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UNITED STATES

INTERNAL REVENUE SERVICE AND TREASURY RELEASE PROPOSED REGULATIONS ADDRESSING DEBT/EQUITY CLASSIFICATIONS FOR US TAX PURPOSES

On 4 April 2016, the United States Department of the Treasury ("Treasury") and the Internal Revenue Service ("Service") published proposed regulations under Internal Revenue Code ("Code") Section 385 addressing the characterisation of certain related party debt instruments as debt or equity for United States tax purposes.

The proposed regulations under Code Section 385 would authorise the Service to treat certain related-party interests in a corporation as indebtedness in part and stock in part for federal tax purposes, and establish threshold documentation requirements that must be satisfied in order for certain related-party interests in a corporation to be treated as indebtedness for federal tax purposes. Additionally, the proposed regulations would treat certain related-party interests as stock that otherwise would be treated as indebtedness for federal tax purposes. Each of these areas is discussed below.

Code Section 385 was originally enacted to allow for the characterisation of an interest in a corporation as either stock or indebtedness for United States tax purposes. The code section provided for a number of factors to be considered in making this determination, and these factors have since been expanded upon and developed in subsequent years through case law. In general, no one factor was dispositive of debt or equity treatment, and the determination was heavily based on the facts and circumstances in each particular case.

Treasury notes in the preamble to the proposed regulations that the historical factors used in this analysis have been applied somewhat inconsistently, and can arrive at results in the related-party context that may be contrary to policy or the intent of the statute.

Taxpayers affected

In discussing the purpose of the proposed regulations, Treasury references excessive indebtedness in the cross-border context between related parties and how this can be used to significantly reduce a company's tax liability. They also note, however, that these regulations may apply to purely domestic situations (U.S. to U.S.) as well. However, they generally exclude related-party indebtedness between members of the same U.S. consolidated group.

The scope of the proposed regulations generally is limited to purported indebtedness between members of an expanded group. The proposed regulations define the term expanded group by reference to the term affiliated group in Code Section 1504(a). However, the proposed regulations broaden the definition in several ways. Unlike an affiliated group, an expanded group includes foreign and tax-exempt corporations, as well as corporations held indirectly, for example, through partnerships. Further, in determining relatedness, the proposed regulations adopt the attribution rules of Code Section 304(c)(3). The proposed regulations also modify the definition of affiliated group to treat a corporation as a member of an expanded group if 80% of the vote or value is owned by expanded group members (instead of 80% of the vote and value, as generally required under Code Section 1504(a)). However, certain rules or thresholds are contained in the proposed regulations that would modify when the rules would or would not apply. For instance, there is a rule limiting the application of Proposed Regulations Section 1.385-2 to certain large taxpayers and a rule in Proposed Regulations Section 1.385-3 providing a USD 50 million threshold exception.

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EDITOR'S LETTER

Welcome to this issue of *BDO World Wide Tax News*. This newsletter summarises recent tax developments of international interest across the world. If you would like more information on any of the items featured, or would like to discuss their implications for you or your business, please contact the person named under the item(s). The material discussed in this newsletter is meant to provide general information only and should not be acted upon without first obtaining professional advice tailored to your particular needs. *BDO World Wide Tax News* is published quarterly by Brussels Worldwide Services BVBA. If you have any comments or suggestions concerning *BDO World Wide Tax News*, please contact the Editor via the BDO Global Office by e-mail at mireille.derouane@bdo.global or by telephone on +32 2 778 0130.

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The proposed regulations

The proposed regulations address three primary areas relating to debt/equity classification. They are:

1. Allowing the Service to recharacterise an instrument as part debt and part equity;
2. Requiring contemporaneous documentation to support debt classification of related-party indebtedness; and
3. Providing specific rules to characterise debt instruments as stock with respect to certain distributions, reorganisation transactions and certain other types of transactions.

Allowing the Service to recharacterise an instrument as partly debt and partly equity

Proposed Regulations Section 1.385-1 provides the Service authority to recharacterise a related-party debt instrument as debt in part and equity in part. This is a departure from the historical application of the rules, which generally seemed to require an instrument be treated wholly as debt or wholly as equity (the 'all-or-nothing' rule). Treasury sees the 'all-or-nothing' approach as reaching consequences that may not reflect the economic substance of the transaction. Therefore, in the proposed regulations Treasury has provided the ability for the Service to characterise an instrument partially as debt or partially as equity, depending on the facts and circumstances of the case. The proposed regulations authorise the treatment of an interest as indebtedness in part and stock in part in the case of instruments issued in the form of debt between parties that are related, but at a lesser degree of relatedness than that required to include them in an expanded group. Under the proposed regulations, treatment as indebtedness in part and stock in part can apply to purported indebtedness between members of modified expanded groups (which are defined in the same manner as expanded groups, but adopting a 50% ownership test and including certain partnerships and other persons).

The preamble provides an example for illustration of this rule by way of a USD 5 million debt instrument of which the issuer can only reasonably be expected to repay USD 3 million, and the instrument could be recharacterised as USD 3 million of indebtedness and USD 2 million of equity.

Requiring contemporaneous documentation to support debt classification of related-party indebtedness

Proposed Regulation Section 1.385-2 contains a new requirement for contemporaneous documentation for certain related-party indebtedness in order to allow for the indebtedness to be respected as debt for United States tax purposes. The rules provide that if a taxpayer does not prepare and maintain the documentation such that they can provide it to the Service upon request, the related-party indebtedness will be treated as stock or equity.

The documentation requirement focuses on taxpayer substantiation of four key elements of the instrument:

1. Binding Obligation to Repay;
2. Creditor's Rights to Enforce Terms;
3. Reasonable Expectation of Repayment; and
4. Genuine Debtor-Creditor Relationship.

The preamble and the regulations provide some examples of the types of documentation that could be used to support these four elements.

As noted above, the preamble and regulations state that in the absence of this documentation treatment as indebtedness will not be allowed. The preamble also states that satisfaction of these four factors by way of the contemporaneous documentation does not conclusively establish the instrument as indebtedness, but rather simply allows for the possibility of indebtedness treatment pending further analysis by the Service based on the facts and circumstances under existing federal tax principles and case law.

Treasury has provided a few limitations and exceptions to the applicability of the above documentation requirements. The documentation requirement is intended to apply to taxpayers that are 'highly related' (i.e., 80% relatedness by ownership) and also only to 'large taxpayer groups'. Therefore, an instrument is not subject to the documentation requirements unless one of the following conditions is met:

- The stock of any member of the expanded group is publicly traded;
- All or any of the portion of the expanded group's financial results are reported on financial statements with total assets exceeding USD 100 million; or
- The expanded group's financial results are reported on financial statements that reflect annual total revenue that exceeds USD 50 million.

Providing specific rules to characterise debt instruments as stock in certain distributions or reorganisation transactions

Proposed Regulation Section 1.385-3 is intended to address specific factual situations identified by Treasury as creating policy concerns. Treasury identified three primary types of transactions of concern addressed in Proposed Regulation Section 1.385-3:

1. Distributions of debt instruments by corporations to their related corporate shareholders;
2. Issuances of debt instruments by corporations in exchange for stock of an affiliate; and
3. Certain issuances of debt instruments as consideration in an exchange pursuant to internal asset reorganisation.

Treasury also noted that similar concerns arise when a debt instrument is issued in order to fund future payments or transfers of cash.

The preamble to the proposed regulations suggests that of primary concern to Treasury is the issuance of debt instruments in situations where no cash or capital has been transferred as part of the transaction. They discuss several cases in which instruments were treated as indebtedness that Treasury now feels creates policy concerns, and are situations now in which the instruments issued should be treated as stock.

The potential characterisation of indebtedness as stock under Proposed Regulation Section 1.385-3 is accomplished through three different rules: a general rule, a funding rule and an anti-abuse rule.

– The general rule provides that a debt instrument can be treated as stock to the extent it is issued by a corporation to a member of the corporation's expanded group (1) in a distribution; (2) in exchange for expanded group stock (subject to a limited exception); or (3) in exchange for property in certain asset reorganisations.
– The funding rule is targeted at debt instruments issued with a principal purpose of funding a transaction described in the general rule. The funding rule contains a non-rebuttable presumption of a principal purpose within a 72-month period surrounding the distribution or acquisition. This would apply if the instrument is issued by a member during the period beginning 36 months before the distribution or acquisition and ending 36 months after the distribution or acquisition. There is an exception in the proposed regulations to the non-rebuttable presumption rule for certain ordinary course debt instruments (as defined in the proposed regulations).
– The anti-abuse rule is targeted towards specific situations that Treasury believes are abusive or may avoid the application of these rules, and the regulations contain several examples outlining these situations.

There are a few exceptions that may apply. For instance, Proposed Regulation Section 1.385-3(c)(1) includes an exception pursuant to which distributions and acquisitions described in Proposed Regulation Section 1.385-3(b)(2) (the general rule) or Proposed Regulation Section 1.385-3(b)(3)(ii) (the funding rule) that do not exceed current year earnings and profits (as described in Code Section 316(a)(2)) of the distributing or acquiring corporation are not treated as distributions or acquisitions for purposes of the general rule or the funding rule. For this purpose, distributions and acquisitions are attributed to current year earnings and profits in the order in which they occur.

Additionally, there is a threshold exception to the general rule and the funding rule if all of the expanded group debt instruments that could be treated as stock do not exceed USD 50 million. This is merely a threshold and not an exemption, so once group indebtedness exceeds USD 50 million, then all of the indebtedness potentially subject to recharacterisation will be subject to these rules. Additionally, there is an exception contained in the proposed regulations for certain funded acquisitions of subsidiary stock by issuance.

Potential consequences of recharacterisation of debt as stock/equity

In general, if debt is recharacterised as stock or equity, then interest deductions on the indebtedness could be disallowed and any payments could be treated as dividend distributions.

Applicability dates

The provisions of Proposed Regulation Section 1.385-2 are proposed to be generally effective when the regulations are published as final regulations. Proposed Regulation Section 1.385-2 would apply to any applicable instrument issued on or after that date, as well as to any applicable instrument treated as issued as a result of an entity classification election under Treasury Regulations Section 301.7701-3 made on or after the date the regulations are issued as final regulations.

Proposed Regulations Sections 1.385-3 and 1.385-4 (dealing with the treatment of consolidated groups) generally are proposed to apply to any debt instrument issued on or after 4 April 2016 and to any debt instrument issued before 4 April 2016 as a result of an entity classification election made under Treasury Regulations Section 301.7701-3 that is filed on or after 4 April 2016. However, when certain rules of the proposed regulations (Proposed Regulations 1.385-3(b) and 1.385-3(d)(1)(i) through (d)(1)(iv) or 1.385-4) would otherwise treat a debt instrument as stock prior to the date of publication of final regulations, the debt instrument is treated as indebtedness until the date that is 90 days after the date of publication of final regulations. To the extent that the debt instrument in the prior sentence is held by a member of the issuer's expanded group on the date that is 90 days after the date of publication of final regulations, the debt instrument is deemed to be exchanged for stock on the date that is 90 days after the date of publication of final regulations.

