NEXIA INTERNATIONAL

TAX link

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Contents

Australia
Purchasing Australian assets from a non-resident: Changes coming - care needed

What happened?
In November 2013, the Government announced that it would proceed with a proposal from the 2013-14 Federal Budget that, from 1 July 2016, it would impose a 10% non-final withholding obligation on a purchaser when a non-resident disposes of certain taxable Australian property.
If this proposal becomes law, from 1 July 2016, a purchaser (resident or non-resident) will have to withhold 10% of the purchase price when buying certain Australian assets from a non-resident owner.

On 31 October 2014, Treasury released a Discussion Paper giving more details of the proposal. According to this Paper, examples of taxable Australian property that would be subject to this type of withholding would include:
- interests in Australian real property;
- assets attributable to a place in Australia where a business is carried on; and
- residential properties of $2.5m or more.

If this proposal becomes law, it will mean that whenever a non-resident disposes of such assets on or after 1 July 2016, any resident or non-resident purchaser will have to withhold 10% of the purchase price from the transaction and pay it over to the Commissioner of Taxation.

This amount of 10% withheld from the proceeds will be kept by the ATO and applied as a credit against the non-resident seller's income tax liability for the relevant income tax year. The plan is that this non-final withholding tax will apply on all such transactions regardless of whether they are on revenue (eg non-resident property developers selling property) or capital account (eg non-resident property investors realising their properties).

What does this mean for affected property purchasers (both resident and non-resident)?
It will mean added compliance costs for purchasers of assets from non-residents.

Purchasers affected by this proposed measure will therefore be faced with additional compliance costs (eg identifying whether the seller is a non-resident, at what time to withhold from the proceeds, as well as what information to provide to the ATO when remitting an amount withheld) to ensure they fulfill their withholding obligations. Likewise, standard sale of land contracts may have to be varied to take into account the proposed new withholding tax regime whenever a non-resident seller is involved. On the other hand, this proposed measure will strengthen the Australian tax collection mechanism relating to non-residents, as non-resident sellers will only be able to use the 10% credit if they have an Australian tax file number and lodge an income tax return.

However, what it boils down to is that only the purchaser's withholding obligation will change (currently, the purchaser does not need to withhold any tax if they buy such assets from a non-resident) – the seller's tax liability will remain the same.

It is worth noting that the great majority of residential house sales will not be affected by this proposal.

How can Nexia Australia help you?
Although it is still early days with the proposal, and its implementation is still some way off, it is important for foreigners owning assets in Australia to be aware of these proposals and how they may affect them.

Some of initial observations are that:
- the great majority of residential house sales by non-residents will not be affected by this proposed measure (because there is a carve-out for residential property under $2.5m);
- it is uncertain how to determine whether the seller is a non-resident (eg through residency declarations from the seller, or will there be a duty on the purchaser to enquire as to the seller's residency status).

Hopefully, final legislation will provide a workable solution to this issue.

We will keep you updated on any new developments in this area.

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China
GAAR, Transfer Pricing and BEPS update

Since the enactment of the 2008 Enterprise Income Tax Law (EITL), China's State Administration of Taxation (SAT) has increasingly focused its attention toward the detection and investigation of global company tax practices that are intended to avoid taxation in the country. In this vein, SAT has continued to upgrade its General Anti-tax Avoidance Regulations (GAAR) and other related regulations, such as the infamous Circular 698, which is designed to potentially collect taxes when offshore entities indirectly dispose of an invested entity in China. SAT has also continued to upgrade its transfer pricing monitoring practices, including triggers for investigations and tax adjustments. China has also contributed heavily to the OECD Base Erosion and Profit Shifting (BEPS) initiative, thereby influencing several of the action plans that have been published since September of last year.

Draft GAAR measures

Although a final draft has not yet been implemented, China's SAT has made reasonably clear its intentions with respect to GAAR. On 3 July 2014, SAT released a discussion draft of a new set of GAAR measures, giving interested parties a one-month opportunity to comment before a final version is written and released. Although the GAAR provisions of the EITL indicated no enforcement preference with respect to domestic or cross-border arrangements, the July draft measures illuminate the SAT's focus of GAAR enforcement only on cross-border arrangements.

The draft measures instruct tax authorities to examine both the purpose and substance of a given tax arrangement in assessing whether or not to apply GAAR. If determined that a "tax avoidance scheme" is in place, in which there is a tax benefit but no reasonable commercial purpose for the arrangement, the case would be subject to adjustment under GAAR. A "tax avoidance scheme" would be any arrangement that has the sole, main or partial purpose to obtain a tax benefit, and which is legal in form but has a form that is inconsistent with the commercial substance. In addition to providing detailed GAAR implementation procedures, the draft measures also indicate that other tax administrative avenues, such as transfer pricing and thin capitalization rules or the provisions of tax treaties, should be exhausted before triggering GAAR procedures.

