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Newsletter

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Introduction to Tax Link

Welcome to the May 2018 edition of Tax Link.

Tax Link is a Nexia publication that gives the readers access to the latest updates from across the globe. The articles were sourced from tax professionals across the network, who provide insightful country information on both national and international developments.

This edition contains 16 articles, that vary from tax reforms and legislative updates to digital technology changes across the industry. Interesting reads include: Ukraine highlighting the new stabilisation measures put in place to improve their economy and Poland's new ability to block taxpayer's bank accounts for up to 3 months.

There was a fantastic response to the last article request and I thank you all again for sharing your information with Nexia International and the wider audience. If you would like any further information on the topics in this edition, the contributor's details are provided for each article and they are happy to give further detail. If you wish to contribute to future editions please contact me.

Best wishes,

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Australia

BEPS - The Australian response: OECD but with a twist...

1. Divergence from OECD Action 13 Standard
2. Australia takes additional unilateral action
3. Heavy penalties introduced
4. Responsibility on Local Entity

At the conclusion of its Base Erosion and Profit Shifting (BEPS) Project, the OECD's Final Report on Action 13 recommended multilateral action by all members (and others) in the form of Country-by-Country Reporting.

As a result, most developed nations have now adopted the recommendations for large multinationals to provide the three recommended levels of reports - Country-by-Country Report; Master File and Local File[1].

In Australia, however, the response has been to both align with - and diverge from - the OECD. As a heavy capital-importing country, Australia has long had robust transfer pricing rules with successive governments alert to revenue risks and a Tax Office willing to challenge the largest of multinationals[2].

So it's perhaps not wholly surprising that whilst it has whole-heartedly embraced the concept of CbC Reporting and multilateral action in general, it has also taken significant additional unilateral steps without waiting for further OECD recommendations. In particular, similarly to the UK, Australia has introduced a new Diverted Profits Tax along with a specific Multinational Anti-Avoidance Rule - both aimed squarely at Australian subsidiaries of large Multinationals.

Does this Affect My Clients?

Before we consider the new rules, it would be good to know to whom they apply. In Australia, the bar has been set at the A$1bn mark - effectively, an approximation of the Euro 750m suggested in the OECD's Report. Broadly, all entities in Australia that are included in the consolidated accounts of a parent entity with over A$1bn of global turnover will be deemed a "Significant Global Entity" (SGE) - regardless of the size of their Australian operations.

What if my client is an SGE?

Broadly, an SGE has:

- Country-by-Country Reporting Obligations arising for any income years commencing on or after 1 January 2016, with all CbC Reports due twelve months after the end of the relevant year;
- Exposure to specific late and non-lodgement penalties across a number of reporting obligations - including CbC Reporting (these can now be up to A$525,000 per entity);
- Exposure to administrative penalties (e.g. on adverse ATO audit findings) of up to 100% of the tax shortfall
- Obligations to file General Purpose Financial Statements with the Tax Office for all income years commencing on or after 1 July 2016 unless it has already lodged these with the Australian Securities and Investments Commission;
- Exposure to the Diverted Profits Tax (DPT); and
- Exposure to the Multinational Anti-Avoidance Law (MAAL).

What's the risk / impact?

Whilst the general CbC and Penalty obligations speak for themselves to a large extent, it's certainly important to be aware of some of the specifics of the Australian Local File requirement, the DPT and the MAAL.

Firstly, the Australian Local File requirements can be a surprise for those who have dealt with Local File requirements elsewhere. In addition to the format of the OECD Annex II recommendations (dubbed the "Short Form" Local File under Australian rules), for all but the smallest of operations, there are then additional and extensive disclosure requirements as to quantitative related party transactional data and provision of intercompany agreements (where these exist) - the "Full" Local File.

The MAAL then addresses another key issue of the OECD BEPS Project - Action 7, The Artificial Avoidance of Permanent Establishments. In brief, the concern is that whilst on a literal interpretation of Australia's tax treaties, there is no conclusion of contracts or dependent agent in Australia, that in substance, the local Australian subsidiary is acting in all other respects as a PE of a foreign parent or associate.