How BDO can help

BDO can help clients to understand the application and implications of these new proposed regulations to their company. With the increase in scrutiny over cross-border financing of operations, especially in light of the proposed base erosion and profit shifting recommendations, cross border transactions have become increasingly complex. These new proposed regulations add an additional layer of complexity and compliance to this area. BDO can help clients to understand what their obligations under these new proposed regulations will be and to comply with such obligations. There will be increased need to document related party financing transactions in light of these new rules, and it is important for companies to understand what they need to do to be in compliance.

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AUSTRALIA

INTERNATIONAL TAXATION DEVELOPMENTS

Over the last few months there have been a number of international taxation developments in Australia. In particular, there have been number of announcements that are related to the Australian Government's implementation of several of the Organisation for Economic Co-operation and Development's ("OECD") Base Erosion and Profit Shifting ("BEPS") Action recommendations. In addition, the recent release of the Government's Federal Budget included some important international tax issues. Below we have summarised some of these important developments.

1. REDUCTION OF THE COMPANY TAX RATE

In its 2016/17 Budget announcement, the Government announced a ten year plan to reduce the company tax rate so that by the year 2026/27 the income tax rate for all companies will be 25%.

The current income tax rate for most companies is 30%. Currently there is a reduced rate of 28.5% for small companies with an aggregated annual business turnover of less than AUD 2 million.

From 1 July 2016, it is proposed that the company tax rate for small companies will reduce to 27.5% and the turnover threshold for this rate will increase to AUD 10 million. The turnover threshold for this lower rate will gradually increase until in 2022/23 the turnover threshold for the lower tax rate will be AUD 1 billion. Over this period the 30% rate will continue to apply to companies that are over the turnover threshold for the particular year.

In 2023/24 the 27.5% rate will apply to all companies. This rate will then reduce gradually to 25% in 2026/27 for all companies.

2. DIVERTED PROFITS TAX

In the Government's 2016/17 Budget announcements the Australian Treasurer has announced the introduction of a new Diverted Profits Tax (DPT). The DPT will impose a 40% tax charge on significant global entities (global revenue over AUD 1 billion) that artificially divert profits from Australia. The DPT is proposed to be effective from 1 July 2017.

The DPT is similar to the second leg of the UK's diverted profits regime.

The new DPT supplements the Multinational Anti-Avoidance Law (MAAL) that was introduced last year, which is targeted at significant global entities avoiding a permanent establishment in Australia. The DPT is more broadly focused at value chain planning structures or excessive payments which lack sufficient economic substance.

The DPT anticipates that a charge will arise where two conditions are met:

- **Effective tax mismatch**: This occurs where, as a result of the cross border transaction or series of transactions, the Australian company has a reduction in its tax liability while the other party to the transaction has an increased tax liability of less than 80% of this reduction in liability. This is likely to catch transactions with entities in tax havens and lower taxed countries.
- **Insufficient economic substance test**: This occurs where the transaction or series of transactions lack sufficient economic substance, which will be based on a determination by the Australian Taxation Office ("ATO") of whether the transactions were designed to secure a tax reduction and whether the financial benefits of the tax reduction exceed the non-tax financial benefits of the arrangement.

Where these conditions are met and the ATO issues an assessment, there will be a 40% tax rate on profits diverted from Australia. The tax has to be paid before the taxpayer can ask for a review or try to prove an alternative position to have the assessment reduced or reversed. This is also similar to the UK requirement of 'pay now, argue later'.

To ensure that this measure is only applied to entities with substantial compliance risk, there will be an exclusion where the Australian company has revenue of less than AUD 25 million. However, this exclusion will not apply if the Australian entity's income has been artificially reported offshore.

The DPT is intended to have application to arrangements without economic substance, regardless of whether such arrangements are caught by Australia's existing transfer pricing laws.

3. HYBRID MISMATCH

The Government has announced that rules will be introduced to eliminate instances of hybrid mismatch as part of the implementation of the OECD's Action Plan on BEPS – Action 2.

The measures are aimed at hybrid mismatch arrangements that result in deferring tax, no tax being paid at all, or double deductions such as the following.

- **Hybrid financial instrument**: This arises where the financial instrument is treated differently for tax purposes in both jurisdictions. For example, a loan may be considered debt in one jurisdiction, giving rise to deductible interest payments, but considered equity in the recipient's jurisdiction, giving rise to tax exempt income.
- **Hybrid entities**: This arises where the same entity is treated differently under the laws of each jurisdiction, resulting in a mismatch in the tax outcomes in each jurisdiction.

These measures are expected to address the tax mismatch; however, details of how this will be done have not yet been released, but the OECD BEPS Action 2 and an Australian Board of Taxation report indicate the following may be how this is accomplished:

- Denial of dividend exemption or similar for payments that are treated as deductible by the payer;
- Denial or delay of a deduction for a payment that is not included in the income by the recipient of the payment;
- Denial of a deduction for a payment that is also deductible in another jurisdiction.

The Government proposes that this measure will apply from 1 January 2018.

4. INCREASED ADMINISTRATION PENALTIES FOR SIGNIFICANT GLOBAL ENTITIES

As a part of the Government's proposed measures to tackle multinational tax avoidance, the Government proposes to considerably increase the administrative penalties for companies deemed to be significant global entities. From 1 July 2017, the penalties for failing to comply with tax disclosure obligations for companies with global revenue of AUD 1 billion or more will be increased by a factor of 100 times.

This will raise the maximum penalty for failure to lodge documents with the ATO from a mere AUD 4,500 to AUD 450,000. Further, the Government will double the rate of penalties relating to making false or misleading statements to the ATO. These measures aim to encourage multinationals to comply with their reporting obligations and penalise those multinationals that are deliberately reckless or careless in their tax affairs.

5. LOOK-THROUGH COLLECTIVE INVESTMENT VEHICLES – PROPOSED CHANGES

The Government has announced the introduction of a new tax and regulatory framework for two new types of look-through collective investment vehicles (CIVs). CIVs allow investors to pool their funds and have them managed by a professional funds manager.

Under the new framework, a corporate CIV will be introduced from the income year starting on or after 1 July 2017 and a limited partnership CIV will be introduced from the income year starting on or after 1 July 2018. The new CIVs will still need to satisfy similar eligibility criteria as a managed investment trust. This includes being widely held and engaging in primarily passive investment. Investors in the new proposed CIVs will generally be taxed as if they had invested directly.

The proposals are intended to enhance the international competitiveness of the Australian managed funds industry and maximise the effectiveness of related Government initiatives aimed at increasing access to overseas markets (e.g. the Asia Region Funds Passport) and help Australia attract foreign investors (such as foreign pension funds) by offering legal structures that are more familiar to them.

6. MANDATORY DISCLOSURE OF TAX INFORMATION

The Government has announced that it will consult on the framing of Mandatory Disclosure Rules in line with the Final Report of Action Item 12 of the OECD's BEPS Project.

Generally, mandatory disclosure rules would require tax advisers and/or taxpayers to make early disclosures of aggressive tax arrangements (often before income tax returns are lodged), to provide the ATO with timely information on arrangements that have the potential to undermine the integrity of the income tax system.

Australia already has a number of specific disclosure and reporting rules, and the Government is looking to draft any mandatory disclosure rules having regard to the current disclosure and reporting rules in the Australian tax system to ensure there is no overlap or unnecessary compliance in relation to such disclosures.

At this stage there is no timeframe for the introduction of mandatory disclosure rules.

7. TRANSFER PRICING – AUSTRALIA TO ADOPT OECD GUIDANCE

The Government has announced that it will adopt the revised OECD Transfer Pricing Guidance into Australia's transfer pricing law, ensuring the rules are current and in line with international best practice.

Adopting the revised OECD Transfer Pricing Guidelines into the Australian transfer pricing law provides the Government with greater ability to address key transfer pricing concerns arising from the application of BEPS action items, and helps ensure that Australian profits are taxed appropriately in Australia.

Entities that have significant transactions involving intangible assets should review their current transfer pricing arrangements, and ensure that they remain appropriate in light of the changes to the OECD Guidelines.

8. TRANSFER PRICING – COUNTRY-BY-COUNTRY ("CbC") REPORTING

Since the introduction of the Australian CbC reporting requirements, for significant global entities (global revenue of AUD 1 billion or more), which apply to income years commencing on or after 1 January 2016, there have been a number of key developments including the following:

- There will be no de minimis rule in relation to the size of a significant global entity's ("SGE") presence in Australia in relation to the Australian CbC reporting requirements. This means large multi-national groups with small Australian subsidiaries will still have to comply with Australia's CbC reporting requirements.
- The Australian entity will have the primary CbC reporting responsibility in Australia. The ATO, however, may also seek to obtain the required information from the overseas revenue authority pursuant to any applicable exchange of information agreement.
- The proposed increase in the administrative penalty regime to a maximum of AUD 450,000 (as mentioned above) will have particular relevance to CbC reporting obligations.
- Meeting CbC reporting obligations will not negate any existing obligations under Australia's transfer pricing rules. For example, the CbC local file does not serve as a replacement of contemporaneous transfer pricing documentation that determines the arm's length nature of its transfer pricing arrangements as required to establish a 'reasonably arguable position' and mitigate the potential imposition of penalties in the event of a transfer pricing adjustment.
- 31 countries (including Australia) have signed the Multilateral Competent Authority Agreement introducing the mechanism for the automatic exchange of CbC reports. It is expected more countries will sign as they ratify their own local CbC rules.
- The ATO has discretion in limited circumstances to exempt an entity from CbC reporting. The ATO has indicated sovereign wealth funds and entities exempt from tax in Australia and/or with a low level of transfer pricing risk may be given exemption. The ATO may also consider other exemption requests in writing on their merits.
- In seeking to balance compliance costs against transfer pricing risk, the ATO has proposed two forms of local files which differ in complexity (short form and regular form). The required form will depend on the client's risk profile, turnover, and the types of transactions entered.