Stepped up investigations on royalties and related party services

On the heels of this July draft, the SAT instructed local in-charge tax bureaus throughout China to examine the cross-border royalty payments and service fees that companies within their jurisdictions have made to related parties in the last ten years (within the statute of limitations for transfer pricing related tax adjustments). The local tax bureaus were instructed not only to report the findings to

SAT, but also to register formal transfer pricing audits of any companies found to have suspicious service and/or royalty transactions. Presumably, the transfer pricing audits would result in tax adjustments.

In keeping with China SAT's practices of the last several years, tax officials are paying particular attention to royalty payments that are made to any entity in a tax haven jurisdiction, or royalties paid to a related party that is perceived to have little or no commercial substance. Furthermore, royalty payments are suspect if the China based payer is perceived to have contributed to the value of the intangible for which payment is made, and in cases where tax authorities deem that the intangible offers little or no value to the payer's business.

With regards to related party services fees, suspect services include any service related to shareholder activities and/or the supervisory functions of the group headquarters. Other suspect transactions include those in which the service appears to be irrelevant to the recipient's business scope or function and risk, or those in which redundant payments appear to be hidden in other transactions.

Announcement on Special Tax Adjustment Policies

Following these orders from SAT to the local tax bureaus, SAT released Announcement [2014] 54, Issues Related to the Monitoring and Management of Special Tax Adjustments, which took effect on 29 August 2014. The announcement covers three administrative principles that shall be used in cases where suspect transaction practices or tax positions are detected in a company's tax declarations, transfer pricing documentation, or other documentation. The first point in the announcement instructs tax bureaus to immediately serve a Notice of Special Tax Adjustment

Risk to a taxpayer as soon as tax officials observe through their monitoring that such risk is present. The taxpayer then will have 20 days to submit related data or documentation. During this period, the taxpayer shall also perform a self-evaluation of its transfer pricing practices or other practices that triggered the Notice, and may elect to perform a tax self-adjustment and pay the additional tax for the period in question. In the event that no self-adjustment is made and the taxpayer requests the tax officials to verify or validate the taxpayer's practices, the tax officials shall initiate formal procedures for a special tax investigation.

The second point makes it clear that even if the taxpayer elects to make a self-adjustment and tax payment, the tax bureau can still initiate a special tax investigation and make further adjustments if deemed necessary. Of some benefit to the taxpayer, the third clause of the announcement allows that if the taxpayer submits its documentation within the 20 day period and also makes a tax self-adjustment and payment, interest will not be charged on the adjusted amount of tax (which would ordinarily be considered a late payment subject to interest penalties).

China responses to BEPS actions

In September of this year, the OECD released reports covering seven of the fifteen actions that were identified in the OECD July 2013 Action Plan on Base Erosion and Profit Shifting. The September 2014 reports include recommendations to amend laws and tax treaties as related to: Tax challenges of the digital economy; problems of hybrid mismatches; transparency and substance issues; tax treaty abuse practices; transfer pricing of intangibles; country-by-country reporting and transfer pricing documentation; and modification of bilateral tax treaties. China's SAT offered considerable input in the development of these OECD recommendations. Based on comments the agency posted on its website when posting the Chinese translations of the OECD reports, SAT's position on several of the actions can be inferred.

Certainly, the SAT is pleased to see the proposals with respect to transfer pricing of intangibles. China has been pushing for acceptance of its practice of recognizing location specific advantages in comparables analysis, a practice featured in the new OECD guidance. Additionally, the OECD's downplay of intangibles ownership and funding in the allocation of group profits in favor of use, function and risks is consistent with the SAT's approach in transfer pricing matters.

Finally, the OECD report supports China SAT's increasing preference to utilize profit split pricing methods rather than net margin methods. The support is not only evidenced in the intangibles transfer pricing proposals, but is also seen in the OECD recommendation to utilize country-by-country reporting in transfer pricing documentation, which China's SAT has also strongly advocated and already put into practice.

Take home lesson

Global companies with invested entities in China, and Chinese entities that invest in companies overseas, both must continually assess their transfer pricing practices and overall tax positions. China's SAT, with increasing support from the OECD, favours a substance and function (over form) approach when evaluating related party transactions and the profits allocated to China entities. Payments made by China entities for services and royalties are increasingly scrutinized and tax deductibility is more frequently denied. This is especially true where the payments are made to offshore entities that lack commercial substance, but also more and more frequently occurs in cases where payments are made for services that are easily performed by (or obtainable by) the China entity, or where the service or intangible are not considered as being relevant to the China entity's business. Global companies can no longer consider a "we have always done it this way" approach to their tax positions in China. China's SAT is rapidly maturing, as is the overall economy. There are many beneficial reasons for doing business in China, and it is likely that the ever-growing market is chief among them. Avoiding tax is no longer a workable reason.