In a typical scenario that the MAAL is designed to counter, a foreign parent entity would use its Australian subsidiary in an extended sales and marketing capacity but then sign the resulting contract directly between the Australian customer and the foreign associate with the latter taking the lion's share of all entrepreneurial profit and typically rewarding the local Australian entity with a slim cost-plus mark up for marketing services.

Where the MAAL is found to apply to such circumstances, the Australian subsidiary will be taxed as if it were a PE of the foreign parent and with a normal allocation of profits attributable to that PE based on transfer pricing principles. It applies after 1 January 2016 - irrespective of when the scheme commenced.

Finally (and only briefly), the DPT seeks to attack cross border related-party arrangements lacking in commercial substance where these result in profits accruing to an overseas associate in jurisdictions with less than 80% of the corporate tax rate of Australia.

The DPT applies to income years commencing on or after 1 July 2017 but, similarly to the MAAL, to schemes or arrangements regardless of when they were entered into. Where it applies a penalty rate tax of 40% (that is, 10% greater than the current corporate tax rate) will be applied to the Australian entity on all profits deemed shifted offshore.

Notes:

1. Albeit with some differing timeframes, especially as regards Master File obligations.
2. The ATO has publically stated it is pursuing some of the world's largest technology and mining companies.

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Australia

Foreign resident capital gains tax update

Withholding
In a bid to strengthen Australia's non-resident Capital Gains Tax (CGT) regime to assist in the collection of tax liabilities, measures were introduced on 1 July 2016 aimed at the collection of CGT from the sale of direct and indirect interests in taxable Australian property by foreign tax residents.

Because compliance with tax Laws was historically low by non-residents when it came to reporting gains, both on capital and revenue account, the measures were introduced to ensure tax was collected on any disposal of taxable Australian property. The measures apply to the buyer, so that where a foreign resident sells property in Australia the buyer is responsible for withholding and remitting to the Australian Taxation Office (ATO) a non-final withholding of 12.5% (previously 10%) of the purchase price.

The measures initially applied to sales of taxable Australian property with a market value (essentially the sale price) of A$2 million and above but now apply to sales of A$750,000 and above. The withheld amount will be creditable against the non-residents final CGT liability.

The withholding regime is limited only to taxable Australian property, being:

- Real property in Australia – land, buildings, residential and commercial property
- Lease premiums paid for the grant of a lease over real property in Australia
- Mining, quarrying or prospecting rights
- Interests in Australian entities whose majority assets consist of the above such property or interests
- Options or rights to acquire the real property or interest therein.

With regard to indirect interests the withholding regime will apply if the purchaser knows or reasonably believes the vendor is a foreign resident, the vendor has a foreign address or requests the purchaser to make payment to an account outside of Australia. An indirect interest is a non-portfolio interest, being greater than 10%, in an entity, or holding entity of another entity, where that entity's value is predominantly represented by taxable Australian property.

The withholding regime also provides for a number of exclusions. In the main, if the foreign resident vendor falls within one of these categories then the 12.5% withholding is not applicable:

- Real property transactions with a market value under $750,000;
- Transactions by entities listed on an approved stock exchange;
- The foreign resident vendor is under external administration or in bankruptcy.

The withholding regime uses a clearance certificate model to provide certainty to purchasers regarding their withholding obligations. The clearance certificate confirms that the withholding tax is not to be withheld from the transaction.

Generally a clearance certificate will need to be obtained by an Australian resident vendor to avoid tax being withheld by a purchaser. A non-resident vendor would not ordinarily be able to apply for a clearance certificate but is able to apply for a rate variation if it is believed a withholding of 12.5% is inappropriate and a lesser rate should apply. For example, a variation could be applied for if the non-resident vendor has Australian tax losses available to offset against the gain.

