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Newsletter

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Contents

Introduction to Taxlink

Welcome to another edition of Taxlink.

This issue is a mix of opportunities and warnings, both of which should make for interesting reading.

At a time when the world is focussed on the outcome of the OECD Base Erosion Profit Shifting action plan, it is good to know that countries are still hoping to attract investors through a favourable tax regime. Here we have guidance on opportunities for clients and contacts interested in investing in Switzerland, Hungary, Tanzania, Indonesia, Cyprus and Jordan.

But we also have warnings, whether it be general anti-avoidance in Poland, China and Singapore or specific new documentation requirements for multinationals in Japan. As will be seen from Spain, sometimes it is not the law which is changing but how the law is interpreted by the courts. As ever, investors need to be aware of what is happening in these countries.

Finally, we have two articles on the common law concept of "domicile". The first article provides guidance on what it means and the second article addresses some of the consequences in the UK. For those coming from or going to a common law country, at any time in their lives, tax residence is not the only thing that could trigger a tax liability.

Thank you to all who have contributed to this issue. If readers would like further information on any of the topics the authors would be pleased to hear from you.

Best wishes

Mike Adams
Nexia Tax Director
E mike.adams@nexia.com
T +44 (0)20 7436 1114

China

BEPS Initiatives Versus Chinese Tax Policies

In the last two years, draft recommendations on 15 major topics included in the OECD's tax Base Erosion and Profit Shifting (BEPS) initiative have been released. In response, some countries are enacting upgraded tax legislation, while others are taking a more passive wait and see approach, and/or relying on already existing regulations to prevent loss of tax revenues caused by the issues identified in the BEPS project. Indeed China mostly falls into the later category. Since overhauling the corporate tax laws in 2008, China has maintained a strong focus on improving its tax base through a variety of anti-tax-avoidance laws related to foreign business activity in the country. As a result of marked success in some areas, China had considerable input into the BEPS process, and many of the country's practices are reflected in the BEPS recommendations. In the following paragraphs, we summarize how China is dealing with a few of the released BEPS-related recommendations.

Digital Economy

China's State Administration of Taxation (SAT) has written very few regulations that specifically target the rapidly expanding and globalized "digital economy." Tax officials have instead tried to draw on laws that target traditional businesses, but this approach has led to considerable uncertainty, both within and outside of China. For example, it is unclear at which point a foreign e-commerce company doing business in China creates a Permanent Establishment that should be paying corporate taxes in the country. It has also been unclear as to how VAT should be handled in cross-border e-commerce. Understanding its weakness in this area, the SAT has begun to address tax issues that are unique to cross-border e-commerce. For starters, a new regulation clarifies VAT responsibilities for B2C e-commerce transactions in which consumer goods are purchased online and imported into the country. Other new regulations targeting B2B e-commerce and addressing specific questions raised in the BEPS initiative are expected in the near future.

Controlled Foreign Corporations

Another area of interest arising from the BEPS project involves Controlled Foreign Corporation (CFC) Rules. China does already have some CFC rules in place. For example, if a Chinese investor owns at least a 10% share of a foreign company, and the tax rate in that country is less than 12.5%, the undistributed profits of the foreign company can be deemed as a dividend to the Chinese investor and can be taxed in China. Beyond that, the SAT is considering the BEPS recommendations, and it is expected that modification of and additions to CFC rules are forthcoming.

Interest Deductibility

The BEPS recommendations also address deductibility of interest payments by companies that borrow funds from related parties. Although the SAT continues to examine this issue, China already has rules that limit the deductibility of interest, and these have been in place since the 2008 corporate tax makeover. One regulation prescribes that borrowers must not exceed certain debt-to-equity ratios. Although some caveats do exist, the general rule allows for a maximum debt-to-equity ratio of 2:1 for borrowers that are not financial institutions, and 5:1 for financial institutions. Additionally, if a related party charges interest, the rates must be determined at arm's length, otherwise deductibility is not allowed.

Tax Treaties Interpreted

Having had strong policies in place since 2009, China has been on the forefront in addressing two other key BEPS-related issues; Tax Treaty Abuse and Permanent Establishment creation. In 2009 the SAT released strict definitions for "beneficial owner" of China-sourced income and the criteria under which tax officials should question beneficial ownership. Ultimately the rules require that where an offshore company registered in a low tax jurisdiction holds ownership of a Chinese entity, the offshore holding company must have substantial business of its own if claiming the treaty benefits afforded to that jurisdiction. The holding company cannot simply exist to own the Chinese entity, otherwise the holding company cannot enjoy the potential treaty benefits.

With regards to Permanent Establishment (PE) creation, the SAT also released guidance for tax bureaus in 2009 and again in 2014, explaining how they should interpret the relevant terms of tax treaties. While the guidance is too complex to cover in detail here, the general rule is that just the presence of a foreign company's employees in China for a specified period can create a taxable PE. In most cases, tax officials require that the China-based party making payments to the overseas party that is deemed to have a PE must withhold the relevant taxes from payments made to the overseas party.

Transfer Pricing Policies

The final BEPS area discussed here relates to Transfer Pricing (TP) in all types of related party transactions. Of primary concern is how related parties should price their transactions and whether or not the party that makes the payment should be able to deduct the expense for tax purposes. These questions especially arise in situations where a foreign parent company or sister company charges management fees, service fees, royalty fees, or interest fees to a Chinese subsidiary. Since the advent of the 2008 corporate tax law, China's SAT has required that every corporate taxpayer submit nine related party transaction forms with the annual

consolidated tax filing. Where a company has more than 200 million RMB in related party transactions, or claims losses year after year, detailed contemporaneous TP documentation must also be maintained, including a global transfer pricing policy that should be utilized by all related companies in a group. Rules allow tax officials to use the TP forms and contemporaneous documentation to determine whether or not tax adjustments should be made as a result of questionable pricing methods. Additionally, where the Chinese subsidiary pays the foreign related party for royalties and/or services, tax officials may question the benefits received by the subsidiary.

In Closing

It is expected that Chinese tax and commerce authorities will continue to address these issues and others that have resulted from the BEPS initiative. And notably, the world is watching. China has taken a number of audacious steps to help curb the loss of tax revenues that resulted from the generally more lax regulations in place before 2008, some of which have raised the eyebrows of the global business community. However, by adopting at least some of the country's ideas, the BEPS initiative has brought considerable credibility to China's tax practices. As governments of other countries respond to BEPS recommendations, China's regulations may just provide the most prudent guidance.

Contributed by
Flora Luo and Scott Heidecke; Nexia TS Shanghai Ltd.
E ForaLuo@nexiats.com.cn, scott@nexiats.com.cn

Cyprus

Recent developments affecting Multinational Enterprises

The Cyprus government has recently reported several important tax developments that will affect multinational enterprises doing business in Cyprus.

Specifically,

- On 30 June 2016, negotiations were completed and an agreement was reached in writing a revised tax treaty between Cyprus and India.
- On 9 March 2015 the first tax treaty between Cyprus and Bahrain was signed and entered into force on 26 April 2016. It will take effect on 1 January 2017.
- The first tax treaty between Cyprus and Latvia was signed on 24 May 2016 and ratified by Cyprus on 3 June 2016. The treaty will take effect on 1 January of the year after the countries complete the legal formalities to bring the treaty into force.
- The Cyprus Tax Department (TD) announced a list of various countries' interest yields on 10-year government bonds for the purposes of the notional interest deduction (NID). The list includes Cyprus, Czech Republic, Germany, India, Latvia, Poland, Romania, Russia, Ukraine, and United Arab Emirates.
- The TD also announced that written responses to expedited advance ruling requests will be issued within 21 business days.

Revised tax treaty between Cyprus and India

The revised Cyprus-India tax treaty is expected to be signed in the coming months, and will enter into force following ratification by both countries.

The revised treaty includes provisions for source-based taxation of capital gains from the disposition of stock and a 'grandfathering' clause for investments acquired prior to 1 April 2017, providing the seller's country with the exclusive right to tax future disposals of such investments.

Once the treaty enters into force, Indian authorities will rescind the classification of Cyprus as a 'Notified Jurisdictional Area,' effective retroactively from 1 November 2013, the date that Cyprus was first classified as a 'Notified Jurisdictional Area.' One of the effects of the current classification is that, in certain circumstances, a taxpayer may rely upon the existing treaty only by following certain administrative procedures in India.

The grandfathering of stock investments acquired prior to 1 April 2017 is a welcome development that provides clarity to taxpayers holding existing investments. When a Cyprus tax resident disposes of a grandfathered investment, Cyprus retains the exclusive right to tax the realized gains under the revised tax treaty, which is consistent with the existing tax treaty.

The upcoming rescission of Cyprus's status as a 'Notified Jurisdictional Area' by the Indian authorities also is a welcome development. This will occur once the revised tax treaty enters into force, so taxpayers must continue to comply with the Indian 'Notified Jurisdictional Area' requirements until they are rescinded retroactively.

Cyprus and Bahrain sign a tax treaty

The treaty entered into force on 26 April 2016 and will take effect on 1 January 2017.