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Korea

Spend more or you'll be taxed. (2015 reintroduction of excess retained earnings tax [ERET] in Korea)

Early in 2014, a big passenger ferry went down in South Korea leaving more than 300 dead or missing. This disaster put the nation in collective mourning all year and is acting as a major drag on the economy. With this backdrop, the second cabinet of the Park administration was inaugurated. The Ministry of Strategy and Finance of Korea announced a stimulus package aimed at spurring consumer spending. The excess retained earnings tax (ERET) is part of the stimulus package enumerated in the 2014 Tax Revision Bill which was passed at the National Assembly and effective as of 1 January 2015.

The ERET is designed to strengthen the link between corporate earnings and household income by inducing companies to increase investments, wages and dividends.

A brief history of ERET in Korea

The ERET had existed in Korea until 2001. It was introduced as an amendment to the corporate income tax law on 31 December 1990 and, after several revisions, the ERET provision was scrapped on 31 December 2001.

Under the previous corporate income tax law, an ERET was imposed on a company with more than 10 billion won in total equity capital or companies under the umbrellas of large business conglomerates. However, at that time, the ERET was not applicable to those companies listed on the KOSPI (Korea Composite Stock Price Index) and KOSDAQ (Korea Securities Dealers Automated Quotation).

The ERET was scrapped in Korea in 2001 in the wake of the Asian currency crisis and the International Monetary Fund's bailout of Korea in the late 1990s. As the fragile financial structure of Korean companies was criticized as one of the major causes of the currency crisis, the relevant law was amended to solidify the financial structure by retaining more profits in the companies.

Korean companies' financials improved substantially and the policy purpose was achieved. The internal reserves, including cash and cash equivalents, of South Korea's top 10 enterprises totaled 34 trillion won at the end of 2013, up almost 20% from the end of 2012, according to company filings to the Financial Supervisory Service. Samsung Electronics, South Korea's biggest company, has over USD 60 billion cash reserves, or 30% of its market capitalization.

It was considered desirable for large Korean companies to spend cash on wages, dividends and investment. The ERET prods large companies to spend their cash hoardings.

Misunderstanding

Because of the name of the ERET, it is commonly misunderstood that the accumulated retained earnings of companies are currently taxable. However, the ERET is not a tax imposed on the retained earnings held by a corporation. Instead the ERET is levied on the amount left after deducting statutory reserves from income generated annually. Therefore, those past retained earnings accumulated in the company are not taxable.

Taxable companies

Companies with a total equity capital exceeding 50 billion won (USD 45.5 million) and large conglomerates under the control of the Fair Trade Commission are taxable. These conglomerates are those with more than 5 trillion won in total assets and there are at present 63 business groups designated as such. Therefore, small and medium-sized companies are exempt from this new tax regime.

Method to calculate taxable retained earnings

Taxable companies should spend a certain target percent of income on investments, wage increases and dividend payments, or the amount calculated by the following methods will be subject to ERET (10%).

Businesses will be able to choose between either the following A[1] or B[2] methods and they have to adhere to the chosen method for 3 years.

A method	B method
[Adjusted corporate taxable income[3] × target percent (60 ~ 80%) – (investment[4] + employee wage increase[5] + dividends[6] , and etc.[7]) × 10% tax rate	[Adjusted corporate taxable income × target percent (60 ~ 80%) – (investment + employee wage increase + dividends, and etc.) × 10% tax rate

Conclusion

The Korean government's goal is not to have this ERET imposed on businesses. Instead its policy target is to make companies spend more. It is expected this ERET will contribute in the following positive ways.

1) Enhancing the overall stock price of Korean companies as a result of increased dividend
2) Stimulating the economy as a result of the increased domestic investment

Recently, Hyundai Motor Group, the largest motor group in Korea, won the bid to purchase the land asset held by the Korea Electric Power Corp. (KEPCO) in Gangnam area, an affluent southern district of Seoul by offering 10.55 trillion won. Hyundai Motor Group is planning to develop the area for a Motor Theme Park, Hotels and office buildings. The final payment of the deal is in September 2015. The key tax issue is whether the Hyundai's land purchase can be admitted as an "investment" for the purposes of ERET. The government has not yet confirmed this. However, it is cautiously expected positive.

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[1] A method includes "investment" in the method where the target percent is higher.

[2] B method excludes "investment" in the method where the target percent is lower.

[3] "Adjusted corporate taxable income" is adjusted to the corporate taxable income by following adjustments.

(Additions)	(Subtractions)
• Depreciation of the current year's investments (*) • Interest of national tax refunds • Dividends from domestic subsidiaries (*) Applicable only to the above A method	• Corporate income tax and surcharges (excluding the ERET) • Statutory reserves • Net operating losses • Donations in excess of limit and etc. (**) (**) However, entertainment costs in excess of limit and other overly spent expenses are not subtracted.