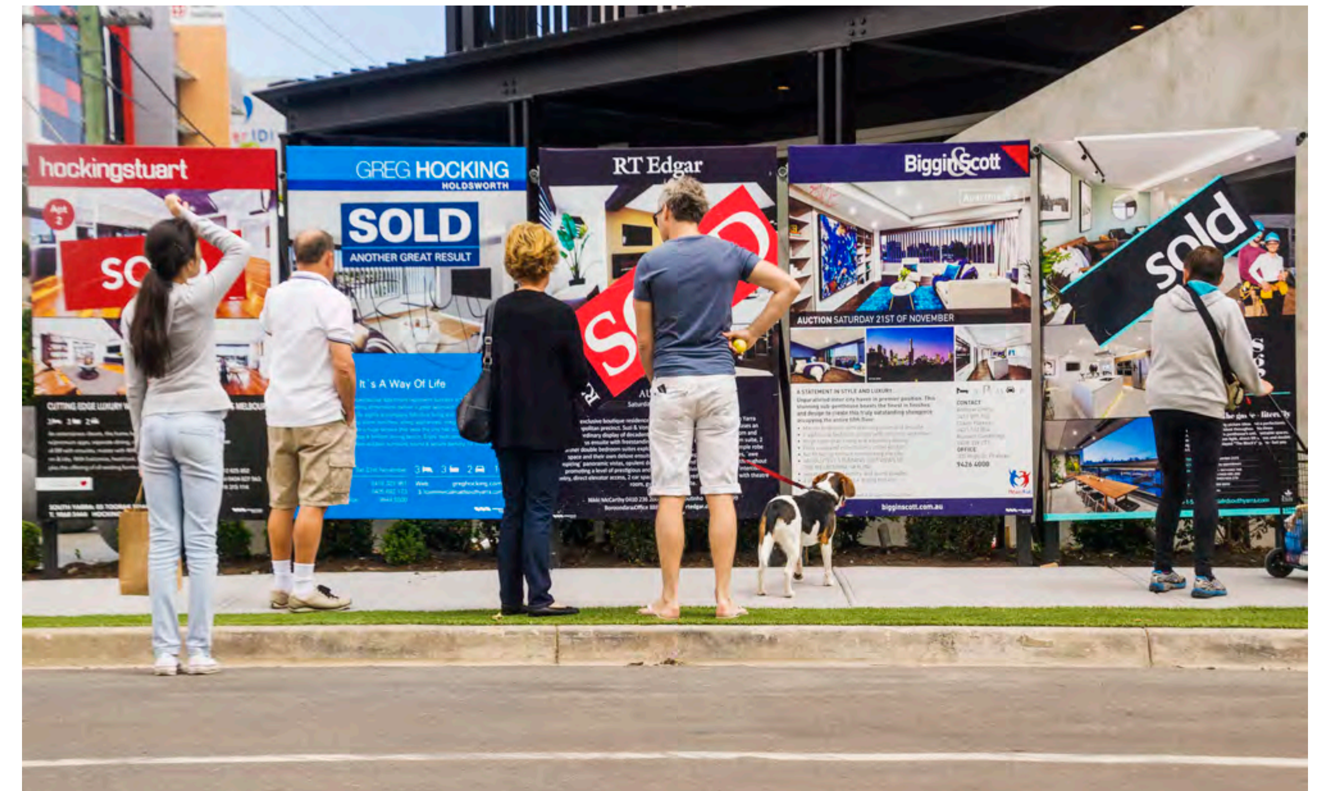
Where a withholding obligation exists, the purchaser must withhold the relevant amount at time of settlement and pay it to the ATO without delay. The penalty for failing to withhold is equal to the amount that was required to be withheld and paid. The ramifications for a purchaser failing to withhold are so severe they invariably will be almost forced to assume withholding applies unless the vendor can prove otherwise.

It is important to remember the new measures impose a non-final withholding tax which means a non-resident vendor is still obligated to lodge an Australian income tax return returning any gain, but they will be entitled to a tax credit (or even a tax refund) for the withheld amount.

CGT discount
The general 50% CGT discount rules do not apply where a foreign resident purchased an asset on or after 8 May 2012. Where an asset was purchased prior to that date the CGT discount may still apply to some of the capital gain. Essentially, this requires a calculation, valuation and apportionment to determine the market value increase prior and subsequent to the 8 May 2012. The portion of the increase prior to the 8 May 2012 will be subject to the 50% discount.

Main residence exemption
Currently, any individual, regardless of their tax residency status, who sells their home, can qualify for the CGT main residence exemption.