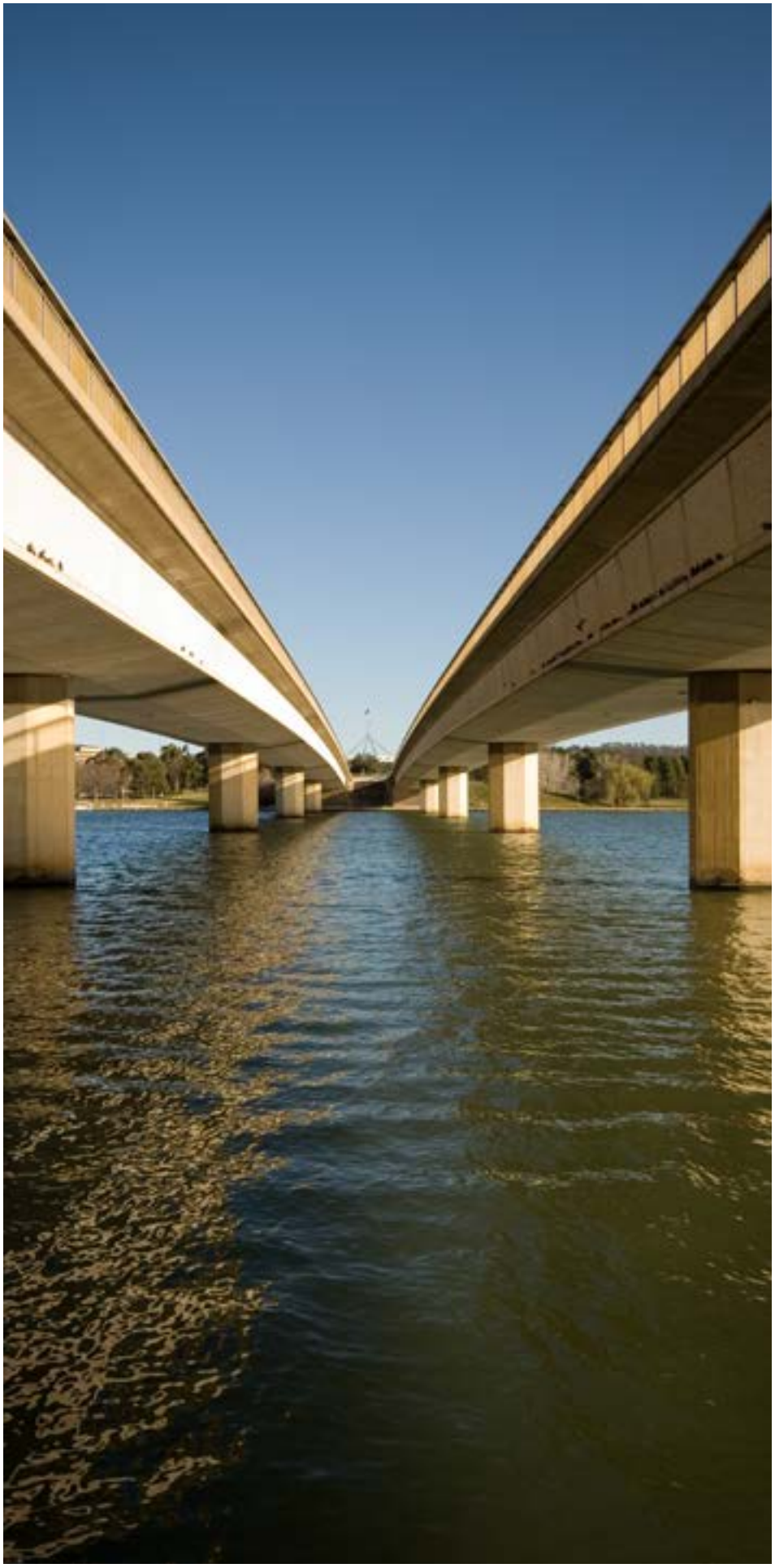
9. REQUIREMENT TO LODGE GENERAL PURPOSE FINANCIAL STATEMENTS (GPFS)

The Australian Government has also introduced a new requirement to lodge GPFS for taxpayers that are members of a 'significant global entity' (global revenue of AUD 1 billion or more):

– This applies for financial years commencing on or after 1 July 2016

– The GPFS must be lodged with the ATO

– The GPFS will need to be prepared in accordance with accounting principles or commercially accepted principles relating to accounting and whether the GPFS are required to be audited is a matter for further consideration.



10. AUSTRALIAN REVENUE AUTHORITY ACTS ON PERCEIVED MULTI NATIONAL PROFIT SHIFTING

The ATO has released four "Taxpayer Alerts" outlining the ATO's concerns over certain practices by some multinational entities. The ATO issued these Taxpayer Alerts to inform taxpayers that it is looking closely at these arrangements and may be reviewing taxpayers that have undertaken such arrangements. The Taxpayer Alerts are summarised below.

Inappropriate recognition of internally generated intangible assets and revaluation of intangible assets for thin capitalisation purposes – TA 2016/1

The ATO is concerned about the following arrangements being entered into to increase maximum allowable debt to avoid the restriction of debt deductions under the Thin Capitalisation rules:

- The inappropriate recognition of internally generated intangible items where the item cannot be separated from the entity or does not arise from contractual or other legal rights e.g. customer relationships, human resources, and internal policies or procedures. Other situations include where the entity does not have the requisite control over the internally generated item, or all the potential future economic benefits of the intangible item do not flow to the taxpayer.
- Inappropriate asset revaluations, e.g. applying unsupportable or questionable management assumptions; revaluation of generic materials such as internal policies; meeting protocols and procedures and double counting of asset value across multiple intangibles; and revaluing the intangible asset based on economic returns which do not accrue to the taxpayer.
- Entities not impairing assets where the fair value or the cash generating unit has declined (as required by the Accounting Standards on impairment of assets).

Interim arrangements in response to the Multinational Anti-Avoidance Law (MAAL) – TA 2016/2

Australia has recently enacted the MAAL, which is a specific anti avoidance measure that is aimed at arrangements that seek to avoid the creation of a permanent establishment (PE) in Australia, or reduce the attribution of income to a PE in Australia. These measures commenced on 1 January 2016.

Many multinationals that are potentially affected by these provisions are reviewing their arrangements and making changes to their arrangements to ensure they are not liable for penalties. As these new rules were implemented quickly, some multinationals had to enter into interim arrangements before they put in place their final arrangements. However, the ATO contends that some of these interim arrangements may in fact be creating other tax liabilities under other tax provisions, such as withholding tax and the general anti-tax avoidance provisions.

The ATO identifies one such arrangement as involving the foreign and Australian entities swapping their roles via contracts. These contracts purport to make the Australian entity the distributor of the products or services and the foreign entity an agent of the Australian entity, collecting the sales revenue from customers on its behalf. The purported result is that no supply is made by the foreign entity and, potentially, the foreign entity becoming a PE of the Australian entity in the foreign entity's jurisdiction. The ATO is concerned that this arrangement may create withholding tax liabilities, transfer pricing adjustments or subject to adjustment under the General anti-tax avoidance provisions of Part IVA.

The ATO suggest multinationals undertaking these interim arrangements consult with the ATO to ensure there are no unintended tax issues.

Arrangements involving related party foreign currency denominated finance with related party cross-currency interest rate swaps – TA 2016/3

The ATO is reviewing arrangements that it contends are designed to increase the tax deductible cost of corporate borrowings by Australian companies from their overseas related parties. There is also concern that some of these arrangements are designed to also avoid interest withholding tax.

Under these arrangements, companies use their related party financing arrangements to create an alleged need to swap currencies and periodical payments for what the ATO says is questionable commercial reasons. These payments represent additional financing costs but are not in the legal form of interest. For Australian tax purposes the arrangement may be treated as a debt interest but could be hybrids that are not treated as debt in the overseas jurisdiction.

The ATO also has concerns that the pricing of these arrangements may not be in accordance with the transfer pricing arm's length principle.

Cross-border leasing arrangements involving mobile assets – TA 2016/4

The ATO is currently reviewing cross boarder leasing arrangements involving mobile assets such as vessels. The arrangements interpose related entities between the foreign owner and the Australian operator of the vessel or other mobile asset. The interposed related entity is generally located in a country that provides favourable tax treaty treatment for the arrangement but with no other apparent commercial or business reason for interposing the related party.

The ATO considers the existing general anti-tax avoidance rules may apply to disallow any treaty shopping tax benefit that may arise in these circumstances. The ATO also considers there are concerns that the arrangements do not meet the arm's length requirements of the Australian transfer pricing laws.

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INDIA

BUDGET 2016

The Union Budget for the year 2016-17 was presented by the Indian Finance Minister on 29 February 2016. The Budget proposals have been built on the 'Transform India' agenda, with nine distinct pillars that, *inter-alia*, include agriculture and farmers' welfare, infrastructure and investment, financial sector reforms, governance and ease of doing business. Acknowledging the role of taxpayers in nation building, the tax proposals are directed at simplification and rationalisation of taxation, reducing litigation and providing certainty in taxation, and incentivising domestic value addition to help 'Make in India' (a flagship initiative to promote manufacturing), etc. The Finance Bill was passed by Parliament (with some amendments to the Budget proposals) and the Bill received the assent of the President on 14 May 2016.

Some of the key amendments enacted through Finance Act 2016 are summarised below:

1. BEPS Measures

a) Introduction of equalisation levy on digital economy

Taking cognizance of Base Erosion and Profit Shifting (BEPS) Action Plan 1, an equalisation levy of 6% has been introduced on consideration paid by a resident business to a non-resident not having a taxable presence in India for specified services. The specified services are defined to include online advertising and provision for digital advertising space or any other facility for the purpose of online advertising. More services may be added to this list later. The payer is obliged to deduct the levy and deposit it with the Government.

The levy is inserted through a separate chapter of the Finance Act and not as an income tax. The income arising to the non-resident from the above specified services and subject to the equalisation levy will be exempt from tax in the hands of the non-resident taxpayer.

b) Country-by-Country Reporting and Master File

With a view to aligning the Indian transfer pricing documentation with OECD/G20 BEPS recommendations, the Finance Act has introduced compliance measures relating to Country-by-Country Reporting (CbCR) and master file documentation. The CbCR compliance is introduced for international groups with consolidated revenue in the preceding fiscal year above a threshold to be specified. In line with the recommendations of BEPS Action Plan 13, the Memorandum to the Finance Bill has indicated a threshold equivalent to EUR 750 million.

The Indian taxpayer, in its capacity, as:

- Parent entity of the international group
- Indian entity (constituent entity) of the international group, where the parent entity is tax resident in a country with which India does not have an agreement for information exchange
- Indian entity (constituent entity) of the international group, where the parent entity is tax resident in a country with which India has an agreement for information exchange but fails to obtain necessary information due to systemic failure

will be required to furnish CbCR with the Indian tax authorities before the due date of filing its tax return in India. The reporting is expected to be in line with the OECD recommendations.

The detailed rules for maintenance of information in the master file, and the manner of furnishing them to the prescribed authority, will be notified at a later date.

2. Changes impacting international businesses

a) Deferral of residency test – Place of Effective Management (PoEM)

The Finance Act 2015 had amended the residency test for foreign companies. Under the amendment, a foreign company having its PoEM in India for fiscal years beginning 1 April 2015 would be treated as resident for Indian tax purposes. The Finance Act 2016 has deferred implementation of the PoEM-based residency test by a year (i.e. to the fiscal year beginning 1 April 2016).