[4] (Scope of Investment)
Tangible and intangible assets for business purpose "Business purpose" will be specified in detail in the enforcement regulations. Investment in foreign companies will not be included in the scope of investment. the deduction will be reversed in case of disposition or rent of the investment within 2 years after the purchase.

[5] Increase in the earned incomes of employees excluding directors, major shareholder family and the highly salaried people (with annual income of 120 million won and more)

[6] (Scope of dividends)
1) Cash dividends (interim and year-end)
2) Buyback of listed shares and retirement within 1 month after buyback

[7] Contribution to the Large-SME Mutual Cooperation Fund

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Malta
Taxation of Trusts in Malta

The Maltese tax system offers attractive tax characteristics for the creation of Trusts. Malta, a white-listed jurisdiction by the OECD with a growing reputation as a trust domicile, is highly beneficial for trusts resulting either in complete neutrality or a low effective rate of tax. In addition, although a Civil Law jurisdiction, Malta has successfully transposed trust legislation into its legal system, regulating trusts clearly and enabling domestic Courts to recognise and uphold trust principles.

Settlement in Trust

The settlement of assets which are not located or registered in Malta into a trust should not be subject to tax in Malta, provided that the settlor is not resident in Malta or not domiciled in Malta. The settlement falls outside the scope of the charge to duty where the assets are located outside Malta. There is also no tax where a non-Maltese resident settlor settles shares in a company which does not have immovable property situated in Malta.

Taxation of Trust Income

The taxation of trusts in Malta is governed by the Income Tax Act Cap. 123, the Income Tax Management Act, Cap. 372 and the Duty on Documents and Transfers Act, Cap. 364. In terms of Maltese tax law, where at least one of the trustees of a trust is a person resident in Malta, tax shall be payable in Malta on any income attributable to a trust. Income attributable to a trust includes the aggregate of any relevant income accruing or derived by the trustee from property which has been settled in the trust, and from property which was acquired in the course of administration of such trust.

However, on the establishment of residence in Malta by one of the trustees, the following options apply:

1. Transparency

Where all the conditions set out below are satisfied, chargeable income or gains characterised as constituting income attributable to a trust would be deemed to have been derived directly by the beneficiaries and would not therefore be chargeable to tax in Malta in the hands of the trustee.

The conditions to be satisfied are the following:

i. All the income attributable to the trust consists of:

- dividends distributed by one or more companies registered in Malta; and/or
- income arising outside Malta; and/or
- income consisting of Interest / Royalties / Gains or profits on disposal of shares or securities in a company which is not a company owning immovable property situated in Malta.

ii. All the beneficiaries of the trust are persons who are either not ordinarily resident or not domiciled in Malta; Should all the above conditions be satisfied, the Malta Commissioner of Inland Revenue would effectively look through the trust for income tax purposes and deem all chargeable income and gains accruing to the trust or realised by the trust to have been derived directly by the beneficiaries of the trust. This option may be an effective tool in efficient tax planning in itself and also in connection with the various double tax treaties currently in force in Malta.

2. Election for Trust to be treated as a Malta Company

Alternatively a trustee of a trust who is a person resident in Malta and who is authorised to act as such in terms of the Laws of Malta may make an irrevocable election to compute the chargeable income in relation to the income attributable to the trust as if such income was derived by a company ordinarily resident and domiciled in Malta. Such an election, which shall be irrevocable, is to be effected from the date of the establishment of the trust or the appointment of a resident trustee whichever is the later.

The resident trustee would, however, only be entitled to make such an irrevocable election should the trust in question have been established by a written instrument which, in turn, specifically restricts the income attributable to the trust to income in the form of royalties, dividends, capital gains, interest, rents or any other income from investment.

In such a case, tax shall be charged at the rate of 35%, it shall be payable in the same manner applicable to companies, and distributions of such allocated profits to beneficiaries of the trust shall be treated as if they were dividends distributed to shareholders of a company and the non-resident beneficiaries would be entitled to claim a refund of the tax paid by the trust as if it were operating as a company resulting in a maximum tax leakage of 5%. In addition such an option may be useful in those instances where the trustee wishes to claim relief from double taxation on income that has been subject to withholding taxes outside Malta.

How we can help

At Nexia BT, we have a fully-fledged team who can assist and provide guidance both at a compliance level as well as advice on the optimal structure that best suits your requirements.

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Russia
Changes in the taxation of foreign organizations

In accordance with Federal Law No. 376-FZ of 24 November 2014, amendments shall be made to the Tax Code of the Russian Federation with regard to profit taxation of controlled foreign companies and income taxation of foreign organizations starting from 1 January 2015.

The question is then, what are we to expect in the coming year?

1. The Law restricts the application of international treaties on double taxation. If a foreign person has limited powers with regard to the disposal of income taxable under the existing international treaties; or acts as an intermediary in favor of another person, without bearing any risks and performing no other functions; or pays, directly or indirectly, fully or partially, such income to another person who, in receiving the income directly from Russia, has no right to apply the provisions of international treaties, then such a foreign person shall not be recognized as having a right to income taxable under the existing international treaties.