In the 2017 Federal Budget it was announced the main residence exemption will no longer apply to a vendor who is a non-resident for tax purposes at the time they sign a contract to sell their home, regardless of how long the home has actually been used as a main residence.



At the time of writing no Legislation has been introduced to reflect the change which will apply from 9 May 2017 and importantly, any homes held before that date are grandfathered until 30 June 2019.

Once (and if) these proposed changes do become law, it will be very important for vendors to determine their tax residency status before they sign a contract to sell a property that would potentially qualify for the full or partial main residence exemption.

It is important to note, there will be no apportionment of the time the individual used the home as a main residence – the only test is residency status at the time of signing the contract of sale.

This "all or nothing approach" can lead to catastrophic consequences for individuals that have used their properties as main residences for an extended period of time but contract to sell their properties when they are non-residents for tax purposes.

Conclusion
Non-residents should carefully consider their obligations on all transactions involving the disposal of taxable Australian property. As information on property sales is now readily available, we would expect the ATO will be vigilant in chasing non-resident taxpayers who do not lodge income tax returns disclosing CGT events where they have disposed of Australian property.

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Brazil

What you and your company need to know about BACEN Returns?

Monthly and annual returns of many ancillary tax obligations are already a routine for most Brazilian companies.

Usually, we discuss that such mandatory attribute makes tax authorities' work easier during inspection processes, which oftentimes lead to notice assessments. In a way, the taxpayer sometimes produces evidence against itself.

In this complex scenario where information technology has become necessary to companies' daily tax practices, the Government, by using its search agencies, constantly finds and implements new obligations to be prepared by the taxpayers, promoting transparency and coherence of information on most diverse levels.

It is the same for mandatory information and returns for BACEN (Brazilian Central Bank).

In this sphere BACEN focuses on the amounts invested in Brazil by non-residents, as well as in values remitted abroad by Brazilians (individuals and/or legal entities).

Although not much publicized and/or known, for years BACEN has implanted in Brazil the Annual Return of Brazilian Capitals Abroad (CBE) and the Foreign Capital Flow Control.

The Annual Return of Brazilian Capitals Abroad applicable to individuals and legal entities domiciled in Brazil that have assets against non-residents, in values over USD 100,000.00 (one hundred thousand United States dollars), calculated in the base-date of December 31, 2017. The deadline to send the annual CBE Return is until April 5, 2018.

CBE will also be mandatory quarterly when assets against non-residents are equal or over USD 100,000,000.00 (one hundred million United States dollars), calculated on the base-date of March 31, June 30 and September 30 of each year.

This year, CBE went through meaningful changes; one of them is the requirement of further information related to participation on companies' capital abroad and the revenue of exportation kept and paid abroad, pursuant to the rules.

Related to the investment on foreign company, the tax return now requires: (i) method of appraisal of investment (be it stock on the market, assessment by specialist, deducted cash flow, recent negotiation or value of net equity); (ii) percentage of participation with voting power rights; (iii) total value of assets and current liabilities of the company; and (iv) information of indirect subsidiaries.

The Brazilian Central Bank had already made a similar change to quarterly tax returns by demanding information on indirect subsidiaries. Due to this, direct investments in companies in which the direct investee abroad has representative participation on control now have to be reported on the annual tax return.

The same is true for investment funds in which the taxpayer holds participation equal or over 10% of the fund's capital; in that case, they must inform direct and indirect company shares subject to control by part of the fund.

Besides, legal entities that export goods that have been paid directly abroad for export of such goods (export of services not included) in an amount equal or over USD 10 million, must inform the total value received and where these resources are destined to abroad, among other categories to be presented.

The Annual Control, which is due on August 15, includes the following legal entities and their position as of December 31 of each base-year: (i) legal entities headquartered in Brazil, with direct participation of non-residents in its capital, in any amount, and with shareholders' equity equal or over USD 100 million; (ii) investment funds with non-resident shareholders and shareholders' equity equal or over USD 100 million; and (iii) legal entities headquartered in Brazil, with a total balance of short-term commercial credits (payable within 360 days) granted by non-residents equal or over than USD 10 million.