The treaty provides for a 0% withholding tax rate on dividends, income from debt claims, and royalties. Cyprus retains the exclusive right to tax capital gains from the disposition of stock by Cyprus tax residents in Bahraini companies, including Bahraini companies holding immovable property located in Bahrain.

Cyprus is an ideal geographic location for the establishment of regional headquarters for business in Eastern Europe, North Africa, and the Middle East. The treaty between Cyprus and Bahrain further expands the Cyprus tax treaty network in the region.

Cyprus and Latvia sign a tax treaty

The treaty provides for a 0% withholding tax rate on dividends, interest and royalties if the payer is a company that is resident in one country and the beneficial owner of the income is a company that is resident in the other country. That is, company-to-company payments. For all the other cases, being other than company-to-company payments except for certain governmental interest, the treaty provides for a withholding tax rate of 10% on dividends and interest and 5% on royalties.

Cyprus retains the exclusive right to tax capital gains from the disposition of stock in Latvian companies, except for dispositions in which more than 50% of the value of the shares is derived directly or indirectly from immovable property located in Latvia or more than 50% of the value of the shares relates directly or indirectly to certain Latvian offshore rights or property.

Although the new treaty provides for withholding taxes on dividend and interest payments, other than company-to-company payments, domestic Cyprus tax law does not require withholding on dividend and interest payments to non-Cyprus tax residents in all cases.

Further, although the new treaty provides for withholding taxes on royalty payments, other than company-to-company payments, domestic Cyprus tax law requires withholding on royalty payments to non-Cyprus tax residents only if the royalty relates to rights used within Cyprus.

The treaty is expected to create new investment opportunities and enhance trade relations between Cyprus and Latvia.

TD announces NID interest rates for 2016

According to the Cyprus NID provisions, the NID (notional interest deduction) interest rate is the yield on 10-year government bonds (at December 31 of the prior tax year) of the country where the funds are employed in the business of the company plus a 3% premium. This is subject to a minimum amount equal to the yield of the 10-year Cyprus government bond (at the same date) plus a 3% premium.

The 2016 NID interest rate for Cyprus is 6.685%. This is also the applicable 2016 NID interest rate to be used for the Czech Republic, Germany, Latvia, and Poland, being the minimum amount under the rule described.

Contributed by
Michael Mavrommatis, Nexia Poyiadjis
E michael.mavrommatis@nexia.com.cy

Hungary

Attractive benefits in the Hungarian corporate tax system

Through a number of measures introduced over the past few years, low corporate tax rates (10% up to HUF 500 million / EUR 1.6 million of the tax base and 19% above) and other targeted benefits have made the Hungarian tax system very attractive for foreign investors. Although a number of articles highlight these regulations, it is still our experience that many investors are surprised that the rules are more favourable than expected.

We will provide a summary of special tax base reductions and tax benefits below that are available to incentivise foreign investment.

1. The most important tax base decreasing items

1.1. R&D activity

Innovation activities carried out in Hungary are supported through tax laws, in addition to public tenders. The tax base can be reduced by deducting the direct costs of fundamental research, applied research and experimental development (including the wage costs and contributions of researchers and the purchase value of purchased materials) carried out as part of the taxpayer's own activities, which means that these costs can be taken into account twice.

If R&D activities are carried out jointly on the basis of an agreement with a Hungarian college or university, the Hungarian Academy of Sciences or a state-run research institute, the tax base may be reduced by an amount up to three times the direct costs accounted for (but by no more than HUF 50 million, i.e. approximately EUR 160,000).

1.2. Royalities - IP box

The tax base may be reduced by 50% of royalties received, up to 50% of the profit before tax.

Profit from the sale of intangible assets generating royalties also reduces the tax base if the company generates a restricted reserve for the amount to be used for the acquisition of similar intangible assets in the next 5 years. (If this criterion is not met, the tax savings must be repaid with late-payment interest.)

1.3. Reported intangible assets

If intangible assets are in the books for at least one year and are then sold, any profit made on the sale may be deducted from the tax base if the acquisition was reported to the tax authority within 60 days.

This option is available without reporting if, before resale, the intangible asset was held in the company's books for at least 3 years.

1.4. Tax base benefit for investment available to SMEs

Companies that are owned by private individuals and that qualify as small or medium-sized enterprises (together with related parties) can immediately decrease their tax base, up to the full amount of the profit before tax if applicable, by deducting the value of a new immovable property, technological equipment or intangible asset they have acquired.

2. Tax allowance

2.1. Development tax allowance available with regard to investment

In the case of a larger investment, a tax allowance of up to 80% of the corporate tax liability may be used in the tax year after the commissioning of the investment and in the following nine tax years (but no later than in the fourteenth tax year after reporting the investment).

The legal categories of the tax benefit are as follows:

- An investment of at least HUF 3 billion (approximately EUR 9.6 million) made anywhere in Hungary (except for investments made by large enterprises in Budapest or the Central Hungary region)
- An investment of at least HUF 1 billion (approximately EUR 3.2 million) in so-called eligible areas

- An investment of at least HUF 100 million (EUR 323,000) in the case of certain special activities such as individual environmental investments, R&D investments and investments exclusively for film and video production
- An investment of at least HUF 500 million (EUR 1.6 million) if made by an SME
- An investment of at least HUF 100 million (EUR 323,000) made in certain disadvantaged areas.

The basis of the tax allowance is the present value of the investment, and the rate of the allowance, established on the basis of the intensity ratio that depends on the size of the company making the investment as well as on the location and value of the investment, could be as high as 40% of the investment value but may not exceed 80% of the calculated corporate tax.

A Government Decree sets out the eligibility criteria for the tax allowance. The general requirements are that 25% of the investment must come from the beneficiary's own resources, and certain non-preferred activities are excluded from the scope of the benefit.

In the majority of cases, no approval is required for making use of the allowance, but a prior report to the Ministry of National Economy is needed.

2.2. Development allowance for job creation

This allowance has no minimum required investment value. The allowance is equal to a certain portion of wage costs (the proportion depends on the intensity ratio of the given region) and requires a prior registration including the calculation of the present value of the wage costs of the expected new jobs.

2.3. Tax allowance for the interest paid by SMEs on investment loans

If an SME uses a bank loan or financial leasing to acquire or produce a fixed asset, it may take advantage of a tax allowance equal to the interest paid on the loan or leasing transaction.

2.4. Tax benefits for special purposes

The Hungarian government offers a tax benefit to companies that support organisations active in the following areas:

- spectator team sports (football, handball, basketball, ice hockey and water polo)
- performing arts
- cinematic art.

The benefit is available in two forms:

- direct support is paid to the beneficiary by the end of the tax year, and the tax payable is reduced accordingly in the tax return of the tax year; or
- where the tax advance payment is offered for the objective in general, without providing direct support, the tax authority provides the benefit to the company in the form of a tax credit after the tax year.

The administrative burden in connection with the benefit is relatively high, as a written contract, a number of registrations and the obtaining of certain certificates are required. However, the tax benefit available ranges from 2.2% to 7.5% depending on the activity of the beneficiary organisation and the method in which support is provided.

3. Other incentives

3.1. Tax free dividend, licence fee pay outs to foreign companies

No withholding tax is charged on the payment of dividends, licence fees or service fees if made from Hungary to a foreign company that verifies its tax residence on an annual basis through a document issued by a foreign authority.

3.2. Tax credit for growth

The tax credit for growth targets fast-growing start-up companies that have been operating for at least 3 years and that have not been affected by company transformation (merger or demerger).

If a company generates a profit level that is at least five times the profit of the previous tax year, it will not be required to pay the complete amount of the higher tax advance payment under the general rules by the last month of the tax year. Instead, it may choose to pay it in 8 instalments over the next two tax years.

Conclusions

Hungary offers a wide range of tax reduction opportunities for prospective investors, whether for larger investments or for the creation of a few new jobs. Hungary is also generous with those seeking to set up new regional research and development centres, but benefits are also available to those who are considering a smaller-scale expansion of their activities or that would like to make better use of the tax options available to their existing Hungarian company.

In many cases, benefits are available through a couple of simple administrative steps, and ABT Treuhand Group's Hungarian team is ready to help with them. However, our colleagues are also available to assist in the preparatory work of implementing more complex investment plans.

Contributed by
Dr. Orsolya Pétervári and Ákos Cseuz, ABT Treuhand Hungary
E orsolya.petervari@abt.hu, akos.cseuz@abt.hu

Indonesia

Tax amnesty

Background

In the meeting of the Finance Ministers and the Central Bank Governors of the G-20 that took place in Shanghai, China last February, the Indonesian government wanted a global commitment to implement the disclosure of information internationally immediately. In 2018 it is expected that countries belonging to the G-20 will agree to adopt the automatic exchange of information for taxation and financial transactions.

In line with the meeting, the Indonesian government designed a policy regarding a tax amnesty that was submitted to the Indonesian Parliament to be passed into law. The policy is intended to increase state revenues, as well to stimulate the economy and produce a better budget position through the repatriation of assets and paving the way for capital inflows into the country. After a long discussion, finally parliament enacted the Tax Amnesty Law on June 28, 2016 and it has been in effect since its promulgation.