   However if a person, having an actual right to income paid to a foreign organization, is recognized as being tax resident in Russia, then such income shall be taxable under the provisions of the relevant chapters of the Russian Tax Code applicable for tax residents in Russia without deducting the relevant tax at source.

2. The Law introduces a new Article, No. 246.2, in the Tax Code, which determines who shall be recognized as tax resident in Russia.

   For example, a foreign organization shall be recognized as tax resident in Russia in the event that its place of actual management is Russia.

   For this purpose, for Russia to be recognized as a foreign organisation's place of actual management, at least one of the following conditions shall be satisfied:

- the maintenance of the organization's financial or management accounts (except for the preparation of consolidated financial statements) is to be carried out in the Russian Federation;
- record-keeping is to be done in the Russian Federation;
- operational management of the organization's staff is to be carried out in the Russian Federation.
  Moreover, the Article stipulates a number of other reasons for recognizing a foreign organization as tax resident in Russia.

3. Introduction of a new concept of "an incorporated foreign structure" in the Tax Code.

   An organization established under the laws of a foreign state without forming a separate legal entity (in particular, a foundation, partnership, association, trust, or any other form of making collective investments and/or trust management), which has the power to carry out operations aimed at deriving income/profit for the benefit of its members (shareholders, principals or other persons) or other beneficiaries, shall be recognized as such a structure (Article 11 of the Tax Code of the Russian Federation).

   An unincorporated foreign structure shall be recognized as a tax payer in cases specified in the Russian Tax Code (Article 19 of the Tax Code of the Russian Federation). An unincorporated foreign structure the controlling persons of which are organizations or individuals recognized as tax residents in Russia shall be recognized to be a controlled foreign company which may be taxable according to the newly introduced Article 309.1 "Specifics of profit taxation of controlled foreign companies".

4. Introduction of a new Chapter in the Tax Code: Chapter 3.4 "Controlled foreign companies and controlling persons". A foreign company satisfying simultaneously the following two conditions (Article 25.13 of the Tax Code of the Russian Federation) shall be recognized as a controlled foreign company:

- the organization is not recognized as tax resident in Russia;
- the controlling persons of the organization are organizations and/or individuals recognized as tax residents in Russia.

The following individuals or legal entities shall be recognized as controlling persons of an organization (including an unincorporated foreign structure):

- an individual or a legal entity the equity stake of which in such an organization is over 25%;
- an individual or a legal entity the equity stake of which in such an organization is over 10% provided that the equity stake of all persons recognized as tax residents in Russia in such an organization is over 50%.

Control over an organization shall mean exercise of or the power to exercise a determining influence on resolutions passed by such an organization regarding the distribution of income/profits net of tax resulting from direct or indirect membership in such an organization, participation in a contract/agreement defining the management of such an organization, or other specifics of relations between a person and an organization and/or other persons.

Control over an unincorporated foreign structure shall mean exercise of or the power to exercise a determining influence on resolutions passed by a person, managing such a structure's assets with regard to the distribution of income/profits net of tax among its members (stakeholders, trustors or other persons) or other beneficiaries by the law of a foreign state or under a contract.

Profit of a controlled foreign company shall not be subject to taxation provided that at least one of the following conditions is satisfied:

- it is a non-profit organization (it does not distribute profit under its personal law);
- it is formed under the laws of a member state of the

Eurasian Economic Union (Russia, Belarus, Kazakhstan, Armenia, Kirghizstan);
- its domicile is a state/territory which is party to an international treaty on taxation, except for states/territories not party to the exchange of information with Russia for the purposes of taxation, and the effective rate of income/profit taxation for such a foreign organisation for the period, for which financial statements for the fiscal year are drawn up under the organization's personal law, is at least 75 percent of the weighted average rate of tax on profits of organisations;
- its domicile is a state/territory which is party to an international treaty on double taxation, except for states/territories not party to the exchange of information with Russia for the purposes of taxation, and the share of such an organization's income, for example, from the sale of shares, stakes, assignment of rights, provision of advising, legal, auditing, advertising, marketing services and other similar types of income, does not exceed 20% of the total amount of income.

The list of states/territories not party to the exchange of information with Russia for the purposes of taxation shall be approved by Russian executive bodies.

In order to confirm exemption from taxation, the relevant confirming documents translated into Russian need be submitted to the tax authority.

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Singapore
Winds of change on the horizon – Are you prepared?

Public Consultation Paper on Contemporaneous Transfer Pricing Documentation
On 1 September 2014, the Inland Revenue Authority of Singapore (IRAS) released a public consultation paper requesting feedback on proposed additional guidance on transfer pricing documentation aimed at supplementing the existing transfer pricing guidelines, first published in 2006. The consultation closed on 24 September 2014. The objectives are primarily to facilitate better transfer pricing compliance as well as to align Singapore's transfer pricing documentation guidance in anticipation of the recommendations of Action 13 of the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan which were subsequently announced on 16 September 2014. So what exactly are the changes recommended in the consultation paper?