The novelty, introduced by Circular Letter n° 3.814/16, changed the registration of Foreign Direct Investment (FDI) in the Electronic Declaratory Register (RDE) and established that further declaration are mandatory for legal entities with non-residents' participation in the capital stock.

Article 34-B of the Circular Letter established that the new tax return should be made annually for companies with assets or shareholders' equity of less than BRL 250,000,000.00 (two hundred and fifty million Brazilian Reais) and quarterly for companies with assets or shareholders' equity over BRL 250,000,000.00 (two hundred and fifty million Brazilian Reais).

To this end, in the first case, the annual tax return must be made until March 31, 2018, regarding the equity situation of December 31, 2017. For other cases, the quarterly tax returns will be presented until March 31, June 30, September 30 and December 31, related to the equity situation of the last day of the quarter immediately before.

It should be noted that this obligation is in line with the need for corporate actions of companies to converge with foreign capital registered in BACEN, a situation that is often forgotten by companies.

Finally, it is important to note that the lack/omission of the provision of any of the returns above or, also, the presentation of false, incomplete, incorrect or outdated information is subject to the following penalties: (i) to register or present the return after the deadlines set forth in the respective standards: 1% (one percent) of the value subject to registration or return, limited to BRL 25,000.00 (twenty-five thousand Brazilian Reais); (ii) to provide incorrect or incomplete information: 2% (two percent) of the value subject to registration or return, limited to BRL 50,000.00 (fifty thousand Brazilian Reais); (iii) not to register, nor presenting the return or not presenting supporting documentation of the information provided to the Brazilian Central Bank: 5% (five percent) of the value subject to registration or return, limited to BRL 125,000.00 (one hundred twenty-five thousand Brazilian Reais); and (iv) to provide false information in registration or return: 10% (ten percent) of the amount subject to registration or return, limited to BRL 250,000.00 (two hundred and fifty thousand Brazilian Reais).

To date, the penalties or obstacles found by taxpayers are unknown, but surely such obstacles must be observed in companies' day-to-day operations.

Statement	Frequency	Receiver	Applicability	Deadline
CBE	Annual	Residents in the country (individuals and legal entities) holding assests abroad.	Amount equal or over equivalent of USD 100,000,000.00.	From 15/02 to 5/04 (Base-date 31/12)
CBE	Quarterly	Residents in the country (individuals and legal entities) holding assests abroad.	Amount equal or over equivalent of USD 100,000,000.00.	Until 31/03 (Base-date 31/12) Until 30/06 (Base-date 31/03) Until 30/09 (Base-date 30/06) Until 31/12 (Base-date 30/09)
RDE-IED	Annual	Legal entities recipient of foreign investment	Net equity or total of assets less than BRL 250,000,000.00	Until 31/03 (Base-date 31/12)
RDE-IED	Quarterly	Legal entities recipient of foreign investment	Net equity or total of assets less than BRL 250,000,000.00	Until 31/03 (Base-date 31/12) Until 31/03 (Base-date 31/12) Until 30/06 (Base-date 31/03) Until 30/09 (Base-date 30/06) Until 31/12 (Base-date 30/09)
Annual Census	Annual	Legal entities and funds in headquartered Brazil	• direct participation of non-resident on capital, in any amount, and with net equity equal or over the equivalent of USD 100 million • non-resident quota holders and net equity equal or over the equivalent of USD 100 million • total outstanding balance of short term commercial credit (due up to 360 days) granted by non-resindets equal or evoer the equivalent of USD 10 millions	15/08 (Base-date of december 31)

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India

Budget amendments 2018

The Union Budget,2018 of India was presented to the Parliament on 1 February 2018. This was the last full budget of the "Modi Sarkar" (PM Modi Government). Amongst the various reforms brought into force by the Finance Act, 2018, in this article we will be focusing on two significant amendments that have been carried out in the Indian Income-tax Act, 1961. These amendments will not only have an impact on the Indian tax payers but will also have far-reaching implications on those non-residents having business allies in India or are investing in India. The said amendments are:

1. Introduction of the concept of Significant Economic Presence (SEP)
2. Taxation on Long-term Capital Gains arising on specified assets.

