law's structure and terminology. It now needs to go through the Luxembourg legislative process and may be subject to amendments before the Luxembourg Parliament's final voting.

As anticipated by ATAD 2, the Draft Law generally will apply beginning with tax years starting on January 1, 2020, with the additional 'reverse hybrid' measures that comprise Article 9a of ATAD 2 applying from the 2022 tax year.

For more information, see our **PwC Insight**.

PwC observation:

Groups and investment funds should assess their situation, considering the potential impact of the precise wording of the Draft Law in applying these 'hybrid mismatch' measures, most of which will begin to take effect on January 1, 2020.

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Luxembourg

Release of the Luxembourg bill for DAC 6 implementation

The Luxembourg government, on August 8, 2019, tabled a Bill (n°7465) before the Luxembourg Parliament setting forth draft legislation (the 'Draft Law') implementing Directive (EU) 2018/822, amending Directive 2011/16/EU with respect to the mandatory automatic exchange of information regarding to the taxation of reportable cross-border arrangements (commonly referred as 'DAC 6'). EU Member States have until December 31, 2019 to transpose the measures in DAC 6 into their domestic laws and must apply the provisions as of July 1, 2020.

However, the first reportable transactions will be those whose first implementation step occurred between June 25, 2018 and July 1, 2020. This information will have to be reported to tax authorities by August 31, 2020.

The Draft Law, which closely follows the DAC 6 text, now needs to go through the Luxembourg legislative process and may be subject to amendments before final voting by the Luxembourg Parliament.

For more information, see our **PwC Insight**.

PwC observation:

The Draft Law does not expand the scope of reporting obligations beyond DAC 6's requirements.

We note, however, the absence of any further guidance from tax authorities on the interpretation and application of the hallmarks. There is no indication as to whether such guidance will be issued in advance of the application date (July 1, 2020). Taxpayers should take a prudent approach when tracking and collecting information on potentially reportable transactions.

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Spain

Spain publishes draft bill implementing DAC6

The Spanish Ministry of Finance, on June 20, 2019, published the draft bill implementing the (EU) Directive on the mandatory disclosure and exchange of cross-border tax arrangements, also known as DAC6.

The draft bill must now follow the Spanish legislative procedure and may be amended before final enactment. It is expected to enter into force on July 1, 2020, which is in line with the directive. The draft bill was subject to a public consultation that ended on July 12, 2019. The draft bill implements a transition period, requiring reporting of arrangements implemented between June 25, 2018 and June 30, 2020 in July and August 2020.

In line with the directive, i.e., indirect and special taxes are not included within the scope of the legislation or domestic arrangements. The measures generally align with the directive, however, the draft bill also includes additional information and clarifications, including:

- The draft bill includes the tax deferral as a tax benefit.
- With respect to hallmark A.2. (arrangement where an intermediary is entitled to receive a success fee based on tax advantage obtained), the draft bill states that the 'success fee' may be total or partial. It also seems to consider A.3. (arrangement that has substantially standardized documentation and/or structure) to be equivalent to the commercial arrangement.
- In relation to the hallmark C.1. (deductible cross-border payments between associated enterprises), the draft bill establishes that: i) cross-border payments also include cross-border expenses, even if the payment has not been de facto made; ii) the recipient of the income could be an indirect recipient or the person to whom the income is attributed; iii) for zero or almost zero tax rates it considers an effective tax rate lower than 1%; iv) a regime authorized by the EU would not qualify as a preferential tax regime; and v) the non-cooperative jurisdictions are those jurisdictions included on the Spanish black list (which Spain reserves the right to modify).

The draft bill recognizes the Legal Professional Privilege (LPP) for any intermediary as defined in the directive. In this sense, the LPP is generally upheld with respect to personal information of parties involved in a reportable arrangement, in particular non-wealth private and confidential data of clients to which the intermediary could have accessed as a result of his/her advise or legal representation. In other words, the LPP protects data whose disclosure may violate personal and family honor and privacy, as well as data related to commercial, industrial or professional secrets, commercial procedures, and data whose disclosure could be against the public interest.

PwC observation:

Taxpayers should become aware of the new disclosure obligations. In particular intermediaries like financial institutions, insurance entities, and alterative investment funds should adjust or adopt internal procedures to comply with the new obligations. In addition, taxpayers will be obligated to annually report the use of previously communicated arrangements.

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China

The Mainland of China and Hong Kong sign fifth tax treaty protocol

The Mainland and Hong Kong Special Administrative Region (HK), on July 19, 2019, signed the Fifth Protocol to the Arrangement between the Mainland of China and Hong Kong for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (the 'Mainland-HK tax treaty'). It will enter into force upon completion of ratification procedures and notifications by both contracting states. The protocol mainly introduces changes in the following areas:

1. incorporating the recommendations in the BEPS action reports released by the OECD, including amending the preamble and articles of the resident, permanent establishment, capital gains, etc., and adding a new 'principal purpose test' (PPT) article on prevention of treaty abuse.