Requirement to maintain contemporaneous transfer pricing documentation
The proposed new guidelines require taxpayers to prepare and keep contemporaneous documentation to support the pricing of transactions undertaken with related parties. This is a shift from the present stance of the existing Singapore transfer pricing guidelines which require adequate documentation with sufficient details demonstrating compliance with the arm's length principle being maintained in a timely manner but offers no definitive guidance beyond that. Under the proposed guidelines, IRAS has indicated that it accepts contemporaneous TP documentation as being records prepared prior to or at the time of undertaking the transactions, and including up to the time of preparing the relevant tax returns.
This provision has been criticized in the sense that it gives power to local tax authorities to impose an obligation on a non-resident of that country, while also, single-handedly, imposing conditions on the availability of benefits of what is a bilateral treaty.

Type and extent of transfer pricing documentation
The proposed guidelines require taxpayers to prepare documentation at the group level as well as at the entity level. At the group level, the documentation is aimed at providing a good overview of the group's businesses including the group's worldwide organizational structure, nature of global business operations and overall transfer pricing policies. This broadly includes providing a description or details in relation to the group's products and services, main geographic markets and competitors, the industry dynamics, key drivers of business profits and group transfer pricing policies. At the entity level, the documentation should provide sufficient details of the taxpayer's business and transactions with its related parties. This broadly includes information on ownership and management structure, details of transactions with related parties, legal contracts and relevant economic analysis and benchmarking performed. More details are provided in the annex to the consultation paper.

IRAS has highlighted examples of circumstances where transfer pricing risks may be considered to be high. These include the use of transfer pricing strategies aimed at shifting

[1] A small and medium enterprise is defined as one with annual sales turnover of not more than SGD 100 million or which employs not more than 200 people.

profits to more favourable tax jurisdictions, cross-border transactions that are of large value relative to other transactions by the same taxpayer, operating results that are not in line with industry norms and the use of intellectual property or intangibles in the business.

Safe harbour threshold for transfer pricing documentation preparation

The proposed guidelines introduce two situations where taxpayers are exempted from having to prepare transfer pricing documentation. The first is where the taxpayer applies the Singapore safe harbour mark-up of 5% for routine services. The second is where the taxpayer is a small and medium enterprise[1] (SME) who engages in local transactions with a related party that is subject to the same tax rate on its income.

Implications of maintaining inadequate documentation

The proposed guidelines state that taxpayers are not expected to incur compliance costs that are disproportionate to the amount of tax revenue at risk or complexity of the transactions. Having said that, in the case where the transfer pricing documentation is found to be inadequate, the taxpayer may be subject to adverse consequences such as upward transfer pricing adjustments, denial of support by IRAS in Mutual Agreement Procedures (MAP) discussions or non-acceptance of any Advance Pricing Agreement (APA) made by the taxpayer.

Are you prepared?

The release of the public consultation paper sends a strong signal to the taxpayer community that IRAS supports the Base Erosion and Profit Shifting (BEPS) initiative by the OECD and is continually seeking to align local transfer pricing rules and guidelines with the current ongoing international efforts to prevent the artificial shifting of profits through transfer pricing activities. IRAS is likely to be mindful of increasing the compliance burden on taxpayers and will no doubt be taking into consideration the taxpayer feedback it receives from the public consultation in seeking the right balance. Indeed, it remains to be seen if IRAS intends for the proposed requirements on contemporaneous transfer pricing documentation to remain as guidelines or for it to be legislated. Nevertheless, there are a number of things that taxpayers can start doing so that they are not caught out if and when the changes do come into effect.

Foremost amongst these is assessing the quantum and extent of related party transactions being undertaken and determining whether they meet the safe harbour thresholds for exemption from transfer pricing documentation and if not, whether the current documentation in place is adequate given the new proposed guidelines. Next, taxpayers would be advised to start identifying any high-risk related party transactions that they may have and conduct the relevant economic analyses in order to ensure relevant transfer pricing documentation can be put in place before the tax filing deadline. Lastly, given the changing local and international transfer pricing landscape, taxpayers would be advised to continue monitoring further updates and changes that are being announced in respect of existing local transfer pricing guidelines as well as ongoing international developments given how closely linked both are.

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Spain
Tax deduction for financial goodwill on purchases of foreign companies

Legal, State aid, illegal, legal again, who knows…

To promote the internationalisation of Spanish companies, in 2002 the Spanish Corporate Income tax Act introduced a rule according to which the financial goodwill arising from the acquisition of an interest in a non-resident company (financial goodwill being, in this case, the excess price paid for the acquisition of the business over its net book value at the date of the acquisition that cannot be allocated to the non-resident company's assets) could be amortised up to a maximum of 5% per year.