Furthermore, where a foreign company is said to be resident in India, then subject to conditions to be notified by the Government, provisions relating to the computation of income, set off of losses, avoidance of tax, etc. will apply with such exceptions or modifications.

b) Relaxation from furnishing tax identification number (PAN) in India for withholding tax

The existing provisions require a non-resident to seek and quote an Indian tax identification number (PAN – Permanent Account Number) while receiving taxable income from India. In the absence of a PAN, a higher withholding tax is applied. The Finance Act has relaxed this requirement in respect of any other payment, subject to conditions to be prescribed.

c) Minimum alternate tax (MAT) for foreign companies prior to April 2015

Under the existing provisions, a company is liable to pay tax on book profits (MAT), if this exceeds the tax payable under normal provisions. Finance Act 2015 amended the provisions to exclude foreign companies from this obligation (subject to certain conditions). Under Finance Act 2016, the exclusion applies retrospectively from fiscal year 2000-01. The amendment excludes a foreign company from the MAT levy, if it is a resident of:

- A country/specified territory with which India has a tax treaty and such company does not have a PE in India; or
- A country with which India does not have a tax treaty, and the company is not required to seek registration under any law in force relating to companies.

d) Withholding taxes on payments by Category-I and Category-II Alternate Investment Funds to investors

The existing provisions mandate a 10% withholding in respect of income credited/paid by an investment fund to an investor. The Finance Act 2016 provides that the withholding will be at the lower of the rate under domestic tax law or prescribed in the tax treaty, in the case of payments of income to non-resident investors. For a non-resident investor, deduction will not be made if income is not chargeable to tax under the domestic law. Additionally, a mechanism for seeking a certificate from Indian Revenue for lower or no withholding has been introduced.

3. Promoting innovation and startups

a) Royalty income of residents from patents registered in India

A concessional tax rate of 10% on royalty income received by a resident taxpayer (true and first inventor and whose name is entered on the patent register) in respect of a patent developed and registered in India has been introduced. The gross amount of the royalty will be taxable and no expenditure or allowance in respect of such royalty will be allowed. The term 'developed' means at least 75% of the expenditure for the invention is incurred in India.

The taxpayer (patentee) can exercise an option for taxation of income under the concessional regime before the due date of filing the tax return. However, if the patentee does not offer income in accordance with the above provisions for any of the succeeding 5 years, then he is not eligible to claim benefit of the concessional regime for the next 5 years.

b) Tax incentive scheme for startups

The Finance Act provides for 100% deduction from profits and gains for any three consecutive years (at the option of taxpayer) out of five years beginning from the year of incorporation, subject to fulfilment of certain conditions for eligible start-ups. An eligible start-up is defined as a company or a limited liability partnership engaged in an eligible business (that involves innovation, development, deployment or commercialisation of new products, processes, services driven by technology or intellectual property), incorporated between April 2016 and April 2019, with turnover less than INR 250 million for fiscal years between 2016 and 2021, and holding a certificate of eligible business from the Inter-Ministerial Board of Certification.

An exemption for long term capital gains has been introduced if such gains are invested in units of a specified fund (envisaged for financing startups), provided such investment in a fiscal year does not exceed INR 5 million. Furthermore, long term capital gains arising from the transfer of a residential property (by individuals) will be tax free if such gains are invested as a subscription for shares in an eligible start-up. This is subject to the condition that the investor holds more than 50% of the shares and the amount invested in shares is utilised to purchase new assets including computer/computer software.

4. Roadmap to reduced tax rates

a) Reduced corporate tax rate for new companies

As a first step to delivering on the promise to reduce the corporate tax rate from 30% to 25% over the next four years, the Finance Act has introduced a reduced corporate tax rate of 25% (at the option of the company) for companies set up and registered from 1 March 2016. The company should not be engaged in any business other than a business of manufacture or production of any article or thing and research in relation to or distribution of such article or thing manufactured or produced by it. The concessional rate is subject to the condition that the eligible company has not claimed any profit-linked deduction and has not obtained tax benefits like accelerated depreciation, a weighted deduction for scientific research expense, etc.

The option of the reduced tax rate has to be exercised before the due date of filing the first tax return. Once exercised, the option cannot then be withdrawn for the first or any subsequent year.

b) Phasing out of deductions and exemptions

The Finance Act introduced provisions for phasing out incentives relating to profit-linked deductions/weighted deductions as below:

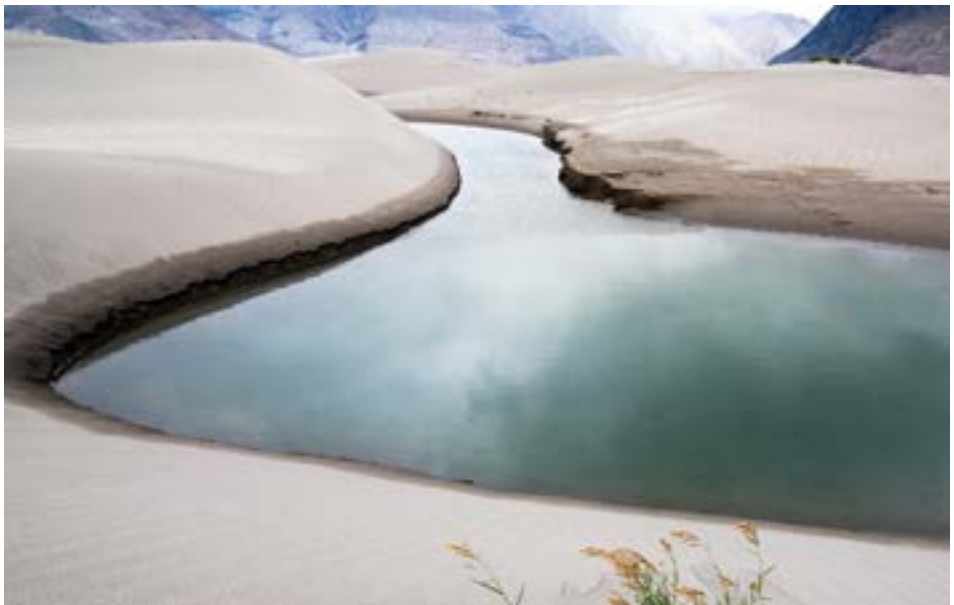
- Sunset date for commencement of activity in Special Economic Zone (SEZ) units;
- Restriction on accelerated depreciation on all assets;
- Restriction on deductions related to scientific research, etc.

5. Dispute resolution scheme

The Finance Act has introduced a scheme to resolve pending litigation. Litigation as below will be treated as concluded, if:

a) In relation to tax arrears (tax, interest or penalty) for which an appeal is pending before the first appellate authority as on 29 February 2016:
   - Tax and interest (and 25% of the minimum penalty, if the disputed tax is in excess of INR 1 million) is paid; and
   - A declaration to this effect is filed by the taxpayer.

b) In relation to tax arising out of retrospective amendments and disputes which is pending as on 29 February 2016:
   - The whole amount of tax is paid;
   - Any writ or petition filed in any court or any appeal against the disputed tax demand before the appellate authorities is withdrawn and proof of such withdrawal is furnished;
   - Any proceedings for arbitration, conciliation or mediation initiated by the taxpayer or any notice given under any law or agreement entered into by India, whether for protection of investment or otherwise, is withdrawn.



DRAFT RULES FOR FOREIGN TAX CREDIT

The Finance Act 2015 introduced an amendment to empower the Central Board of Direct Taxes (CBDT) to notify rules laying down the procedure for granting relief or deduction of income tax paid outside India. In this regard, the CBDT has issued draft rules for stakeholder comments.

The draft rules provide that a resident taxpayer will be allowed credit for foreign taxes paid by him in a foreign country/territory, by way of deduction or otherwise. The credit will be allowed in the year in which the income corresponding to such tax has been offered or assessed to tax in India. The credit will be available against income tax, surcharge and cess payable under the Indian Income tax Act, but not against any interest, fee or penalty payable. No credit would be allowed for the amount of foreign tax which is disputed by the taxpayer in any manner.

The amount of foreign tax credit is to be computed separately for each source of income arising from a particular foreign country/ territory. The foreign tax credit so computed will be aggregated.

The foreign tax credit will be the lower of the foreign tax actually paid or tax computed under the provisions of the Indian Income tax Act on such income.

Under the draft rules, a foreign tax credit would be allowed to the taxpayer upon furnishing certain documents.

For further details, please refer to our Direct Tax Update at http://bdo.in/pdf/draft-rules-for-foreign-tax-tredit.pdf

CLARIFICATION REGARDING TAXABILITY OF CONSORTIUM ARRANGEMENTS

International consortium arrangements executing Engineering, Procurement and Construction (EPC) projects in India have been prone to much tax litigation in the past, the principal issue being classified as Association of Persons and being subjected to a higher rate of tax. In a resolve to implement a non-adversarial tax regime, the CBDT has issued a circular stating that Association of Persons will not apply to consortium arrangements for executing EPC contracts, if:

- Each member is independently responsible for executing its share of work through its own resources and bears the risk of its scope of work;
- There exists a clear demarcation regarding work and costs between members of the consortium;
- Each member incurs expenditure only in its specified area of work;
- Workers and materials used are under the risk and control of respective members;
- Each member earns profit or incurs losses based on performance of the contract falling strictly within its scope of work. An exception has been carved out to provide that members may share the contract price at gross level to facilitate convenience in the billing process;
- The control and management of the consortium is not unified except for the purpose of inter-se co-ordination between members for administrative convenience.

For further details, please refer to our Direct Tax Update at http://bdo.in/pdf/bdo-india-clarification-on-taxability-of-consortium-arrangements.pdf

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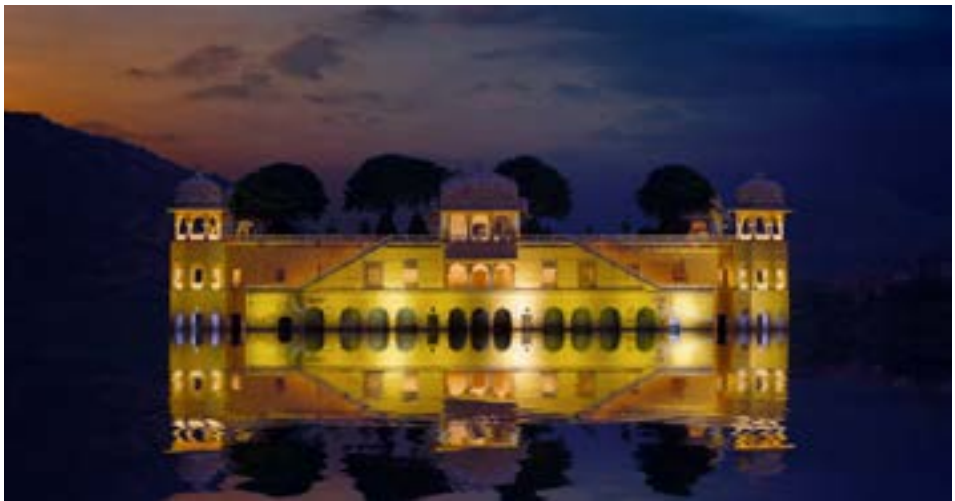

SINGAPORE

VALUE CREATION AND INNOVATION INCENTIVES

In view of the OECD's Base Erosion and Profit Shifting (BEPS) developments, many companies are in the midst of re-strategising their value chain. The search is now on for the most ideal place to carry out value creation and innovation activities. It is worthwhile paying attention to Singapore, which has been gearing up its efforts to develop itself into a leading centre for Intellectual Property (IP) in Asia.