The following are some points that are mentioned in the tax amnesty law.

Tax Amnesty?

The tax amnesty program is an amnesty granted by the Government to taxpayers including the elimination of tax payable, the removal of administration sanctions, as well as the elimination of criminal sanctions in the field of taxation on property that was acquired in 2015 and previously had not been reported in a tax return, provided that taxpayers settle all tax arrears owed and pay the redemption money due.

For who?

All taxpayers are entitled to benefit from the tax amnesty, unless:

1. The investigation cases have been declared complete by the prosecutor;
2. The taxpayer is already involved in the court proceedings; or
3. The taxpayer is undergoing criminal punishment for a tax crime.

When it applies?

The tax amnesty took effect from its promulgation and is in effect up to March 31, 2017. It is divided into 3 (three) periods:

1. 1st Period: from the date of promulgation up to 30 September 2016;
2. 2nd Period: from 1 October 2016 up to 31 December 2016; and
3. 3rd Period: from 1 January 2017 up to 31 March 2017.

Redemption money?

One of the requirements to take advantage of the tax amnesty is to pay the redemption money. The following are the rates of redemption money:

Onshore assets declaration - not repatriated to Indonesia					
Rate	1st period	Rate	2nd period	Rate	3rd period
4%	July 1, 2016 to September 30, 2016	6%	October 1, 2016 to December 31, 2016	10%	January 1, 2017 to March 31, 2017

Offshore assets declaration - repatriated to and invested in Indonesia for minimum three year					
Rate	1st period	Rate	2nd period	Rate	3rd period
4%	July 1, 2016 to September 30, 2016	6%	October 1, 2016 to December 31, 2016	10%	January 1, 2017 to March 31, 2017

Onshore assets declaration - retained in Indonesia for minimum of three years					
Rate	1st period	Rate	2nd period	Rate	3rd period
4%	July 1, 2016 to September 30, 2016	6%	October 1, 2016 to December 31, 2016	10%	January 1, 2017 to March 31, 2017

Small and Medium Taxpayer			
Rate	Assets declaration	Rate	Assets declaration
0,5%	Up to IDR 10 billion	2%	More than IDR 10 billion

Facility?

The tax amnesty facilities that are acquired by a taxpayer include:

1. Elimination of tax due (income tax and value added tax and/or sales tax on luxury goods), administrative sanctions and criminal sanctions where no tax assessment has been issued;
2. Elimination of administrative sanctions arising on tax assessments already issued;
3. Exemption from tax audit, preliminary evidence audit, and tax crime investigation;
4. Termination of tax audit, preliminary evidence audit, and tax crime investigation, in cases where the taxpayer is under audit and investigation; and
5. Elimination of the final tax on transfers of land and/or buildings as well as shares.

Consequences?

The assets that are repatriated must be invested in Indonesia for 3 (three) years after transfer in:

1. Government securities;
2. State-Owned Enterprise bonds;
3. State-Owned Financing institution bonds;
4. Financial investments on perception bank;
5. Private company bonds, the trading of which is supervised by the Financial Services Authority;
6. Infrastructure investment through co-operation between the Government and business entities;
7. Real Estate sector investment based on the priorities set by the Government; and/or
8. Other investments as constituted under provisions of the law.

Sanctions?

1. Taxpayers who do not meet the obligation of the holding period are treated as receiving additional net income equal to the net assets treated in fiscal year 2016, subject to tax and sanctions under the provisions of the tax law.
2. Taxpayers who have followed the tax amnesty program but further net assets have subsequently been discovered not to have been disclosed, then those assets are treated as income when discovered and taxed in accordance with the income tax law, coupled with 200% (two hundred percent) administrative sanctions as if the tax was not paid; and
3. Taxpayers who do not follow the tax amnesty program but are discovered to have net assets that have not been expressed/reported then those assets are treated as income when they are found and will be taxed with the administrative sanctions as provided under the provision of the tax law.

Contributed by
Rochmat, KAP Kanaka Puradiredja Suhartono
E rochmat@kanaka.co.id

Japan

New Japanese Transfer Pricing Documentation Rule

In accordance with the recommendation in the "Guidance on Transfer Pricing Documentation and Country-by-Country Reporting" issued by the OECD as BEPS Project ACTION 13: 2014 Deliverable (referred to as "ACTION 13: 2014 Deliverable" hereinafter), Japan has adopted, in the 2016 Tax Reform Act, a three-tiered standardized approach to transfer pricing documentation which consists of (1) a Master File, (2) a Local File and (3) a Country-by-Country Report (referred to as "CbC Report" hereinafter).

Before the 2016 Tax Reform, there had not been any documentation requirements, but rather a timely submission requirement of the "necessary documents" which are those substantially equivalent to a Local File. Accordingly, the "necessary documents" have been voluntarily prepared in advance, but not contemporaneously, in order to avoid penalties on failure of timely submission, in the context where a taxpayer regards the transaction amount with a foreign related party as being material.

In addition to the above three documents, there is another document called "Notification for an Ultimate Parent Entity (referred to as "NUPE" hereinafter)", which is also required to be submitted and which has been introduced in order to implement this new standardized approach efficiently and consistently.

The following is the outline of above four documents stipulated in Japanese Tax Law.

Master File

1. Reporting entity:
   (1) A Japanese Constituent Entity[1] including a Japanese ultimate parent entity, or
   (2) A foreign Constituent Entity with a Japanese permanent establishment (referred to as "PE" hereinafter), (collectively referred to as "Japan Resident CE" hereinafter) in the multinational enterprise ("MNE") group with annual consolidated group revenue in the immediately preceding fiscal year of JPY 100 billion or more (referred to as "the Specific MNE Group" hereinafter).

   Technically, each Japan Resident CE shall be required to submit a Master File. However, if one of the Japan Resident CEs submits a notification of a reporting entity for the Master File, through an e-Tax system (an electronic filing system), to the District Director of the Tax Office by the due date of the Master File, other Japan Resident CEs shall be exempted from the filing requirement of the Master Fi le.
2. Contents:
   The same as those in Chapter V (Documentation) of the OECD Transfer Pricing Guidelines of which the text has been replaced with the ACTION 13: 2014 Deliverable (Referred to as "the Revised Chapter V of the OECD TP Guidelines" hereinafter).
3. Submission:
   to be submitted via an e-Tax system.
4. Due date:
   One year following the last day of the applicable fiscal year for the ultimate parent entity in the Specific MNE Group.
5. Reporting language:
   Japanese or English.
6. Penalty:
   The monetary penalty of the fixed amount of JPY 300,000 for failure of submission shall be imposed on both a reporting entity and on its representative individual or in-charge employee of the reporting entity.
7. Initial applicable year:
   The fiscal year for the ultimate parent entity in the Specific MNE Group beginning on or after 1st April 2016.

Local File

1. Preparing entity:
   (1) A Japanese entity which has transactions with foreign related parties, and
   (2) A foreign entity with a Japanese PE which has transactions with non-Japanese related parties or has inter-office transactions.
2. Contents:
   (1) Documents describing foreign related party transactions, and
   (2) Documents for confirming a Transfer Price to be an arm's length price, both of which contain the information stipulated in the Revised Chapter V of the OECD TP Guidelines.

   Although the Revised Chapter V of the OECD Transfer Pricing Guidelines suggests that the searches in databases for comparables supporting part of the local file shall be updated every 3 years and that financial data for the comparables shall be updated every year, the Japanese Tax Law has been silent as to a frequency of documentation updates.
3. Period and place of documents retention:
   For 7 years following the due date of the corporate tax return for the applicable fiscal year at the office in Japan.
4. Due date to meet the contemporaneous documentation requirement:
   Same as the due date of the corporate tax return which is the last day of the second month (or the third month if the application for an extension is filed) of the following fiscal

1 The definition of "Constituent Entity" in the Japanese Tax Law is same as the one in the ACTION 13: 2014 Deliverable.

year.

5. Conditions for exemption from the contemporaneous documentation requirement:
(1) Aggregate amount of the transactions per a foreign related party or a foreign inter-office in the immediately preceding fiscal year shall be less than JPY 5 billion, and
(2) Aggregate amount of the intangible asset transactions per a foreign related party or a foreign inter-office in the immediately preceding fiscal year shall be less than JPY 300 million.
6. Due date to meet the requirement of timely submission:
Within 45 days and 60 days following the date of request by a tax examiner for documents subject to the contemporaneous documentation requirement and for other documents, respectively.
7. Language:
Basically Japanese, but the translation of a foreign language into Japanese may be requested by a tax examiner.
8. Penalty:
Any monetary penalty shall not be imposed on failure of contemporaneous documentation, but a non-monetary penalty (an application of the so-called "presumptive taxation" rule[2]) for failure of timely submission shall be imposed on a preparing entity.
9. Initial applicable year:
The fiscal year of a preparing entity beginning on or after 1st April 2017.

CbC Report

1. Reporting entity:
(1) The Japanese ultimate parent entity in the Specific MNE Group, and
(2) The Japan Resident CEs in the Specific MNE Group of which the ultimate parent entity is a foreign entity, in the context where Japan has not concluded either of a bilateral comprehensive tax treaty containing the information exchange clause or a tax information exchange agreement (referred to as "TIEA" hereinafter) with the country, in which the foreign ultimate parent entity is the resident (referred to as "Foreign-owned Japan Resident CE" hereinafter).