According to this article, if a Spanish company paid 10,000 million euros for a Company whose book value was 2,000 million, it could deduct from its Corporate Income tax base 5% of 8,000 million over 20 years. This meant that it could recover via lower corporate tax costs, over 20 years, 2,400 million euros, 30% of the premium paid by the company.

Other major European companies realized that Spanish companies offered higher prices in some acquisitions, and they blamed this tax deduction. Consequently, they complained to the European Commission which initiated an investigation.

Two Decisions of the European Commission (2011/5/CE and 2011/282/UE) concluded that this deduction was a "State aid" as in practice it benefited certain sectors or products and altered competition in Europe.

The grandfathering effects of the Decision were limited based on the "legitimate expectations" of the companies that made investments confident that the incentive was legal:

First Decision: On financial goodwill arising on the acquisition of EU companies. The Decision's effects were limited only to acquisitions made after 21 September 2007. Second Decision: On financial goodwill arising on the acquisition of non EU companies. The Decision's effects were limited only to acquisitions made after 21 September 2007 and with the exception of the countries where obstacles on investments (eg ban on cross-border legal combinations) have been or can be demonstrated (India and China).

A so called Third Decision of the Commission based on similar criteria, dated 15 October 2014, also declared as State Aid the deduction arising from investments made in foreign holding companies which happened to be a loophole confirmed by a binding ruling issued by the Spanish Directorate of Taxes in 2012.

The Kingdom of Spain obeyed the ruling by changing the Corporate Income Tax Act and asking for the recovery of unpaid taxes under the First and Second Decisions. A refund of credits from the execution of the Third Decision is not yet effective.

Two Spanish companies (Autogrill and Banco Santander) appealed the Decisions (First and Second) of the European Commission to the General Court. On the other side, a German company also appealed the principle of legitimate expectations and asked to recover all the amounts deducted from 1 January 2002.

The unexpected outcome has been that on 7 November 2014 the General Court declared that article 12.5 was a general rule of Spanish tax and was not selective, and consequently could not be considered as a "State Aid". Accordingly the First and Second Decisions of the Commission were considered non-compliant with EU legislation. Even though this is only a judgment and may be appealed, it may be enforced by all the affected Spanish tax payers. This means that not only amounts refunded on execution of the First and Second decisions can be claimed, but it brings into question whether all investments made before the change of the Corporate Income Tax act in 2011 may benefit from this tax incentive.

To be continued..

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United Kingdom
Welmory Sp. Z.o.o. Case C-605/12

A CJEU VAT case from Poland which may also have direct tax implications for the future concepts of establishment
With changes in technology dictating that the way we do business today is very different from how businesses operated 20, 15 or even 10 years ago, many of the established principles for indirect and direct taxes are coming under scrutiny and being tested as to their current relevance. This is particularly true for the concept of an establishment. VAT practitioners are used to working with the concepts of a "business establishment", typically a headquarters location where decisions are made, and a "fixed establishment" which might be where human and technical resources exist in order to operate a business activity ie. a branch. For direct tax purposes the concept of a permanent establishment is defined by a number of rules and by reference to Double Tax Treaties. However, these long established definitions are becoming increasingly irrelevant for many businesses which operate via "the cloud", and where a business establishment is now often represented by someone with a rucksack on their back who might be anywhere in the world, and where they happen to plug their laptop into the internet. These concepts do however remain important, because they also dictate which jurisdiction will have taxing rights, and, in hard economic times, many countries will want to claim those rights.

In brief, the Welmory case involved an online bidding website whereby those people wishing to bid for an item paid a Cypriot company a small amount of money to give them the right to make a bid for an item advertised on a Polish (Welmory) website. Significant sums were received by the Cypriot company from bidders, but of course only one bid is successful. The Polish company Welmory provided resources to the Cypriot company in Poland in order that the Cypriot company could operate its business of running the website in Poland, and the Cypriot company paid for those services. The VAT question was whether Welmory when it raised its invoices to the Cypriot company should charge Polish VAT or not. Welmory took the view that this was a cross border B2B supply of services and that the Cypriot company should apply the reverse charge in Cyprus. However, the Polish tax authorities, and now the CJEU have held that where the human and technical resources of a company are put at the disposal of a third party to the extent that the third party may effectively call on those resources as though they were their own, then that third party may be considered to have a fixed establishment in the same country as where those resources exist. It follows that although this is a B2B supply, it is not across borders, and Polish VAT should have been charged.