Preamble

The protocol amends the language used in the tax treaty's preamble, which emphasizes that in addition to eliminating double taxation, the purpose of Mainland-HK tax treaty is to prevent non-taxation or reduced taxation through tax evasion or avoidance.

Article 4 Resident

According to the protocol, the State Taxation Administration (STA) and HK Inland Revenue Department shall endeavor to determine the tax residency status of a person by mutual agreement by taking into account its place of effective management and its place of incorporation or is otherwise constituted (and any other relevant factors).

Article 5 Permanent Establishment (PE)

The protocol adopts the recommendations in the final BEPS Action 7 report, which introduced a stricter definition for a PE constituted through an agent ('Agency PE'). Specifically, it broadens the scope of Agency PE and provides a stricter definition for 'independent agent'.

Article 13 Capital Gains

The protocol applies a more precise wording for the gains from the alienation of shares, clarifying that Article 13 applies not only to shares in a company, but also to comparable interests, such as interests in a partnership or trust. In other words, the Mainland is granted the right to tax the relevant gains from alienation of such comparable interests derived by a HK resident.

Article 24(A) Entitlement to Benefits

The protocol adds a PPT article, under which a tax treaty benefit shall not be granted if one of the principal purposes of any arrangement or transaction was to directly or indirectly obtain such benefit.

2. adding a new 'Teachers and researchers' article to exempt teachers and researchers from one side from taxation of remuneration for services performed in the other side:

Article 18(A) Teachers and Researchers

The protocol provides an individual income tax exemption for eligible remuneration received by a resident individual employed by a university, institute, school, or any other officially recognized educational or research institution for a three year period.

PwC observation:

The protocol contains more stringent requirements on anti-tax avoidance. Enterprises and individuals conducting cross-border business in the Mainland and Hong Kong should comply with these new changes in international tax practice to mitigate cross-border tax risks and enhance tax compliance.

Also of note is the relevant tax benefit provided by the newly added 'Teachers and Researchers' article which will facilitate the flow of teachers and researchers between the Mainland and Hong Kong. This development should provide an education mechanism benefiting science and technology in both Mainland and Hong Kong, particularly the cooperative education project in the Guangdong - Hong Kong - Macao Bay Area (GBA).

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China

Protocol to China and India tax treaty enters into force

China and India, on November 26, 2018, signed a Protocol to the China-India tax treaty (Protocol). In July 2019, China's State Taxation Administration (STA) issued STA Public Notice [2019] No.28 to announce that the Protocol entered into force on June 5, 2019. The Protocol applies to income derived in China in tax years beginning on or after January 1, 2020, and to income derived in India in fiscal years beginning on or after April 1, 2020. The Protocol also introduces changes in the following areas:

Resident

- The Protocol abolishes the old method to determine the residency status of a person who is a tax resident of both contracting states by looking at its head office. Instead, Chinese and Indian tax authorities shall endeavor to determine the tax residency status of a person by mutual agreement by taking into account its place of effective management, the place where it is incorporated, or the place where it is otherwise constituted (and any other relevant factors).

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Permanent Establishment

- The Protocol aligns the definition of Agency PE with BEPS Action 7 by introducing a stricter definition of Agency PE by broadening the scope of Agency PE to those who habitually play the principal role leading to the conclusion of contracts.

Other important features

- The Protocol adopts the 'fiscally transparent rule' that income derived by or through an entity or arrangement that is established in either Contracting State and that is treated as wholly fiscally transparent under the tax law shall be considered income of the contracting state resident.

The Protocol adds a principal purpose test (PPT) article, under which a benefit under the China-India tax treaty shall not be granted if obtaining that benefit was one of the principal purposes of any arrangement or transaction that directly or indirectly resulted in that benefit.

PwC observation:

The Protocol indicates China's intention to realign the treaty with other tax treaties China concluded or re-negotiated in recent years. The strengthening of the treaty abuse provisions reflect the determination of both China and India to counteract treaty abuse. Taxpayers should consider their own business arrangements and determine how to correctly utilize the tax treaty.

Glossary

Acronym	Definition
ATAD	Anti-Tax Avoidance Directive
ATO	Australian Tax Office
BEPS	Base Erosion and Profit Shifting
CFC	controlled foreign corporation
CIT	corporate income tax
DAC6	European Union Mandatory Disclosure
DST	digital services tax
DTT	double tax treaty
EU	European Union
GBL	Global Business License
GST	Goods & Services Tax
HK	Hong Kong
HRMC	Her Majesty's Revenue & Customs

Acronym	Definition
JCT	Japenses Consumption Tax
LPP	Legal professional Privilege
MEC	Multiple Entry Consolidated
MFN	Most Favored Nation
MNE	Multinational enterprises
OECD	Organisation for Economic Co-operation and Development
PE	permeant establishment
PPT	Principal Purpose Test
R&D	research and development
STA	State Taxation Administration
VCC	Variable Capital Companies
WHT	withholding tax

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