Technically, each Foreign-owned Japan Resident CE shall be required to submit a CbC Report. However, if one of the Foreign-owned Japan Resident CEs submits a notification of a reporting entity for the CbC Report, through an e-Tax system, to the District Director of the Tax Office by the due date of the CbC Report, other Foreign-owned Japan Resident CEs shall be exempted from the submission requirement of the CbC Report.
2. Contents:
The same to those in the Revised Chapter V of the OECD TP Guidelines.
3. Submission:
An e-Tax system.
4. Due date:
One year following the last day of the applicable fiscal year for the ultimate parent entity in the Specific MNE Group.
5. Reporting language:
English only.
6. Penalty:
The monetary penalty in the fixed amount of JPY 300,000 for failure of submission shall be imposed on a reporting entity and on its representative individual or in-charge employee of the reporting entity, respectively.
7. Initial applicable year:
The fiscal year for the ultimate parent entity in the Specific MNE Group beginning on or after 1st April 2016.

Notification for an Ultimate Parent Entity (NUPE)

1. Reporting entity
Japan Resident CEs.
Technically, each Japan Resident CE shall be required to submit an NUPE. Similar to the Master File and the CbC Report, however, if one of the Japan Resident CEs submits a notification of a reporting entity for the NUPA, through an e-Tax system, to the District Director of the Tax Office by the due date of the NUPE, other Japan Resident CEs shall be exempted from the filing requirement of the NUPE.
2. Contents:
(1) Name of the ultimate parent entity
(2) Address of the ultimate parent entity
(3) ID number assigned to the ultimate parent entity, if any
(4) Name of an individual representing the ultimate parent entity.
3. Submission:
An e-Tax system.
4. Due date:
The last day of the applicable fiscal year for the ultimate parent entity in the Specific MNE Group.
5. Penalty:
None.
6. Initial applicable year:
The fiscal year for the ultimate parent entity in the Specific MNE Group beginning on or after 1st April 2016.

Contributed by
Matt Muramatsu, Gyosei Certified Public Tax & Accountants' Co.
E m-muramatsu@gyosei-grp.or.jp

2 This rule allows the NTA (The National Tax Agency) to presume a certain price to be at arm's length, based the comparable data collected from a comparable company by a tax examiner. Since the comparable data is not disclosed to the taxpayer undergoing a transfer pricing ("TP") audit (hence the "secret comparables" term), the taxpayer would face difficulties in rebutting the secret comparables argument of a TP assessment.

Jordan

New Incentives to encourage investment in IT and Tourism

As published in the Jordan official Gazette No. 5405, under the Provisions of Investment Law no. (30) of 2014, the following incentives and exemptions have been approved with effect from financial years starting on January 1, 2016:-

a. exemption of materials, equipment, machinery, appliances, spare parts, production requirements, and building materials from customs, fees, and other taxes, except services tax, and a reduction in the rate of VAT to zero.
b. Reduce the rate of VAT on sales of services to 7% instead of 16%.
c. Reduce the rate of tax on companies from 20% to 5% for the first l0 years from date of commencement.

These incentives are to be immediately available for operations in the following industry sectors and which are located outside Amman, the capital city: Information Technology, Hotel and tourism facilities and restaurants.

Contributed by
Abdulkareem M. Qunais, Ghosheh & Co.
E abd@ghosheh.com

Poland

New general anti-avoidance rule (GAAR) in Poland

On 15th July 2016 an amendment to the Polish Tax Code dated 29th August 1997 (Journal of Laws 2015, item 613, with further amendments; hereinafter: the Amendment) came into force, introducing the general anti-avoidance rule (hereinafter: GAAR) to the Polish tax system. As a result of the GAAR, for actions conducted by an entity artificially, and which lead to achieving tax benefits not intended, in given circumstances, by a tax regulation, these tax benefits will be denied. The tax authorities will be able to question such activities and estimate the tax results either as if the transaction was conducted based on economic, not only tax, reasons (so called appropriate transactions), or if it was not conducted at all.

Artificially conducted activities are activities which result in, among others:

(i) unreasonable division of transactions,
(ii) agent engagement in transactions without any economic reason,
(iii) elements leading to a state identical or very similar to the state which existed before the carried activities,
(iv) elements offsetting each other or compensating mutually or
(v) economic risk is higher than the expected benefits, other than tax benefits, to the extent that it would be reasonable to conclude that an entity acting rationally would not act that way.

It is noteworthy how the tax benefit was defined in the Amendment. According to the new provisions it is:

(i)a lack of tax liability or the understating of its amount,
(ii)occurrence or overstating of a tax loss or
(iii)occurrence or overstating of a tax overpayment.

There are several cases foreseen which are exempted from the above described GAAR. First of all the GAAR shall not be applied to Polish VAT or other fees and non-tax governmental liabilities. Additionally, situations which result in tax benefits not exceeding the amount of PLN 100,000 (approx. EUR 25,000) are not taken into consideration when applying the GAAR. Moreover, it shall not be used in cases where the application of other anti-avoidance tax law provisions is possible.
Additionally, in relation to the newly introduced GAAR the Amendment provides for the possibility to apply for a, so-called, protecting opinion. Entities having doubts connected with tax consequences of their business activities, and possible enquiry into them by the tax authorities, will be allowed to apply for an opinion to a relevant body, called by the Minister of Finance. Where the opinion they receive in a given case is positive, the tax authorities will not be able to question in the future the confirmed approach, and thus the GAAR will not be applicable. The fee for issuing such an opinion is PLN 20,000 (ca. EUR 5,000) and the tax authorities have 6 months to issue it.

The GAAR is applicable to transactions where the tax consequences occur after the Amendment's entry into force, i.e. after July 15th, 2016. Therefore, even in the case where an action was conducted before that date, but it has an influence on tax settlements after the Amendment's entry, GAAR is still applicable. This regulation regarding the entry into force leaves some doubts as to the future practical approach of the tax authorities – it is not clear, for example, how optimizations of the depreciation basis (step-ups), done in the past however still having an impact on depreciation tax costs, will be approached by tax authorities.

The new provisions were introduced in order to eliminate or at least minimize the activities of entities conducting their economic activity in Poland which try to avoid taxation using artificial structures or transactions. The legislator justified the Amendment by invoking analogous tax provisions binding in other countries, among others in Germany or Austria.

The Amendment will most probably result in the reluctance of some taxpayers to optimize their tax burden to the extent that it had been optimized before. However, there are still doubts as to whether the tax authorities will overuse the Amendment in some cases, for example when there are still other provisions focused on anti-avoidance activities like the transfer pricing provisions. Additionally, in the opinion of some experts, the wording of the GAAR is not precise enough, as it was drawn-up in very general terms in the Amendment. Therefore, the tax authorities would be able to interpret the provisions widely. However, every particular transaction will have to be analyzed individually and the tax authorities will be obliged to prove the existence of a tax avoidance activity.

Moreover, it is still unclear how the tax authorities will estimate the tax consequences resulting from a so-called appropriate transaction (i.e. a transaction that should have been conducted for economic reasons) and when they will consider a given transaction as such. Some experts point out that the taxpayer will be able to indicate such activities and therefore, taxpayers still will have some influence on the possible tax consequences of their actions.

The Amendment also allows for possible corrections of tax returns during proceedings connected with the GAAR. Therefore, where tax authorities begin a proceeding the taxpayer will be entitled to correct the tax return related to the questioned actions and, consequently, pay the due tax. If the taxpayer decides to take such steps to correct tax returns, the Minister of Finance shall issue a decision of discontinuance of the proceeding.

The possible tax penalties for individuals responsible for tax settlements in a given company also are noteworthy. The Amendment did not introduce any provisions connected with penalties specifically for tax avoidance activities. However, in the Penal Fiscal Code dated on 10th September 1999 (Journal of Laws 2013, item 186, with further amendments) there are two fiscal crimes foreseen – tax evasion and tax fraud connected with non-disclosure of tax basis or subject, declaration of untruth or concealment of truth. However, some experts consider that tax avoidance described in the Amendment cannot be treated as any of the crimes mentioned above.

However, the final approach of the tax authorities to the application of the GAAR is still unclear. The Ministry of Finance has not launched its official opinion or approach regarding the Amendment yet. The only statements issued so far indicate that the priority of the Ministry of Finance is first of all to reduce the artificial activities used by international companies. Therefore, such companies should be on the alert for possible auditing actions of the Polish tax authorities and take the GAAR into consideration when planning any transactions.

Contributed by
Katarzyna Klimkiewicz-Deplano, Advicero Tax Sp. z o.o.
E kklimkiewicz@advicero.eu

Singapore

Removing the fences: Singapore General Anti-Avoidance Provisions

On 11th July 2016, the Singapore tax authorities issued an e-Tax guide on the General Anti-avoidance Provision and its Application.