Introduction of Significant Economic Presence (SEP)

According to the erstwhile provisions in the domestic tax law, a non-resident assessee is not liable to tax in India unless he has "Business Connection" in India. More specifically, Section 9(1)(i) of the Income-tax Act, 1961 provides that "all income accruing or arising, whether directly or indirectly, through or from any business connection in India" shall be deemed to accrue and arise in India. Thus, by virtue of the deeming fiction under section 9(1)(i), India retains the territorial nexus to tax the incomes arising through or from any "business connection" in India. The scope of erstwhile provisions was restrictive as it essentially provided for physical presence based nexus rule for taxation of business income of the non-resident in India.

Modern technology has made it possible for many companies to do business in several countries without business connection or permanent establishment. Phrases like "Borderless world" and "Modern technology defies Geography" have become reality for E-Commerce. But governments do want to collect income tax based on geography. Realising the need to match the pace of the rapid changes in the business environment and the loss of revenue caused to the government, the amended domestic tax law now contains the provision which brings into play the concept of "Significant Economic Presence"(SEP).

According to the provisions existing as on date, a non-resident will be considered to have an SEP in India

(a) If the non-resident receives revenue exceeding an amount to be prescribed; for transactions carried on by the non-resident within India,

OR

(b) (i) If the non-resident systematically and continuously solicits business in India through digital means;

OR

(b) (ii) If the non-resident engages in interaction with users in India through digital means. The minimum number of users that would attract the provision of SEP will be prescribed by notification.

With the introduction of the concept of SEP many foreign companies having business in India without physical presence may also come under the tax net. Further, as per the provisions prevailing as on date, between the domestic tax law and tax treaties, the more beneficial provisions will prevail. Thus, this appears to be the first roadblock while implementing the concept of SEP, since it is not part of any of the Tax treaties, and hence it is likely that Indian Government may look at renegotiating tax treaties to include this.

This amendment clearly shows that Indian Government is taking note of the changing business environment, digitization of businesses and also finding ways to collect taxes.

Taxation on Long-term Capital Gains arising on specified assets

Under the erstwhile provisions of the domestic tax law, gains arising on the transfer listed equity shares or units of equity oriented fund or units of business trusts, held for a period of more than 12 months were exempt from tax. Such an exemption was brought into picture with a view to foster equity investments amongst the nation. In order to minimize the economic distortions and curb erosion of tax base, such an exemption has now been withdrawn.

As per the law as on date, long term capital gains arising from transfer of an equity share, or a unit of an equity oriented fund or a unit of a business trust shall be taxed at 10% of such capital gains. Such capital gains tax shall be levied in excess of INR 100,000 (USD 1,600 approx). This concessional rate of 10% will be applicable if Securities Transaction Tax (STT) has been paid on both acquisition and transfer of such capital asset, in case of equity shares, and paid at the time of transfer in case of unit of equity oriented fund or a unit of a business trust.

From a domestic tax payer perspective, this amendment was not welcomed well. Moreover, the stock markets in India also saw a correction post proposal of this amendment.
The computation of gains mechanism offers slight relief to the tax payers. When a taxpayer sells securities acquired before 01.02.2018, then the cost of acquisition for such securities shall be higher of:
1. Cost of acquisition or;
Highest trade price of the security on 31.01.2018. Thus, the government has been considerate enough to grandfather the gains of the securities purchased before 01.02.2018 by allowing as a deduction the highest traded price as on 31.01.2018.

With respect to the Foreign Portfolio Investor (FPI) sentiment, such an amendment could adversely impact the revenue for the government since it could lead to significant drop in FPI flows thereby lowering the collections of the STT. Also, there are FPIs who act as an asset manager or pooling vehicle and thus transferring the tax liability to end-beneficiary also becomes complicated going forward.

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India

Taxation of digital economy – India leads the way!

In the recent past, more and more countries have been voicing their concern on the fact that the current rules are not adequate to tax nexus due to the significant digital presence in a country. While the world is still grappling with devising means to tax the digital economy, India continues to lead the way in dealing with these emerging tax issues – this time by proposing a new nexus rule to tax digital transactions.