The impact of BEPS

Action 5 (Harmful Tax Practices), under the 15 Action Plans on BEPs, which emphasises substance, will have an impact on the location of IP activities. There must be real business activities and not just shifting of profits from the location in which the value was actually created to another location where they may be taxed at a lower rate. The expectation is that profitability should be aligned with substance. Singapore is a popular base used by many multi-national companies due to its world-class legal and financial infrastructure, highly-skilled work-force, and geographical location. There are hardly any reasons to use Singapore as a location for IP activities merely for tax purposes.

IP Hub Master Plan

Under an initiative by the Singapore Government, the IP Steering Committee has come up with an IP Hub Master Plan to develop Singapore as a Global IP Hub. There are three strategic outcomes that Singapore is striving towards:

1. A hub to support international transactions and management of IP.
2. A hub for quality IP filings, by providing a strong value proposition for IP owners to file their IP in Singapore, so that both local and international companies will use Singapore as a gateway for IP protection in markets all over the world.
3. A hub for IP dispute resolution, so that companies can bring their disputes to Singapore for expeditious and effective resolution through its courts and alternative dispute resolution avenues.

R&D incentives

Of course, Singapore has a competitive tax regime. While enjoying a corporate tax rate of 17%, one of the lowest in the world, companies in Singapore which perform research and development (R&D) activities, develop IP or acquire IP are eligible for various tax benefits.

A 100% tax deduction is allowed for costs incurred on R&D work. To boost R&D activities, the tax deduction is extended to R&D work carried out in Singapore that is unrelated to the existing trade of the company. Costs in respect of R&D work carried out overseas are deductible if they are related to its existing trade. The eligible R&D costs, whether incurred in-house, outsourced works or part of cost-sharing project, are allowed an additional 50% deduction, i.e. a total of 150% deduction. For bigger R&D projects, companies can apply for a tax incentive which grants an additional 100% deduction, i.e. a total of 200% deduction.

Where the R&D work leads to the creation of IP, the qualifying costs incurred to protect the IP are allowed a 100% deduction under a special tax deduction scheme. This special tax deduction scheme allows a tax deduction for capital expenses incurred to register patents, registered trademarks or designs, or grants of protection of a plant variety, which are otherwise not deductible.

Writing down allowances

Companies using Singapore as a location to manage its IP can claim writing down allowances on qualifying capital expenditure incurred to acquire the qualifying IPs. The IPs include patents, copyrights, trademarks, registered designs, geographical indications, lay-out designs of integrated circuits, trade secrets or information that have commercial value, or the grants of protection of a plant variety. Information of customers and information on work processes (such as standard operating procedures), other than industrial information, or a technique that is likely to assist in the manufacture or processing of goods or materials, are excluded.

Tax treaties

Singapore also has an extensive tax treaty network, and the tax treaties reduce the withholding tax rate for royalties to as low as 5% or even 0%. Double tax relief is available for foreign taxes paid or, where there is no tax treaty, Singapore provides a unilateral tax credit. Separately, there is a tax incentive that provides concessionary tax rates at 15% or lower, instead of the prevailing corporate tax rate of 17%, on IP income for substantive activities in Singapore.

Incentive scheme

There is a sun-setting incentive scheme which grants additional 300% claims, i.e. a total 400% claim, for R&D, IP protection and acquisition costs. Companies are advised to act fast, as this scheme ends in year of assessment 2018.

IP Box regime

The above IP Hub Master Plan has recommended an IP Box regime, currently adopted by some countries in Europe and China, which provides for a reduced effective tax rate on qualifying income from IP. If Singapore adopts it, it will bring greater certainty and transparency to the Singapore tax regime. In the meantime, the Singapore Government has not announced any plan to implement it.

There is no better time for companies to consider Singapore in their IP plan.

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SRI LANKA

AUTOMATION OF THE TAX OFFICE

Taxation is an important tool in the hands of any Government to boost the country's economy. Therefore, an efficient tax system is a mandatory prerequisite. A key challenge in Sri Lanka's tax system has been its complex nature. Successive governments have sought to simplify the tax structure by removing nuisance taxes and simplifying rate bands.

In Sri Lanka it has been observed that the tax system is not collecting sufficient revenue for the country. The revenue authority has implemented various measures to increase the tax base, ease revenue collection and make the system both efficient and taxpayer-friendly. The Department of Inland Revenue (IRD) is currently moving from its legacy system (manual filing system with some computerised records) to an automated system called the "Revenue Administration Management Information System (RAMIS)". This shift towards the full automation of its core activities reflects the IRD's commitment to improve efficiency, transparency and financial flexibility in a government burdened by decreasing revenue.

The RAMIS will enable taxpayers to make payments online from the convenience of their offices or homes. The implementation of the system is being phased. Once fully implemented, it will ensure proper and effective management in revenue collection and administration. It will also be linked to computer systems of other State institutions to avoid revenue leakages.

The system will facilitate an increase in revenue collection by providing access to timely and accurate information, monitoring collections, and enabling the tax office to reach out to taxpayers in a more efficient and effective manner. The increased revenues will help the Government to allocate resources towards addressing the country's needs.

The Integrated Treasury Management Information System (ITMIS) of the Finance Ministry will be interfaced with the IRD's RAMIS to ensure that there is fiscal revenue consolidation, having accounted for and reconciled all aspects on a more frequent basis, following an initial study of the Treasury business process and operations. This is a joint initiative with the Asian Development Bank as part of its ongoing Financial Management Efficiency Project.

The Fiscal Management Efficiency Project will address the inefficiencies in the current revenue management system by establishing the proposed revenue administration management information systems (RAMIS) aimed at automating all the business processes of the IRD relating to tax administration.

The core functions which will be IT-enabled after implementation of RAMIS are registration, returns, tax payments, appeals, collections, cancellations, directions, clearances, etc. RAMIS will also support electronic filing of tax returns and provision of online taxpayer services. Upon development and testing of all functions of RAMIS, the expansion of RAMIS to provincial sites of revenue offices will be undertaken as sites are identified by relative importance, infrastructure availability and communications capability.

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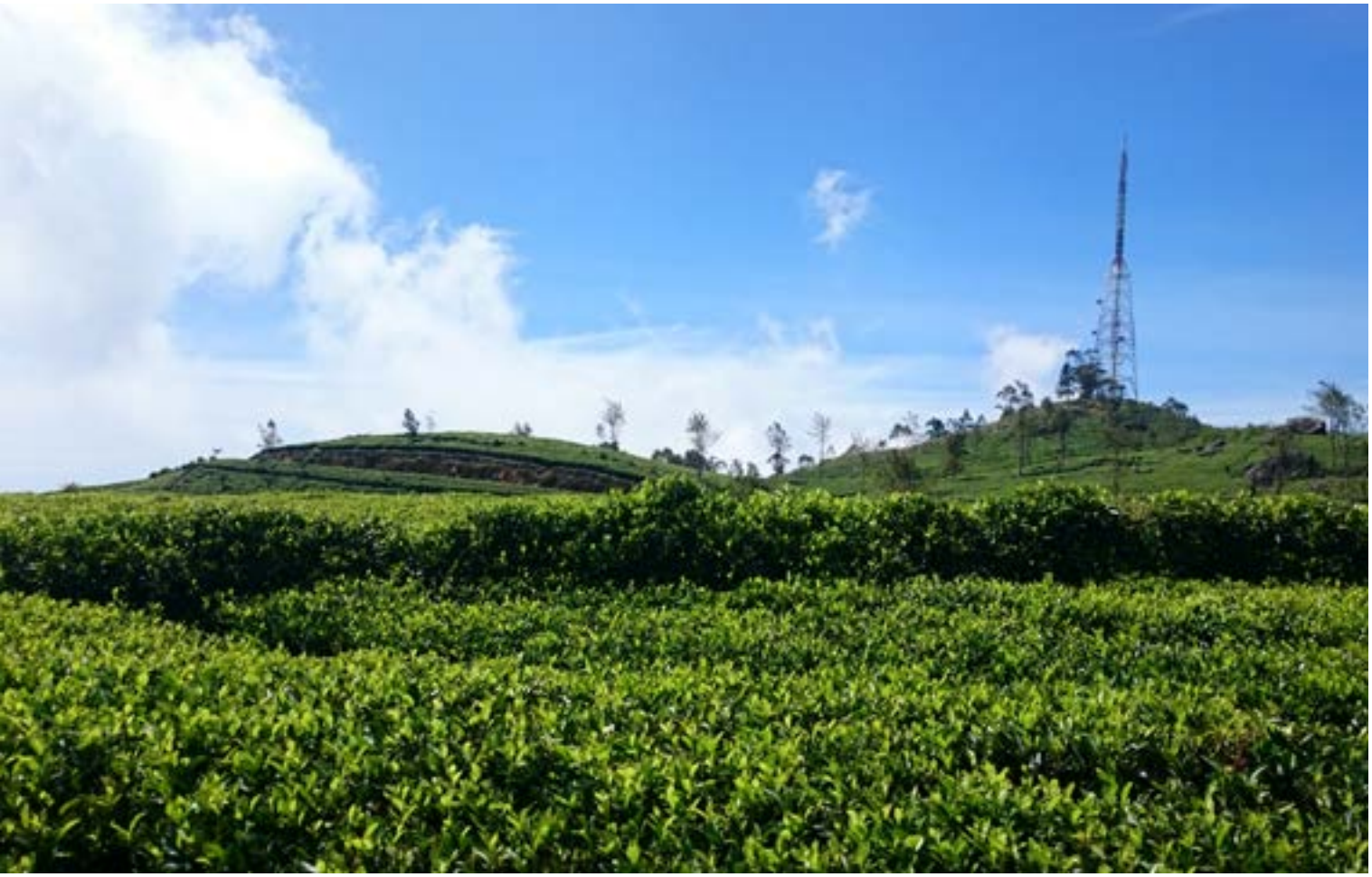

BELGIUM

BELGIAN TAX LAW IMPLEMENTING THE TATE & LYLE CJEU DECISION

A law of 18 December 2015 implemented into the Belgian tax legislation the CJEU decision C-384/11 of 12 July 2012 related to the "Tate & Lyle Investments Ltd" case.