The guide essentially sets out the Singapore tax authorities' approach to the construction and application of the general anti-avoidance provisions promulgated in Section 33 of the Singapore Income Tax Act and illustrates by way of specific examples the types of arrangements that the authorities regard as having the purpose of effecting tax avoidance within the meaning of the Section. The guidelines and accompanying examples in the guide are not meant to be exhaustive.

The examples in the guide focus on certain selected scenarios – circular flow or round-tripping of funds, the setting up of more than one entity for the sole purpose of obtaining a tax advantage, changing business forms for the sole purpose of obtaining a tax advantage and attribution of income that is not aligned with economic reality. Nevertheless, it makes expressly clear that arrangements not discussed or described should not be taken as falling outside the ambit of Section 33. The guide does not cover arrangements that form the subject of specific anti-avoidance provisions in the Singapore Income Tax Act and/or that involve evasion of tax.

Section 33(1) essentially grants powers to the Singapore tax authorities to disregard or vary arrangements that directly or indirectly:

a. Alter the incidence of any tax which is payable by or which would otherwise have been payable by any person;
b. Relieve any person from any liability to pay tax or to make a return; or
c. Reduce or avoid any liability imposed or which would otherwise have been imposed on any person.

In drafting the guide, the Singapore tax authorities have essentially adopted the principles outlined by the case of CIT v AQQ (2014) SGCA 15. Indeed the structure of Section 33 is based on the "scheme and purpose" approach that formed the basis of the Court of Appeal's ruling in the AQQ case.

The approach can essentially be delineated into three steps. The first step is to essentially establish whether an arrangement falls within any of the three limbs mentioned above. This is an objective test based on the observable acts surrounding the arrangement itself to determine if there has on prima facie been any tax advantage derived.

If so, the second step entails ascertaining whether the taxpayer can avail himself of the statutory exception granted under Section 33(3)(b). This entails considering any subjective commercial motives and consequences that the taxpayer had for entering into such a scheme. In particular, due regard is given by the relevant Section to bona fide commercial transactions which do not have as one of its main purposes the avoidance or reduction of tax.

In the event that the taxpayer cannot seek protection under Section 33(3)(b), the third and final step involves ascertaining whether the tax advantage arose from the use of a specific provision "within the intended scope and Parliament's contemplation". In that regard, a general anti-avoidance provision should not be read as "overriding" any specific provision of the legislation or vice versa. Among the factors that should be given consideration in determining whether a tax avoidance arrangement exists include the manner in which the arrangement was carried out, the role of all relevant parties and any relationship they may have with the taxpayer, the economic and commercial effect of documents and transactions, the duration of the engagement and the nature and extent of the financial consequences that the arrangement has for the taxpayer. It is said that a classic indicator of a use that is "outside parliamentary contemplation" is the structuring of an arrangement such that a taxpayer gains the benefit of the specific provision in an artificial or contrived way.

Overall, the guide appears to be an effort by the Singapore tax authorities to communicate their perspective on the construction and application of the anti-avoidance provisions that are already enshrined in the legislation, underpinned firmly by the principles extolled from the AQQ case. The authorities may update the guide with new guidelines and new examples of arrangements, where necessary. In a broader sense, this is perhaps unsurprising and possibly timely given the clear imperative of combating harmful tax practices as one of the action points being implemented under the Base Erosion and Profit Shifting (BEPS) initiative by the OECD. Other countries in the region have also been steadily jumping on the anti-avoidance bandwagon in recent years. China's State Administration of Taxation issued its administrative measures on the General Anti-Avoidance Rule (GAAR) in late 2014 with the measures having come into effect in early 2015. India's Central Board of Direct Taxes too has tabled its GAAR which is currently awaiting implementation in 2017/18 financial year. Against a backdrop of increasing global tax scrutiny, the release of these guidelines by Singapore tax authorities points to a worldwide tax environment that is becoming increasingly complex and less forgiving to those who seek to bend the rules.

Contributed by
Lam Fong Kiew, Nexia TS Tax Services Pte. Ltd.
E lamfongkiew@nexiats.com.sg

Spain

Commissionaire structures and permanent establishment

The Spanish Supreme Court, as of June 21, 2016, issued a final Court judgment related to the Dell case.

The Dell group operated in Spain a commissionaire structure in which Dell Products Ireland Ltd ("DPI"), resident in Ireland, sold computers and equipment to Spanish clients. A Spanish subsidiary of the Dell group Dell España SA (DESA) was contracted by Dell Products Ltd as an independent agent that performed some ancillary functions related to its Spanish sales.

DPI had no direct title on any Spanish premises, so it considered that it had no fixed place of business.
DESA had no power to execute agreements and acted as a commissionaire agent acting in its own name and on behalf of DPI.

The Spanish tax administration considered that DESA was to be considered as a PE of DPI and accordingly taxable on the profits generated on the products sold to Spanish based clients.

Similar structures had been used by the Group in other territories. In Norway for instance this structure was not considered to create a PE.

The OECD BEPS Action 7 relates to the definition of a PE, and also targeted commissionaire structures, including modifications on the Model Tax Convention. It sought to

- Expand the scope of agent activities that would create a PE under article 5(5) not only to actually executing contracts but also to negotiating the material elements of contracts; and
- Include a new definition of independence requirements in art 5(6), excluding the situation when a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is connected.

The Spanish tax administration considered that

1. DPI carried out its activities through a fixed place of business that was the premises of DESA.

   It was considered that even though it had no legal title over the premises, the agreements between the parties authorized Dell Products Ltd to use both the premises and the DESA Personnel to carry out functions and activities within the business objective of Dell Products Ltd, and that these were not to be considered as merely ancillary activities.
2. Regardless of the wording of the commissionaire agreement between the parties, it was considered that DESA acted, in fact, as a dependent agent for DPI.

The Audiencia Nacional issued a judgment as of June 8, 2015 confirming the criteria of the Spanish Tax administration. This judgment was appealed by Dell.

The Supreme Court has confirmed both the interpretations from the tax authorities and therefore considered that DESA was to be considered as a PE of DPI in Spain.

The Court confirmed the interpretation that the expression through a fixed place of business also included those situations in which an indirect right to use premises for the development of the business existed. The analysis of the different functions undertaken by the personnel of DESA was key in defending such an interpretation. The tax administration had described 7 different functions related to the sales (technical services, guarantee, maintenance etc.) that were carried on in DESA's premises by DESA personnel. Taking into account the limited resources that DPI had in Ireland for the execution of such functions, it was determined that the ones in DESA could not be qualified as ancillary. Accordingly, the indirect use of premises and personnel of DESA was enough to be qualified as carrying on business through such a fixed place.

Moreover, in relation to the qualification of DESA as an independent agent, the Supreme Court confirmed the interpretation of the Audiencia Nacional. It stated that, according to the circumstances that had been taken into account by the Spanish tax authorities in a "comprehensive and exhausting manner", DESA was considered as dependent to DPI as long as

a. DESA follows DPI's instructions
b. DPI must authorize prices and commissions
c. DPI accepts or rejects the delivery applications
d. DESA must report periodically to DPI
e. DPI has the right to audit DESA registers and premises
f. Purchase of goods by DESA must by authorized by DPI
g. DPI keeps control over intellectual property rights

It is quite arguable that this extensive interpretation of the Model Treaty provisions and commentaries made by the Supreme Court goes beyond the wording of the treaties currently in place, also bearing in mind opposite interpretations made in other countries (Norway) and the actual implementation of BEPS action plans, targeting structures that were considered legal and valid but produced global tax reductions not considered "acceptable" by the States.

This Judgement actually means that, in Spain, there is an expansion of the PE definitions and the interpretations of the PE concept in the OECD model convention that anticipates, in practice, the application in Spain of BEPS Action 7 even before it has been enacted in new legislation or treaties or modifications of the ones currently in force. In fact, the Spanish Tax Auditors' governing body has ordered a full review of similar Irish structures in place by other international groups operating in Spain.

Contributed by
Pablo Gómez-Acebo Temes, De Andés Y Artiñano
E p.gomez-acebo@daya.es

Switzerland

Switzerland remains an attractive location for corporate taxation

Introduction

Switzerland has a long-standing track record as one of the most attractive locations when it comes to corporate income taxation in Europe. The corporate income tax rates, although varying quite considerably between different cantons and municipalities, are generally moderate (between 12% and 24%). Moreover, there are numerous possibilities to defer corporate income taxation by means of accelerated depreciation schemes, lump-sum valuation allowances on assets and accounting for provisions.

In addition, Switzerland's corporate tax law includes several **preferential tax regimes**, leading to an even more attractive taxation of income from certain mobile functions such as group financing, exploitation of intellectual property and international trading activities. Faced with pressure from the EU, the OECD and G20 member states, the preferential tax regimes were reviewed. This process was initiated several years ago. The analysis led to the conclusion that the preferential regimes are no longer in line with international best practice and it was therefore decided to abolish them. In order to maintain Switzerland's attractiveness as a corporate taxpayer jurisdiction, countermeasures were analysed. Thereby, the latest developments in international taxation, in particular the BEPS reports of the OECD, were taken into consideration. Within the so-called Corporate Tax Reform III (CTR III), the former preferential tax regimes will be abolished and countermeasures that are fully compliant with the final BEPS reports shall be introduced. In the summer session of 2016, Swiss Parliament has adopted the CTR III by a majority vote.