Based on this decision it is possible to see a number of circumstances whereby company A avails itself of the resources of another company B in country B, and the tax authorities decide to treat this arrangement as creating an establishment for company A in country B giving rise to the requirement that company B should charge and account for VAT to the tax authorities of country B on the services provided, rather than company A applying the reverse charge in country A. Country B has acquired the taxing rights to those services! There already exist a number of VAT issues around the "force of attraction" rule which some countries apply where a local branch becomes involved in a transaction and is required to charge local VAT on supplies contracted for in another country, and this has similarities to the problems raised by this rule. It is also possible to extend the Welmory result to the world of direct tax. Is there an argument that the use of a third party's resources in another country could create a permanent establishment for direct tax purposes? This would result in numerous international tax complexities. While it is likely that the key issues will continue to revolve around where the decision makers reside, and where those that have power to conclude contracts reside, as the worlds of direct and indirect taxes come closer together in trying to address some of the modern world's taxation issues around the concept of establishment in a technological internet age, we should not be surprised if we see the world of direct tax start to take a few lessons from the experiences of the indirect tax world.

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Ukraine
New law on the disclosure of information re: ultimate beneficiaries in Ukraine

On 25 November 2014 the Law No. 1701-VII of Ukraine "On Amending Certain Laws of Ukraine regarding the Identification of Ultimate Beneficiaries of Legal Entities and Public Figures" came into force. This law is one of the five corruption fighting laws passed by the Parliament on 14 October 2014. The Law introduces a number of amendments to a number of Ukrainian codes and laws, regarding disclosure of information on individuals who are the "ultimate beneficiaries" of a legal entity for tax and certain other purposes in Ukraine.

There has been a global push towards greater transparency in ownership of legal entities, first and foremost fuelled by anti-money laundering efforts. The authorities have now made an effort to introduce similar policies in Ukraine, a jurisdiction known for a heavy use of offshore vehicles and other mechanisms of keeping the ultimate beneficiaries of businesses unknown. All Ukrainian companies will be required to identify their ultimate beneficiaries, maintain and regularly update their records of ultimate beneficiaries, and report to the authorities any changes in their ultimate beneficiaries and/or holders of a material interest (ie. 10% or more of all shares or votes, held directly or indirectly). All service providers including banks and law firms will be required to identify the ultimate beneficiaries of their clients. All companies registered before the law came into force will have to submit the this information within six months from the date when the law takes effect (so approximately, by 1 June 2015).

What is the Law about?

- companies will have to identify their ultimate beneficiaries, keep records on such beneficiaries and update such information.
- the Law extends the list to include information on the founders of a company.
- the information on the founders must be disclosed during the incorporation of a company and further published in the State Companies Register.
- the Information should then be updated in the Register on a regular basis.
- information on ultimate beneficiaries (full name, state of citizenship, passport and tax identification data) of companies will become publicly accessible.
- administrative liability (a fine from UAH 5,100 to UAH 8,500) will be applied to the officials of a Company, who fail to disclose the information to the Register.

Ultimate Beneficiaries, Public Officials and Substantial Stake Holders

"Ultimate beneficiary" is defined as an individual, who directly or indirectly, individually or jointly with other related persons, can influence the company due to holding 25% of voting shares, or who, formally or informally, can exercise any other form of control over the legal entity, irrespective of actual ownership by that individual of any interest in that legal entity. Thus, the law emphasises potential influence, rather than actual control. Besides, the law expressly provides that a nominal holder, trustee or an agent cannot be deemed an ultimate beneficiary.

"Substantial stake" is not defined in the law. The law refers to the law on financial monitoring, which currently sets the threshold at 10% of the charter capital or votes. However, simultaneously with the law on disclosure of the companies' ultimate beneficiaries a new law on financial monitoring was adopted. The new law on financial monitoring, at least in the currently available draft law, does not contain a definition of a "substantial stake"; hopefully the finally adopted law will bring clarity.

Furthermore, the law lists, in detail, state officers which are considered to be public officials for financial monitoring purposes. As the previous definition was very vague and ambiguous, this is a progress.

Scope of Disclosure and Liability

The scope of information about holders of material stakes and beneficial owners was expanded and will include the full name, citizenship, passport details, Ukrainian tax number (if any) and residence address for individuals, and full name, country of incorporation, registered address, and identification number for legal entities. Information on ultimate beneficiaries and substantial stake holders should be publicly available.

Unlike the previous version of the draft, the approved law does not suggest criminal liability for non-submission or incorrect submission of the obligatory information. The law provides for an administrative fine of up to 500 tax exempt allowances (currently, UAH 8,500 or EUR 500) for a failure to submit information about ultimate beneficiaries. The fine can be imposed on the company's management. It is not clear what happens if the fine is paid but no disclosure follows.

Conclusion

The new law significantly raises the bar in anti-money laundering compliance and disclosure of beneficial ownership information generally. As such, it is likely to require concrete and prompt actions by Ukrainian corporates. The effectiveness of this law will largely depend on the availability of control mechanisms (and the authorities' readiness to use them) but also on whether the market sees this as an appropriate level of regulation, in particular from the privacy point of view given mandatory disclosure of passport details in a public register. This is yet to be tested.

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Notes

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