Background

In that case, the Court ruled that the free movement of capital must be interpreted as precluding legislation, as prohibited by Article 63 TFEU, whereby dividends distributed by a Belgian company to Belgian or foreign shareholders which hold less than 10% in the Belgian subsidiary's capital but with a purchase value of at least EUR 2.5 million are subject to Belgian withholding tax (27%), while a mechanism to reduce subsequent tax levies only exists if the receiving company is a Belgian resident.

New reduced withholding tax rate

As a result, the Belgian Income Tax Code was amended so as to address this discrimination. As from 28 December 2015 (date of entry into force of the law), a reduced withholding tax rate of 1.6995% applies on dividends distributed by a Belgian corporation to an eligible foreign corporation which owns less than 10% of the Belgian corporation shares in so far as the acquisition value of said shares is at least EUR 2.5 million.

This new tax rate equals the hypothetical tax due by a Belgian parent company on the dividends received. Indeed, based on Belgian tax law, 95% of the dividends derived from the subsidiary are exempt at the level of the shareholder, so that only 5% of such dividends are taxable at the rate of 33.99%.

The application of the new reduced tax rate is subject to some conditions detailed hereunder.

Certificate to be provided

Prior to the dividend payment (or attribution), eligible corporate shareholders must provide the Belgian distributing company with a certificate confirming that the following conditions are met:

a) The shareholder must be a corporation established either in a member state of the Economic European Area (EEA) or in countries with which Belgium has a qualifying double tax treaty or other agreement providing for a qualifying exchange of information;

b) The shareholder must have a legal form as mentioned in the EU Parent-Subsidiary Directive or a similar legal form;

c) The shareholder must have a capital shareholding in the Belgian company of less than 10% but with an acquisition value of at least EUR 2.5 million;

d) The shareholder must hold its capital shareholding for a period of at least one year in full ownership;

e) The shareholder is not entitled to a credit or reimbursement of Belgian withholding tax in its State of residence.

Claiming the excess withholding tax

The Belgian tax authorities issued guidelines to allow foreign shareholders that qualify for reimbursement to claim the excess Belgian tax withheld before 28 December 2015 (administrative circular n° 26/2013). Companies may file a notice of objection with the Belgian tax authorities in the five years following the year in which the tax was withheld.

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Illustration - basic case

A foreign shareholder (an eligible corporation) who owns less than 10% of the shares of a Belgian company receives a dividend of EUR 100. The acquisition value of those shares amounts to EUR 3 million. The Belgian basic withholding tax rate is 27%. The foreign company is entitled to credit EUR 10 of Belgian withholding tax in its state of residence. Pursuant to the new provision of the Belgian tax Law, Belgian withholding tax is applied at a rate of 1.6995% on 17/27 of the dividend (EUR 63), and a rate of 27% will apply on 10/27 of the dividend (EUR 37). Hence, total Belgian withholding tax amounts to EUR 11.06 (1.07 + 9.99).

DENMARK

A DIFFERENT RULING ON PERMANENT ESTABLISHMENT

In several cases over the past few years, the Danish tax authorities have ruled that an employee working in Denmark from a home office resulted in the formation of a permanent establishment (PE) in Denmark for the foreign enterprise involved.

This practice has affected foreign enterprises seeking to establish their businesses on Danish territory, initially applying a tentative approach – e.g. by hiring a salesperson to work from his residence without authority to conclude contracts on behalf of the enterprise.

Often, the activity of a salesperson will be considered as part of the core business of the enterprise despite the fact that the salesperson is unauthorised to conclude contracts independently.

Consequently, the home office constitutes a PE, and the enterprise must register for corporate tax in Denmark from first day of business.

The primary definition of a PE entails a fixed place of business through which the business of an enterprise is wholly or partly carried on.

A secondary definition exists entailing that an agent of a dependent status is acting on behalf of an enterprise and has – and habitually exercises – authority to conclude contracts in the name of the enterprise.

The definitions are delimited as the term does not include business solely for the purpose of carrying on activity of a "preparatory or auxiliary character".

In a recent case before the National Tax Tribunal (SKM2016.111.SR), the employee – an experienced senior working for an employer in the financial sector – relocated from the UK to Denmark due to illness.

His duties were changed from interaction with clients to solely having a supporting role for his colleagues, with limited contact to clients.

Hence, the National Tax Tribunal ruled that his work activities were of a "preparatory or auxiliary character", thereby not constituting a PE in Denmark.

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HUNGARY

ACHIEVEMENTS AND PLANS OF THE ELECTRONIC MONITORING SYSTEM

On 1 January 2015 Hungary introduced an online monitoring system in connection with the transportation of goods on public roads. The system is called the Electronic System for Controlling the Road Transport of Goods (EKAER).

The objective of the EKAER system is to make circulation of goods more transparent. EKAER also serves as a tool for the Hungarian Tax Authority to identify fraudulent tax transactions, missing traders and to detect tax evasion by related entities.

Taxpayers are often selected for inspection based on filtering performed in the EKAER database, i.e. based on contradictions, data deficiencies, and presumably false or unrealistic data reported in the EKAER system.

EKAER reporting generally applies to the transport of goods on public roads by vehicles that weigh more than 3.5 tons and that are subject to e-toll payments. EKAER reporting also applies to the transport of so called "risky foodstuffs" and "other risky products" (together referred to as "risky goods"), regardless of the vehicle weight or whether it is subject to e-toll payments.

As a result taxpayers must obtain a valid EKAER number before the departure in the case of:

- Inward transportation of goods from the European Union to the territory of Hungary;
- Supply (or outward transportation) of goods into a member state of the European Union;
- First taxable domestic supply of products to non-end users within the country.

In the case of a failure to satisfy a reporting obligation, the unreported product will be regarded as being of unverified origin and a default penalty up to 40% of the value of the goods concerned can be imposed. In certain cases the tax authority is entitled to seize the transported goods.

MORE EFFICIENT TAX AUDITS

The Hungarian Tax Authority has published its Annual Policy on Tax Audits, which includes the trends and focuses of tax audits for 2016. The Tax Authority auditors will continue to pay special attention to compliance with the obligations of the EKAER system in 2016. There were more than 70,000 road controls in 2015. Up to the middle of March 2016 approximately HUF 46 million (EUR 148 000) in default penalties were imposed.

Based on recent EKAER-audits, the tax authority's ex-post EKAER-inspections focus on cross-checking of information deriving from the details reported on the EKAER system, values declared in VAT returns and figures indicated on transportation documents.

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ISRAEL

UPDATES REGARDING RECENT LEGISLATION

As part of the steps taken by the Israeli Tax Authorities ("ITA") to combat tax evasion and money laundering, several legislative steps were recently enacted by the Israeli Government. These steps are intended to expand the disclosures required by Israeli residents with respect to their personal income.

The recent legislative steps also include requirements to report the use of a tax opinion and/or the taking of a position which contradicts the ITA's position regarding any tax issue; an amendment which regards tax evasion as a criminal offence as defined in the Money Laundering Law; and an amendment to the exchange of information law.

Requirement to submit an annual tax report

The following individuals are now required to submit an annual tax report:

1. Israeli individuals who within a 12 month period have transferred money abroad in the amount of ILS 500,000 or more.
2. With respect to certain trusts, in the past, besides for the trustee who was required by law to submit an annual tax report, beneficiaries in a trust would only be required to submit an annual tax report if a distribution was received. The new legislation expands the annual reporting requirement to beneficiaries of a trust who are 25 years of age or above and the trust's total assets amount to more than ILS 500,000 (unless proven that they had no knowledge of the fact that they are beneficiaries).
3. A residency determination for an individual according to Israeli domestic tax law is based upon a number of days test – if fulfilled then the individual is presumed to be Israeli resident, and also a more subjective centre of life test. The new legislation requires an individual who is presumed to be Israeli resident due to the number of days test yet claims to be foreign resident due to the centre of life test to submit a specific tax report and to detail his claim.

This amendment will take effect from the beginning of reporting year 2016 and onwards.

Requirement to report the use of a tax opinion and/or adopting a position contradictory to the ITA

Until 2015, there was no requirement to report a tax opinion received by an individual or a company and/or to report the adoption of a position that contradicts the tax authorities' position. At the end of 2015, new legislation was enacted that requires the reporting of certain tax opinions subject to the conditions set forth in the legislation. This report must be submitted together with the annual tax report. Furthermore, it is now required to report the adoption of a position that contradicts the tax authorities' position. The assessee will be required to report such a position if it entitles him to a tax advantage of ILS 5 million in a specific tax year or ILS 10 million for the previous 4 tax years. The law will apply from 2016 onwards.

Amendment of Money Laundering Law

The Israeli government has recently passed legislation stating that tax evasion will be deemed a criminal offence in accordance with the Money Laundering Law.

Exchange of information

Further to our update in *World Wide Tax News* Issue 39 dated November 2015, the proposal to extend exchange of information rules has been enacted. The law is part of the ITA's battle against tax evasion which, subject to certain conditions and restrictions, allows the ITA to provide information to and receive information from Tax Authorities in other jurisdictions. The legislation was made pursuant to the fact that in accordance with Israeli domestic tax law, the exchange of information was permissible only in accordance to a tax treaty and not any other international agreement.

Bulletin regarding internet activity

The ITA has finalised the draft bulletin with respect to internet activity of foreign companies. The bulletin extends the current interpretation of the PE rules to include profits derived from the digital economy. For further details and elaboration regarding this bulletin please see our update from *Transfer Pricing News* Issue 18, at the link below.

http://www.bdointernational.com/Publications/Tax-Publications/Documents/Transfer%20Pricing%20News%2018%201215.pdf

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ITALY

ALIGNMENT OF TAX RULES TO OECD'S BEPS PROJECT: FOCUS ON CBCR AND PATENT BOX

Country-by-Country Reporting (BEPS Action 13)

The 2016 Finance Act provides for Country-by-Country (CbC) Reporting. Italian MNEs with consolidated revenue of EUR 750 million or more must annually file a CbC report. Italian subsidiaries may also be required to file the CbC report if the parent company meets the threshold but is resident in a country that has not introduced CbC reporting, or if that country either does not have an agreement for CbC exchange or effectively fails to exchange such information. Note that no reference has been made in the Finance Act to any potential changes to the existing Italian transfer pricing documentation rules, which provide that the TP documentation (which is structured in Master File and Local File format) is not mandatory.

Patent box (BEPS Action 5)

In the 2015 Financial Bill the Government introduced a favourable optional tax regime for revenues from the use of certain intangible assets (Patent Box), based on the OECD's "Nexus Approach". The regime covers income arising from the use or licensing of qualifying intangible assets, such as patents, trademarks and other intellectual property, that are linked to research and development activities carried out in Italy.