Tax holidays for newly established businesses are basically not considered as harmful tax practices according to international standards. Switzerland's corporate tax law has foreseen such tax incentives for a long time. With the CTR III and the BEPS discussion in the background, Switzerland decided to amend its respective regulations in order to increase attractiveness.

Measures of the CTR III

Most of the measures of the CTR III apply only to cantonal/ municipal taxes and some are optional in order that cantons can tailor their laws to their specific circumstances. The CTR III includes particularly the following measures:

- **Preferential tax regimes:** Cantonal special income tax regimes (in particular holding companies, mixed companies and domiciliary companies) as well as certain federal tax privileges are abolished through the CTR III. The preferential tax regimes end upon the entry into force of the CTR III (mandatory law for all cantons). The earliest possible date for the implementation of the new law is 1 January 2019.
- **Step-up upon change of tax status/transitional system:** Hidden reserves generated under a tax privilege can be taxed separately at a lower tax rate during a transition period (for further details cf. Taxlink - May 2016: Issue 111, p. 35).
- **Step-up upon migration to Switzerland:** A tax neutral step-up of built-in gains (including self-generated goodwill) upon migration to Switzerland will be allowed (mandatory law for all cantons). The step-up in tax basis applies both on the federal as well as on the cantonal level. The subsequent amortization of the disclosed built-in gains will be tax deductible according to the general amortization rules. Self-generated goodwill will have to be amortized over a maximum period of 10 years.
- **Reduction of cantonal income tax rates:** The cantons will receive 21.2% of the revenues from direct federal income taxes in the future (currently 17%) so that cantonal tax rates can be reduced (optional). Certain cantons have already communicated reduced combined effective income tax rates of 12-18%.
- **Patent box:** Income from patents and comparable rights are excluded from the taxable base to the maximum extent of 90% on cantonal level (mandatory law for all cantons). The patent box is based on the OECD modified nexus approach (see separate article in this Taxlink issue).
- **R&D super deduction:** Cantons can introduce R&D incentives in the form of excess R&D deductions of up to 150% of actual R&D expenditure (optional law for cantons - see separate article in this Taxlink issue).
- **Notional interest deduction on equity (NID):** Cantons can introduce a notional interest deduction allowing for a deduction of a deemed interest on excess equity (optional law for cantons). On the federal level, the introduction of the NID is mandatory.
- **Limitation on cantonal level:** The tax reduction of the measures patent box, R&D incentives and notional interest deduction is limited to 80%, i.e. at least 20% of the profits remain taxable on cantonal level (mandatory law for all cantons). This could lead to combined effective income tax rates of as low as 9-12%.
- **Individual taxation of dividends:** Cantons which apply an individual income taxation of at least 60% on dividends from qualifying participations (i.e. of 10% and more) can introduce the NID measure (mandatory law for all cantons).
- **Capital tax:** Cantons can allow reduced capital taxes in relation to participations and patents (optional law for cantons).
- **Stamp duty on equity and tonnage tax:** The abolition

of the stamp duty on equity and the introduction of a tonnage tax have been excluded from the CTR III and will likely be part of a separate legislative draft in the future.

The final legislative bill is subject to an optional referendum. It is currently expected that such referendum will be taken. As a consequence, the CTR III legislation will become subject to a popular vote which is expected to take place in February 2017.

Tax holidays

In general, cantons are autonomous in granting tax incentives. On 3 June 2016, revised regulations on the Swiss federal tax holiday scheme were adopted. Those regulations came into force on 1 July 2016. Federal tax incentives can be granted to industrial enterprises or production-related service providers located in qualifying areas of economic development. Currently qualifying areas are the following 93 regional centers in 19 cantons (cp. figure).

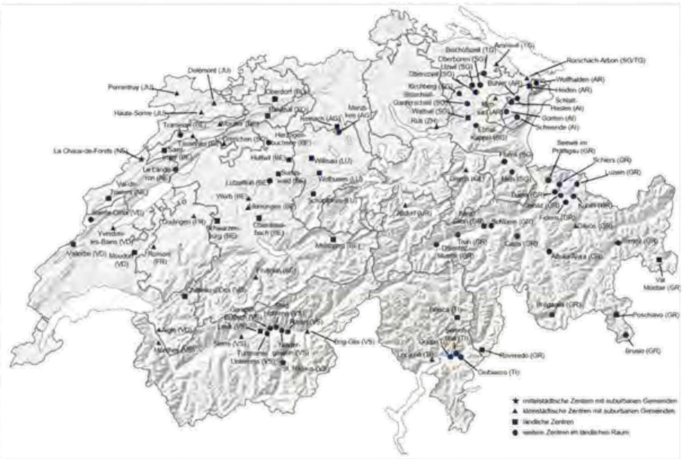


Figure 1 - Qualifying areas according to the State Secretariat for Economic Affairs (SECO)

It is a prerequisite for federal tax holidays to be granted that (i) the activities are of particular economic relevance for the qualifying area, (ii) new jobs are created (or existing jobs are preserved) and (iii) the respective canton has granted tax holidays on the cantonal level. Further, production-related service providers have to create at least ten jobs within the first five years of the tax holiday.

The federal tax relief is limited to the amount and time frame of the cantonal tax relief, i.e. the relief at federal level cannot exceed the cantonal tax holiday. Since July 2016, the maximum amount of federal tax relief is capped at CHF 95,000 of tax per year and job created or CHF 47,500 per year and job maintained. The maximum period for tax holidays is ten years. The federal tax holiday is granted in the form of a tax credit, i.e. tax credits can be offset against federal income taxes and can - if unutilized - be carried forward within the tax holiday period. In line with the current practice, federal tax holidays are subject to a claw-back provision (e.g. in case cantonal tax holidays are cancelled or the requirements are no longer met).

Contributed by
Fabian Duss and Marc Dietschi, ADB Altorfer Duss & Beilstein AG
E fabian.duss@adbtax.ch, marc.dietschi@adbtax.ch

Switzerland

Taxation of R&D activities

Background

Against the background of international pressure, Swiss special income tax regimes considered harmful (in particular holding companies, mixed companies and domiciliary companies) are abolished through the Swiss Corporate Tax Reform III (CTR III) and replaced with internationally accepted measures. One of these measures is the introduction of a **patent box** which allows for a privileged taxation of income arising from intellectual property (IP). Alongside the patent box, an increased tax deduction for research and development (R&D) expenditures (so-called **super deduction**) creates an additional tax incentive for R&D activities performed by Swiss companies.

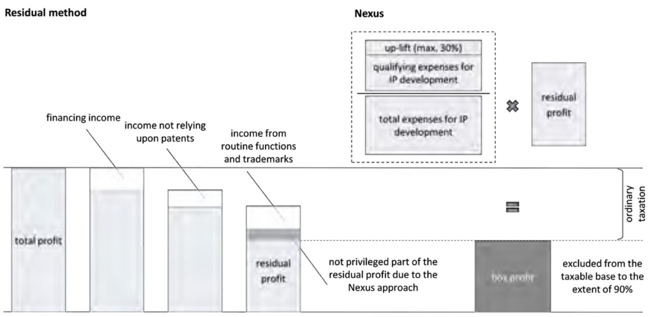
Patent Box

The Swiss patent box solution was definitively influenced by current developments in international tax law. Recently, the focus was particularly on the OECD project Base Erosion and Profit Shifting (BEPS). Against the background of countering harmful tax practices, the OECD countries have agreed to the modified nexus approach for the assessment of preferential IP regimes. The key point of this is that the tax privileges for IP income should be dependent on the extent of a company's R&D activities.

In the summer session of 2016 the Swiss Parliament adopted the CTR III by a majority vote. With regard to the patent box, the legislation provides that income from patents and comparable rights can benefit from privileged taxation insofar as it is based on R&D activities of the taxpayer.

In a subsequent step, the Federal Council will draft the implementing provisions which will govern the details. According to the current state of information, both Swiss patents (which have not undergone a substantive examination procedure) and substantively examined or unexamined foreign patents will qualify for the patent box. It is still unclear what rights will be regarded as comparable rights in the future. Copyrighted software, non-registered technical know-how and plant variety rights may be cited as examples. What appears certain is that income from trademark rights cannot be privileged through the patent box.

Income receiving tax benefits is determined in a two-step procedure: In a first step the profit directly attributable to IP (so-called residual profit) is ascertained which is then, in a second step, multiplied with the nexus factor (cf. diagram). The nexus factor is the ratio between qualifying development expenses and total IP development expenses. Qualifying expenses are the R&D costs borne by a company (self-incurred costs), costs from outsourcing R&D to domestic related or third parties as well as costs from outsourcing R&D to foreign third parties. Non-qualifying expenses (e.g. costs from outsourcing R&D to foreign related parties or costs of IP acquisition) are taken into account in the qualifying expenses through the so-called up-lift. The up-lift is limited to 30% of the qualifying expenses. Multiplication of the residual profit with the nexus factor (max. 1) results in the so-called box profit. The box profit is excluded from the taxable base to the maximum extent of 90% at cantonal level, i.e. 10% of the box profit is subject to ordinary taxation[1]. At federal level all of the box profit continues to be subject to ordinary taxation. This results in a combined effective income tax rate of around 10% for the IP income of a legal entity (federal, cantonal and municipal).



On the transition into the patent box, the historic R&D expenses in relation to the patents will be subject to a one-off tax. Since this can lead to liquidity shortage, it is expected that there will be some cushioning provided by the implementing provisions.

The patent box will further be associated with documentation requirements (so-called tracking and tracing). Particularly with regard to the assessment of historic R&D expenses and for companies/products with many patents the compliance obligations will be extensive.

Super deduction

The CTR III legislation provides for an additional measure aiming at improving Switzerland's international position as a location for R&D activities: The cantons can introduce excess

1 Corporate income taxes in Switzerland consist of federal tax and cantonal/municipal taxes. While the federal tax rate is approx. 8%, the standard rate for cantonal taxes varies from approx. 4% to 16% depending on location. Altogether this equates to an ordinary effective tax rate of between 12% and 24% (fiscal period 2015).

tax deductions of up to 150% of actual R&D expenditure. This so-called super deduction is, however, limited to expenses incurred in Switzerland by the Swiss resident taxpayer or paid to third parties for R&D activities performed within the Swiss territory. Expenses for foreign R&D activities do generally not qualify for the super deduction.

Conclusion

The Federal Council's implementing provisions for both the patent box as well as the super deduction are eagerly awaited. Of particular interest in the case of the patent box is how rights comparable to patents will be defined and what opportunities will open up for taxpayers. The question also arises whether a certification office or authority will be created which will undertake the assessment of rights comparable to patents (without the need to submit a patent application) going forward. In any event it needs to be checked more frequently in the future whether obtaining patent protection for R&D results makes sense considering the new tax rules.

The new R&D tax incentives are particularly attractive for SMEs, as they usually perform their R&D domestically or by way of outsourcing R&D to foreign third parties. This results in a higher nexus factor when applying the patent box regime. Furthermore, easier transition into the patent box is provided for SMEs in that even non-protected inventions are to qualify for the patent box. If the R&D activities are performed domestically, this also ensures the application of the super deduction.

The time of implementation is still uncertain, particularly also in view of the referendum that has already been announced. It is currently expected that the CTR III will become effective as of 1 January 2019, provided that the CTR III will be adopted by the Swiss voters.

As soon as the implementing provisions become more concrete, transition into the patent box can be examined from a tax and patent perspective as part of a feasibility analysis.

Contributed by
Dr. Pascal Taddei and Marc Dietschi, ADB Altorfer Duss & Beilstein AG
E pascal.taddei@adbtax.ch, marc.dietschi@adbtax.ch

Tanzania

Impact of the recent budget announced to business community in Tanzania

On 8th June 2016, the Minister of Finance Hon. Dr. Philip I. Mpango presented the 2016/17 budget to be effective from 01st July 2016. The budget mainly emphasized the implementation of the fifth phase of government by resolving the challenges facing citizens and improving living standards of the middle income earners by 2025. Industrial development is highlighted where strategies will be directed to improving necessary infrastructure such as water, power, transportation and increasing industrial raw material by boosting agricultural produce.

As a result, TShs 17.71 trillion was allocated for recurrent expenditure and TShs 11.82 trillion for development expenditure. Polices have been formulated to enforce government collection by imposing stringent taxation measures with an aim to reduce tax evasion and ensure compliance at all levels. Taxpayers are required to use the Electronic Fiscal Device (EFD). Nw sources of revenue collection have also been introduced and measures to control and reduce tax exemptions have been initiated. Wasteful government spending has also been curtailed.

Consequently, the 2016/17 budget brought about numerous changes that thrilled the business community in Tanzania. Furthermore, the Finance Act issued on 30th June 2016 did not cater for the tremendous changes recommended by various stakeholders, based on the 2016/17 budget, in an attempt to provide efficient measures for implementing the objective of 2016/17 budget **"Industrial Growth for Job Creation".**

The foremost collection measure emphasized was on the use of EFD machines. Each sale whose value is not less than TShs 5,000 requires to be accompanied by a fiscal receipt issued using an electronic fiscal device. Inspection measures have been enforced by the Tanzania Revenue Authority to verify whether receipts are issued for anything purchased, failure to which huge fines will be levied both on the seller and on the purchaser. This enforcement initially created confrontations between the Revenue Authority and small and medium income traders, however, this has increased the transparency of transactions and the Revenue Authority anticipates that this will increase revenue for the government.

The Revenue Authority have been empowered in assessing the market value of real estate in order to determine the appropriate base for calculating withholding taxes on rental income in an effort to minimize tax evasion. Additionally, levies that were previously collected by local government are now collected by the Revenue Authority, such as property rates and city service levy.

New taxes have also been introduced such as Value Added Tax (VAT) at the rate of 18% on tourism and financial services, excluding interest on loans. Although the aim of this was to harmonize the tourism sector in Tanzania, this may probably shrink the tourism industry and in turn hit the country's major source of foreign exchange. In addition, it may become more expensive to tourists than neighbouring countries where VAT is not charged on such services. Due to such inconsistent and unpredictable polices, the industry players are now sceptical about the future of Tanzania's tourism. "I think the future of tourism will remain challenged and the government will stand to lose more, not only because of VAT but also due to its abrupt changes", says the Chief Executive Officer of Tanzania Association of Tour Operators. The financial sector in Tanzania accounts for less than 30% and the increase in cost via 18% VAT and excise duties on money transfers which are eventually borne by customers will again put off not only businesses but also small and medium size traders from using these services, which in turn will be unfavourable to such an industry.

Moreover, some exemptions that were to be eliminated, for instance the exemption from capital gains tax on transfers of shares listed on the Dar es Salaam Stock Exchange were reinstated. The removal of this exemption would have widened the tax base by taxing net gains on the sale of shares or securities held in a resident entity. This removal was intended to counteract the current tax avoidance practice of selling local companies through overseas holding companies. Over the past 15 years, the capital markets have significantly improved their liquidity from an average of TShs 50 billion per annum to currently an average turnover of TShs 750 billion per annum. Securities listed on the Dar es Salaam Stock Exchange have also appreciated over the years and these could be the factors that might have prompted the Revenue Authority to eliminate this exemption and increase its revenue collection. Following the remonstration by the concerned group, this exemption was reinstated in the Finance Act 2016 in order to promote

use of capital market services by the informal and private sector. This will encourage more businesses to be listed on the Dar es Salaam Stock Exchange and, as a result, corporate governance principles will be aligned more efficiently in Tanzania.

The procedures for claiming tax exemptions have been amended whereby beneficiaries such as religious institutions, diplomats and non governmental organizations are now required to pay VAT on goods or services procured and then apply for a refund. They are then reimbursed by the Revenue Authority upon proper verification of records and items procured. Although this will reduce tax exemption misuse, it has however affected liquidity of such organizations and increased time and costs spent by beneficiaries in following up refunds.

On the other hand, a number of policies have been devised to support the theme of the 2016/2017 budget. For instance, current levies and taxes on fuel have been maintained to foster price stability and thereby improve infrastructure. The minimum Pay As You Earn rate has been revised from 11% to 9% in an attempt to implement the government's intention to minimize the tax burden progressively. The exemption on final gratuity payments to members of parliament has been removed to promote equitable taxation treatment to all individuals.

In a nutshell, the government expects that the real GDP will increase to 7.2% in 2016 from 7% in 2015. Inflation will be maintained at a single digit increase. Tax revenue is projected at 13.8% of GDP and the fiscal deficit at 4.5% of GDP. Total expenditure is forecast to increase to 27% and the ratio of current account deficit to GDP is forecast to narrow down to 7.5%.

Contributed by
Sujata Jaffer, Nexia SJ Tanzania
E sjaffer@nexiasjtz.com

United Kingdom

Non-UK resident = Non-UK domiciled?

I have been living outside of the UK for many years now, does that mean I am no longer UK domiciled?

Many people confuse tax residence and domicile, in particular it is common for individuals to assume that because they have ceased to be tax resident in the UK, it must follow that they have also ceased to be UK domiciled. But is this necessarily the case? In short, the answer is definitely no.

What is domicile?

Domicile is a common law concept rather than a matter of tax law. In simple terms, a person is normally domiciled in the country that he/ she regards as his/ her "home", this is not necessarily the country where they are currently living temporarily. It is perfectly possible, therefore, for a person to emigrate to another country, live there for many years but still retain a UK domicile. The key point to note, is that domicile and residence are not interchangeable concepts.

At any one point in time, an individual has one country of domicile. Whilst it is possible to be tax resident in more than one country, you can only be domiciled in one country at a time. When determining an individual's domicile position, there are 3 concepts which need to be considered:

- domicile of origin;
- domicile of dependence; and
- domicile of choice.

I do not propose covering each of these concepts in detail, as the analysis would be too lengthy for the purposes of this article. Nevertheless, a brief summary of each is below.