The regime excludes from the taxable base (both for corporate income tax and regional tax) 50% of the revenues from the use of patents and other intangible assets functionally equivalent to patents. Know-how, which could be potentially protected, and trademarks, are specifically included in the scope of the Patent Box. The effective main tax rate for income streaming from intangible assets will be reduced to 15.7% (compared to the standard rate of 31.4%).

In addition, the capital gain derived by a business from the sale of the qualifying intangibles is not subject to tax if at least 90% of the proceeds are reinvested into research and development activities aimed at maintaining and developing other intangible assets before the end of the second fiscal year following the date of sale.

The Patent Box can be claimed by entities deriving taxable business incomes in Italy. It follows that foreign taxpayers will be given access to the benefit only if they carry on their business in Italy through a permanent establishment. Furthermore, foreign taxpayers must reside in countries having a Tax Treaty in force with Italy and that effectively exchange tax information.

To enter the Patent Box Regime taxpayers must exercise an option, which will last five FYs and cannot be revoked.

In the case of "direct use of own intangibles", taxpayers must sign an "ad hoc" Advance Pricing (APA) with the Italian Revenue Agency. The APA is optional where the intellectual property is based on an intercompany license.

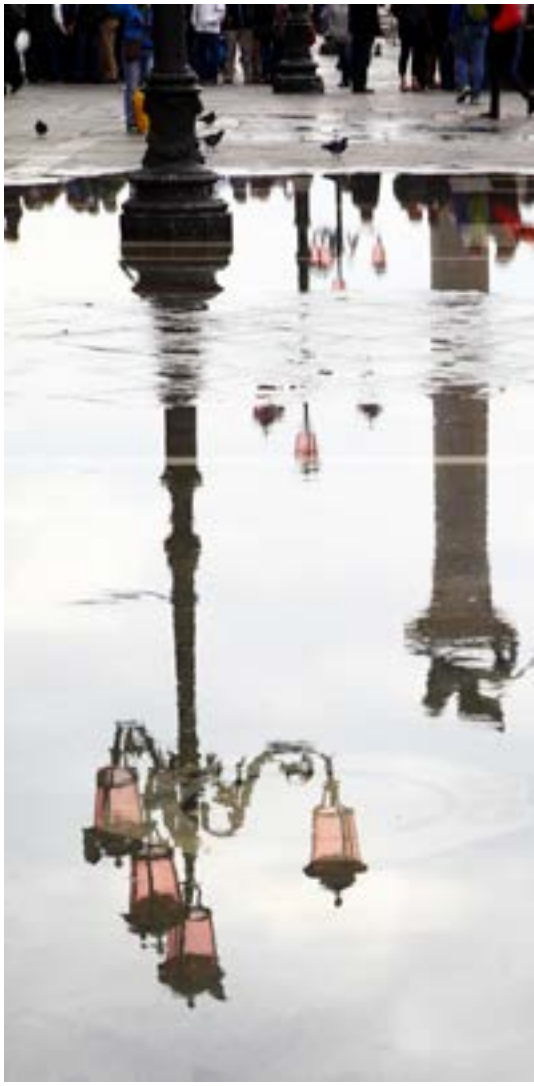
For a mandatory APA, or where the taxpayer chooses to apply for a voluntary APA, the request must be submitted to the Italian Revenue Agency (Central Department or Regional Department in the case of turnover of EUR 300 million or lower). The first step coincides with the submission of the application, which will include general information, such as the description of the intellectual property generating the qualifying income and the relevant research activities performed. During the next 120 days the taxpayer must submit additional documentation disclosing how single IP assets are linked, an analysis of the R&D activities performed and an explanation on how they relate to the intangibles, and the methods and criteria used for the computation of the income to be excluded form CIT and RIT. The method to be used to calculate the income must be compliant with the OECD Transfer Pricing Guidelines. Is important to note that the Italian Revenue Agency can conduct further investigations, for example through an exchange of information with the tax authorities in other jurisdictions, before issuing the final ruling request.

After receiving all documentation, the Italian Revenue Agency will invite the applicant company to appear through its legal representative in order to verify the completeness of the information provided, making any request for further documentation deemed necessary and eventually define the terms of the procedure. The ruling process will finally be completed by the signing of an agreement by the IRA and the company.

The domestic patent box legislation will surely be impacted by BEPS Action 5 and most likely, after 30 June 2016, the regime will no longer apply to trademarks and know how.

As of December 2015, more than 4,500 applications were submitted to the Italian Revenue Agency to exempt income derived from the economic exploitation of:

– Trademarks	36%
– Know How	22%
– Patents	18%
– Designs and models	14%
– Software	10%.



HORIZONTAL CONSOLIDATION

In line with Case C-40/13 of the Court of Justice of the European Union, the Italian Government has recently introduced the possibility of electing for a domestic tax consolidation between two or more Italian sister companies with a common parent residing in any European Union (EU) or qualifying European state.

The horizontal consolidation will also include Italian PEs of qualifying EU and EEA group entities.

The horizontal consolidation applies from FY2015.

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UNITED KINGDOM

TAX ON PROFITS FROM TRADING IN OR DEVELOPING UK LAND

Proposed change

On The Government has proposed a change in the basis of taxation of UK land, such that profits arising from disposals of land derived from a trade of dealing in or developing UK land will be chargeable to UK corporation tax or income tax, irrespective of the residence status of the landowner and regardless of whether or not the activity is conducted through a permanent establishment (PE). Draft legislation will not be available until the Report Stage of Finance Bill 2016, but we summarise the proposals below, based on details contained in a Technical Note issued by HMRC.

Reason for the change

The Government states: "*Some property developers use offshore structures to avoid UK tax on their profits from trading in property in the UK. In line with international standards, the government is acting to ensure that non-resident developers of UK property will always be brought into UK tax on the profits from that development. This will ensure a level playing field between UK developers and those based in offshore jurisdictions*."

Detailed proposals

The new rules, applying equally to resident and non-resident businesses, will tax trading profits derived from land in the UK, irrespective of whether or not the activity is conducted through a PE in the UK.

In advance of publication of draft legislation, HMRC has confirmed that for corporation tax purposes:

– If the company's only activity is a UK property trade, the taxable profits will be the full trading profits of the company, regardless of the residence of the company.

– If the trade of the company comprises both the disposal of UK land and some other activity (such as the disposal of non-UK land), or if, unusually, the company carries on more than one trade, the new charge will apply only to that part of the company's trade or trades that comprises trading in UK land.

– The whole of the profit will be charged to corporation tax (and foreign PE exemption will not be available).

Equivalent changes will be made for income tax.

The charge to tax will apply to all trading disposals of land by affected landowners which occur from the date that Finance Bill 2016 passes the Report Stage in its passage through the House of Commons (originally expected to be in June 2016, although it appears that this may now be delayed).

However, a Targeted Anti-Avoidance Rule (TAAR), effective from 16 March 2016, will apply where either:

– Between 16 March 2016 and Report Stage a person transfers land to a related party who is not intended to be the ultimate recipient. This will prevent arrangements to "rebase" the land value between 16 March 2016 and Report Stage, and will apply regardless of whether there is a main purpose of avoiding tax; or

– In any other case where arrangements are entered into the main or one of the main purposes of which is to secure that profits are not subject to the new charge.

The legislation will also contain anti-fragmentation and anti-enveloping rules which will enable such arrangements to be counteracted without consideration of whether there is a tax avoidance purpose. If there is both fragmentation and enveloping, both the anti-fragmentation rules and the anti-enveloping rules will apply.

The new rules took effect from 16 March 2016 for developers resident in the Isle of Man, Jersey and Guernsey as new protocols amending the double tax agreements with these territories were agreed and published alongside the Budget and take effect from 16 March 2016.

The Government states that it will monitor the impact of the new rules and consider introducing a withholding tax if that proves necessary to ensure full compliance with the legislation.

Implications

The new rules continue the recent trend of extending UK tax charges to non-residents, and will significantly change the position for traders and developers who are non-UK resident and have no PE in the UK. The rules should ensure that the Government's aim, that non-resident developers of UK property will always be brought into UK tax on the profits from that development, will be achieved without the need for protracted challenges on matters such as whether a company has created a UK PE. However, the downward trend in the corporation tax rate will reduce the impact of the change.

HMRC confirms that the change will not affect UK developers who are already fully within the charge to corporation tax on property development.

However, concerns have been expressed about certain aspects. For example, it is to be hoped that the legislation (including the anti-enveloping measures) will make it clear that the charge to tax is only on trading (and not investment) activity, and that the diverted profits tax provisions are amended so as to exclude real estate projects, in order to avoid the possibility of a double tax charge.

Care also needs to be taken that the legislation does not go beyond the stated policy objectives and potentially catch innocent commercial transactions.

The main considerations now for overseas developers intending to carry out UK real estate projects will be whether to continue to use an offshore structure for practical or commercial reasons or for reasons connected with the eventual tax charges on shareholders when withdrawing profits, which will depend on where the relevant entities or individuals are located.

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ARGENTINA

SUPPREME COURT RULING ON MINIMUM PRESUMED INCOME TAX

A new precedent ruling by the National Supreme Court of Justice confirms the non-application of the Minimum Presumed Income Tax, consolidating the criteria established in the "Hermitage S.A." case, for companies which incur Income Tax losses and which are highly indebted.

The benefit of this ruling is the cancelling of the assessment amounting to 1% of the company's assets.

Consequently, companies which are in an economical and financial loss-making situation (often caused by a marked debt), can now take action to cease paying Minimum Presumed Income Tax and request reimbursement of the tax paid in the past.

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CANADA

2016 FEDERAL BUDGET – INTERNATIONAL TAX MEASURES

Summary

On 22 March 2016, Canadian Finance Minister the Honourable Bill Morneau presented his first Budget, which includes several provisions that impact international business transactions.

Details

Some of the key international tax provisions included in the Budget are discussed below.

Base Erosion and Profit Shifting

Canada is actively engaged in coordinated multilateral efforts of the G20 and the Organisation for Economic Co-operation and Development ("OECD") to address base erosion and profit shifting ("BEPS"). The Budget announced the following actions related to the OECD BEPS recommendations:

- **Country-by-Country Reporting ("CbCR")** – The Budget proposes to implement CbCR as part of required transfer pricing documentation, applicable to large multinationals (groups with annual consolidated revenue of EUR 750 million or more). Multinational enterprises with an ultimate parent entity resident in Canada will be required to file a CbC report with the Canada Revenue Agency ("CRA") within one year of the end of the fiscal year to which the report relates. This reporting will be required for tax years beginning after 2015, consistent with the OECD recommendations. The first exchanges of this information between tax authorities in other jurisdictions are expected to occur by June 2018, but only once exchange agreements are finalised, to ensure the confidentiality of taxpayer information is maintained.
- **Revised transfer pricing guidelines** – The OECD transfer pricing guidelines have been revised to improve the interpretation of the arm's-length principle. These revisions generally support the CRA's current interpretation and assessing practices.
- **Treaty abuse** – The Budget confirmed Canada's intention to address tax treaty abuse in accordance with the minimum standard outlined in the OECD recommendations. Canada will look to amend its tax treaties, adopting either a limitation-on-benefits approach or a principal purpose test, depending on the particular circumstances and discussions with Canada's treaty partners. Canada is also participating on work on a multilateral instrument that could streamline the amendment of its tax treaties.
- **Spontaneous exchange of tax rulings** – The Budget confirmed the Government's intention to implement the BEPS minimum standard for the spontaneous exchange of certain tax rulings with tax authorities in other jurisdictions, to improve transparency. This process will begin in 2016.

Cross border surplus stripping

Section 212.1 of the Income Tax Act contains an "anti-surplus stripping" rule that is intended to prevent a non-resident shareholder from entering into a transaction to extract (or "strip") without tax a Canadian corporation's retained earnings (or "surplus") in excess of the paid-up capital ("PUC") of its shares or to artificially increase the PUC of the shares. Subsection 212.1(4) is an exception to this "anti-surplus stripping" rule, that essentially turns off subsection 212.1 when certain conditions are met. The Budget suggests that some non-resident corporations have misused this exception by reorganising the group into a sandwich structure as part of a series of transactions designed to artificially increase the PUC of shares of those Canadian subsidiaries. To address this, subsection 212.1(4) will be amended so it will not apply if there is a sandwich structure, and a non-resident person (i) owns shares of the top-tier Canadian purchaser corporation and (ii) does not deal at arm's length with the Canadian purchaser corporation. This amendment will apply to such dispositions that occur on or after 22 March 2016.

Extension of the back-to-back loan rules

There are currently rules in place to ensure that a back-to-back loan arrangement cannot be used to reduce the amount of withholding tax on a cross-border interest payment. The Budget proposes to build on the current back-to-back loan rules by:

- Extending the application of the rules to royalty payments made after 2016.
- Adding character substitution rules to the back-to-back rules, which will apply to interest and royalty payments made after 2016. These rules will prevent the avoidance of the back-to-back loan rules through the use of arrangements that provide payments that are economically similar to interest or royalty payments, which can be substituted between a non-resident intermediary and the other non-resident person.
- Adding back-to-back loan rules to the existing shareholder loan rules which will generally apply to back-to-back shareholder loan arrangements as of 22 March 2016.

Also, the Budget clarifies the application of the back-to-back loan rules to multiple-intermediary structures, which will apply to payments of interest and royalties made after 2016 and to shareholder debts as of 1 January 2017.

Businesses with Canadian activities should review the impact of the provisions on their business activities and structure. BDO can assist in evaluating the impact of the Budget proposals in particular businesses' facts and circumstances.

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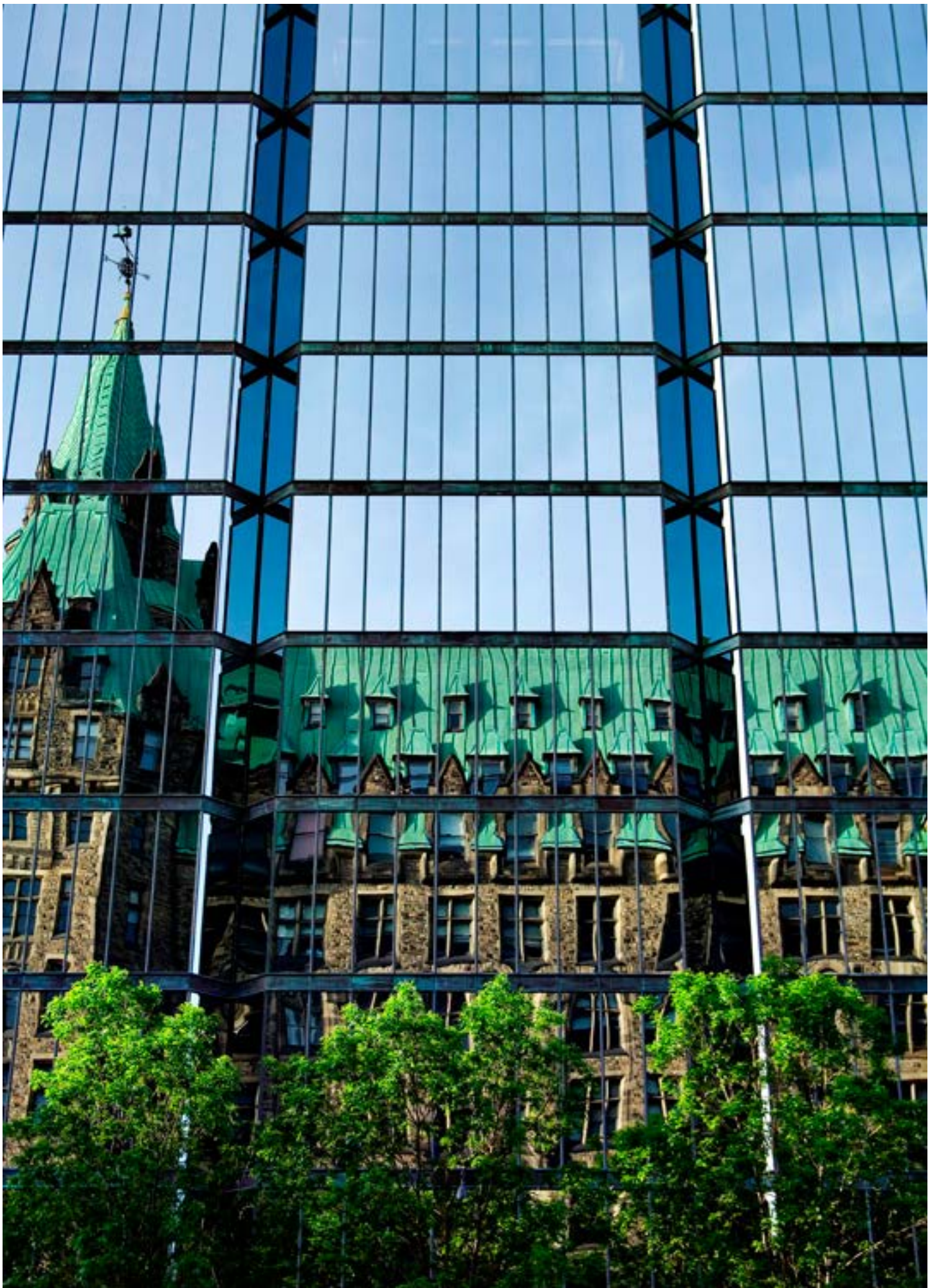

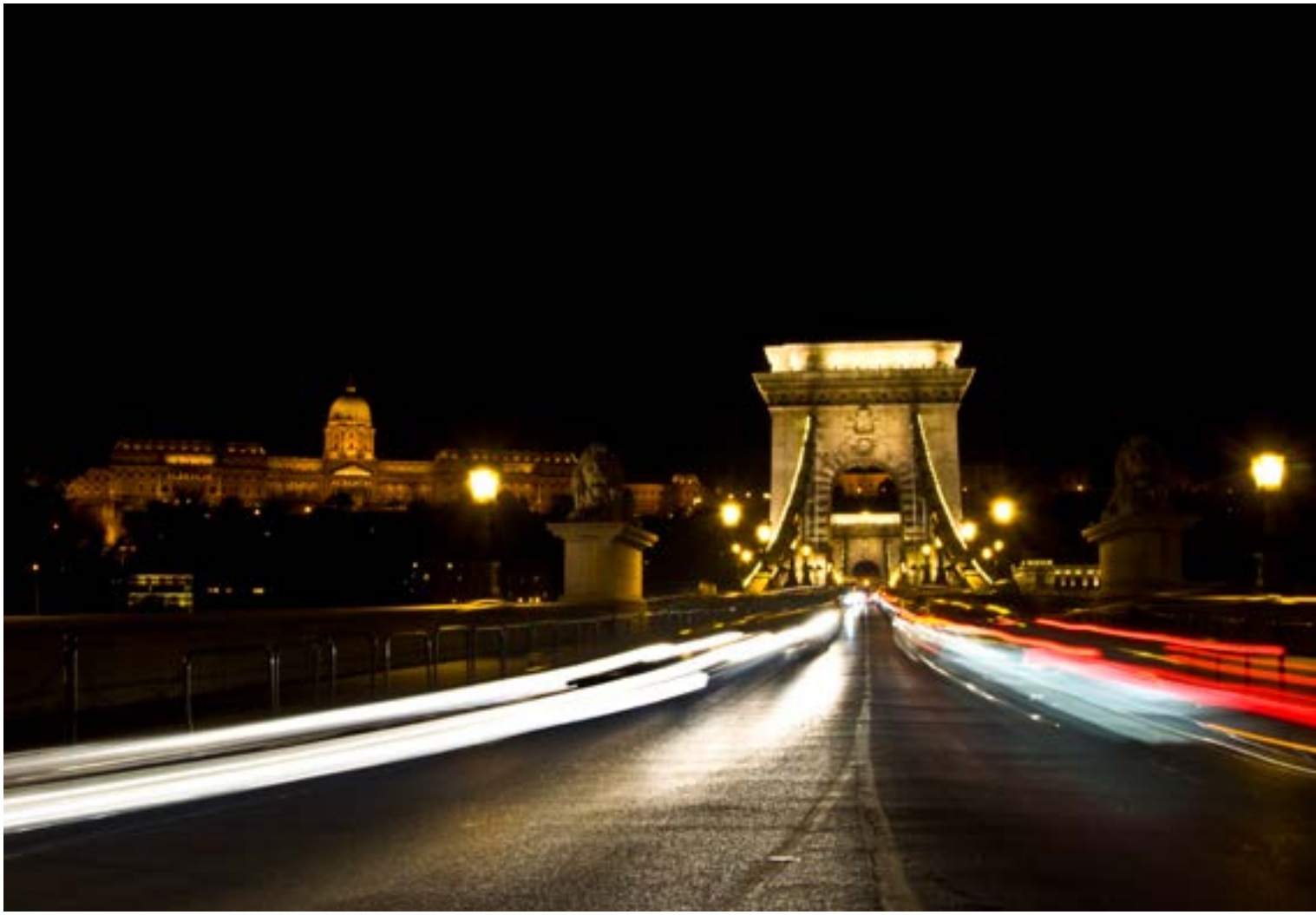

CURRENCY COMPARISON TABLE

The table below shows comparative exchange rates against the euro and the US dollar for the currencies mentioned in this issue, as at 22 June 2016.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
Australian Dollar (AUD)	0.66097	0.74733
Euro (EUR)	1.00000	1.13056
Hungarian Forint (HUF)	0.00319	0.00360
Indian Rupee (INR)	0.01305	0.01476
Israeli New Shekel (ILS)	0.22910	0.25905
US Dollar (USD)	0.88439	1.00000

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