Domicile of origin

Everyone is born with a domicile, your domicile of origin. This is normally your father's domicile at the time you were born (note, this is not necessarily the country you were born in). A domicile of origin can be displaced; however, it never goes away.

Domicile of dependence

The domicile position of a "dependent person" (eg a minor/ child or mentally disabled person) will normally follow that of the person on whom they are dependent. Typically, this will be the father of the child. If a father changes his domicile position, any minor children will adopt his new domicile.

Domicile of choice

Once an individual has reached the age of 16, they are entitled to obtain a domicile of choice. In order to displace an existing domicile (eg a domicile of origin) with a new domicile of choice, an individual is required to move to another jurisdiction with an intention to remain there permanently or indefinitely. On the face of it, obtaining a new domicile sounds relatively simple; however, it is notoriously difficult to acquire and two key factors are required:

- the intention to reside in the new country; and
- living in the new country as an inhabitant.

The key point is the individual's intention. Have they formed an intention to remain in the new country permanently or indefinitely? If the answer to this is no, they have not adopted a new domicile of choice.

So how does this apply to the person who has emigrated from the UK?

Let us consider a typical scenario. An individual is born with a UK domicile of origin and later in life, decides to relocate to another country, perhaps for work purposes. If the individual in question remains in the new country for many years, at what point, if at all, do they cease to be UK domiciled? As noted above, the key is their intention. If the individual is only in the new country for work purposes and they plan to return to the UK on retirement, their UK domicile of origin will remain (even if they spent their entire working career in the new country!) If, however, at some point they decided they wanted to stay in the new country permanently and never return to live in the UK, they will displace their UK domicile of origin with a new domicile of choice in the new country.

It is important to note that significant evidence is required. Proving an intention to reside in another country permanently or indefinitely is notoriously difficult. Simply buying a burial plot and drafting a will under domestic law of the new country will not be sufficient. Also, an individual simply stating they intend to remain in the new country permanently will not be sufficient if it is not supported by significant evidence.

What is the significance of domicile?

The reason domicile is a key UK tax concept is that it determines an individual's liability to UK inheritance tax. If an individual is UK domiciled, all of their worldwide assets are within the scope of UK inheritance tax on death (and as the rate of tax payable is 40%, this can be a significant cost). Also, if an individual is UK domiciled, there can be inheritance tax costs as a result of undertaking estate planning measures, such as establishing an offshore trust to benefit future generations.

It is crucial, therefore, for an individual to consider their domicile position carefully and obtain appropriate tax advice. Tax advice on an individual's domicile position should be obtained as a matter of course when considering how assets will be passed on to future generations or if establishing an offshore trust is being considered.

What is the benefit of ceasing to be UK domiciled?

If an individual is able to displace a UK domicile with a domicile of choice in another country, then this can result in significant inheritance tax savings. Any non-UK situated assets would be outside the scope of UK inheritance tax (ie UK inheritance tax at a rate of 40% would not be payable in relation to these assets). Furthermore, an individual who is not domiciled in the UK can establish an offshore trust if they wish without there being any UK inheritance tax consequences, provided they settle non-UK assets (tax advice should be sought to ensure there is no UK tax leakage). This should mean that assets can be passed down to future generations without the UK Government taking a 40% cut first.

Other points to note

There are a couple of other key points which should be borne in mind. First of all, the UK has rules which deem an individual to be UK domiciled. For example, if an individual were to displace their UK domicile with a new domicile, they would continue to be deemed UK domiciled for a further 3 years. If the individual were to die within this 3 year period, their entire estate would continue to be subject to UK inheritance tax.

The second common misunderstanding to note is that the burden of proof falls on the taxpayer or the executor of their estate. If HMRC challenge an individual's claim to be non-UK domiciled, it is up to the individual (or the executor of their estate) to prove they are non-UK domiciled. HMRC are not required to prove the individual's domicile of origin remains in place. It is, therefore, crucial that significant evidence to support the individual's non-UK domicile status is collated. Having a pre-prepared package of evidence to support a claim to be non- UK domiciled is especially important from the perspective of the executors of an estate. After all, proving the intention of the deceased is extremely difficult if they are no longer alive to speak to!

Summary

Hopefully what is clear is that an individual's domicile position is crucial to establishing liability to UK inheritance tax. Furthermore, should an individual want to evidence that they have adopted a new domicile of choice (displacing their UK domicile of origin), significant evidence will be required. That said, adopting a domicile of choice outside of the UK is possible and in the right circumstances can result in significant UK tax savings.

Contributed by

Kevin Loundes, Senior Tax Manager, Abacus Trust Company Limited
E kevin.loundes@abacusiom.com

United Kingdom

Taxation changes affecting UK resident non domiciled individuals

The UK Government is pressing ahead with proposed tax changes for non UK domiciled individuals which will come into force from 6 April 2017. It will also no longer be possible to protect UK residential property from UK inheritance tax by acquiring the property via a non UK incorporated company.

The UK Government published some further information on their proposals in August 2016, although much of the important detail will not be available until later this year as part of the draft Finance Bill 2017.

Key developments

There are two key announcements within the Government's update. The first provides some further information for 'deemed domiciled' (see below) individuals including details of a promised rebasing of offshore assets to the 6 April 2017 value when calculating a subsequent gain. Crucially, it will be a condition for relief that the taxpayer has paid the remittance basis charge at least once since 2008. This will considerably restrict the scope of this relief. The second is the inclusion within inheritance tax of UK residential property held within an offshore structure, such as a company. The property is caught whether the shares in the company are in the ownership of an individual or of offshore trustees.

Deemed domiciled individuals

Two categories of individuals will be treated as UK domiciled from 6 April 2017. Those domiciled outside the UK will be deemed domiciled ('DD') for income tax, capital gains tax ('CGT') and inheritance tax ('IHT') purposes if they have been resident in the UK for at least 15 of the previous 20 tax years before the year in question. If they are to break their DD status for income tax and CGT they will need to be non UK resident for six complete tax years. For IHT, a non-resident individual will need to have been non-resident for the previous four consecutive years.

Individuals born in the UK with a UK domicile of origin who acquired a different domicile before resuming UK residency will be DD for income tax and CGT while UK resident. For IHT, this is modified and they will be treated as DD in the tax year only if resident in one of the two previous tax years as well.

In addition to any rebasing of non-UK assets, there will be a one year window for those previously on the remittance basis to separate out their clean capital, capital gains and income held offshore into separate bank accounts. Funds from these accounts can then be remitted, as desired, to the UK. Neither rebasing nor mixed fund segregation is open to those born in the UK with a UK domicile of origin.

Taxation of DD settlors of non UK resident trusts

UK source income will continue to be taxed on the settlor as under the current rules. Foreign income would appear not to be taxable directly on the settlor while the trust remains 'protected' except where the settlor was born in the UK with a UK domicile of origin. Protection is dependent on no additions being made to the trust. It is also dependent on the settlor, spouse and minor children not receiving more than the income of the year; a payment in excess of this amount from the trust after 6 April 2017 appears to trigger a loss of protected status so that as well as the payment itself being taxed there is a possibility the settlor would be taxed on all income arising in the structure thereafter (to be confirmed).

Capital gains arising in the offshore trust will not be taxed on a DD settlor while the trust remains protected. Gains will continue to be added to the 'stockpiled gains' pool and would be matched to capital payments to other beneficiaries. However, if the settlor receives a capital payment, after matching to income it would be matched to any stockpiled gains. Thereafter, it seems all current year and future gains would be taxed on the settlor. We still await confirmation of many details here, and also detail on whether any changes will be made to the taxation of the income of an offshore trust on non UK domiciled beneficiaries.

Inheritance tax excluded property trusts

In most cases, property outside the UK in trusts established before a settlor becomes UK DD will remain outside IHT as 'excluded property'. This protection will no longer apply if the settlor was born in the UK with a UK domicile of origin. Hence a trust settled by such a settlor could go from being fully outside the scope of UK inheritance tax on 5 April 2017 to being fully within it the following day.

UK residential property held in offshore companies/ partnerships

From 6 April 2017 offshore companies holding UK residential property will no longer be 'excluded property' whether the shares are owned by an individual or an offshore trust. Borrowings by the company will be deductible where they relate to the acquisition of the UK residential property but loans between 'connected parties' will be disregarded. The

definition of 'connected parties' has not yet been confirmed. It will not be possible to sell a property while any IHT charge is outstanding. The liability will be extended to anyone with legal ownership of the property, including the directors. No 'de-enveloping' relief will be available.

Business Investment Relief (BIR)

There is to be further consultation with a view to making this tax relief more attractive for non doms wishing to invest in the UK.

Commentary

Individuals and trustees will need to consider now the implications of these proposals upon particular structures to progress initial planning and consideration of the options. Please speak to your usual Smith & Williamson contact to discuss any of these issues further, or the author of this article.

Contributed by

Angela Hughes, Smith & Williamson LLP
E angela.hughes@smithandwilliamson.com

Contact us

1200 - 609 Granville Street,
PO Box 10372, Pacific Centre
Vancouver, B.C. Canada V7Y 1G6

Tel: (604) 687-0947

Davidson-Co.com