In the Indian Budget presented on 1 February 2018, the government expanded the definition of a Business Connection (Indian version of Permanent Establishment (PE)) by introducing the concept of 'Significant Economic Presence' (referred as Digital PE hereafter in the text) to tax digital transactions. The law now provides that significant economic presence of a non-resident in India shall constitute a business connection in India and resultantly, the income attributable to such significant economic presence would be taxable in India. This is in line with India's recent comments to the revised Organisation for Economic Co-operation and Development's (OECD's) model treaty and commentary.

Significant economic presence

Significant Economic Presence (SEP) is defined as:

a. A transaction in respect of any goods, services or property carried out by a non-resident in India including provision for download of data or software in India if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or

b. Systematic and continuous solicitation of business activities or engaging in interaction with such number of users as may be prescribed in India through digital means.

The law further provides that even where a non-resident does not have a residence or place of business in India or does not provide services in India, a business connection would still be constituted.

The government has announced that it will begin a consultation process with different stakeholders to determine what should be the threshold limits for qualifying as SEP. The above change is a significant departure from the existing rules on PE. Under the existing rules, a PE is generally constituted based on physical presence in a country.

The above provisions will come into force from 1 April 2018.

OECD – Lack of consensus to tax the digital economy and unilateral measures

The OECD released an interim report in March stating that there is still no consensus among countries on whether changes should be made to international tax rules that apply to multinational digital firms. The report also states that there is no consensus on short-term interim measures to tax the digital economy.

The European Union (EU) in a report released in March, along with OECD's report, provides for two directives. One of the two proposed directives provides for a temporary EU tax on digital firm revenues at the rate of 3% to serve as a stopgap measure until an international agreement is formed as a long-term fix for corporate income tax rules applicable to digital multinational firms.

The second directive provides for a long-term fix stating that alternative indicators for SEP are required to protect taxing rights in the new digitized business models.

Similarly, the United Kingdom discussion draft on the digital economy highlights the need to consider the active participation of users in determining how the taxable profits of digital businesses are allocated.

Even before these developments, India had already taken the lead by formalizing the concept of digital or virtual PE and taxing digital transactions. Equalization Levy, similar to EU's first directive, was introduced by India in 2016. It provides for a 6% tax on income earned by a non-resident from digital advertisement. Indian Budget 2018 has now introduced the concept of Digital PE.

India's transition, along with concerns raised by other countries, highlights that this is an area of interest globally. Until there is a multilaterally agreed and implemented solution on this, countries taking unilateral measures will increase, leading to double taxation and further uncertainty.

No immediate impact – tax treaties remain unaffected

A taxpayer can apply the provisions of the Indian domestic law or the tax treaty, whichever is beneficial to him.

Therefore, while the concept of Digital PE finds a place in the domestic tax law of India, tax treaty's definition of PE with various countries remains as it is currently. The government has acknowledged this fact and has announced that these changes will enable India to renegotiate its tax treaties to provide for the inclusion of SEP rule in the treaties and unless corresponding modifications are made to the tax treaties, the existing tax law would continue to apply.

The application of the Digital PE rule would largely depend on the cooperation of India's tax treaty partners by way of amending the respective tax treaties. As such, until the time these tax treaties are re-negotiated, the Digital PE rule remains a domestic tax law concept and may not apply to non-residents who are eligible for tax treaty benefits.

Impact on non-digital transactions

While the government intends to tax emerging business models, such as digitized businesses, the way the law is drafted, the concept of significant economic presence could apply to brick-and-mortar businesses as well.

One of the parameters of significant economic presence is 'transaction in respect of any goods, services or property carried out by a non-resident in India.' This poses a question as to when can one say that the transaction is carried out in India? For instance, for a non-resident taxpayer engaged in Engineering, Procurement and Construction (EPC) activities, as a general rule, the offshore supply of goods is not taxable in India where the sale concludes outside India. Now, if one goes by the situs of the buyer, such transactions could be taxable in India.

The definition of SEP, therefore, needs suitable modifications.

Enforcement could be a challenge

The present nature of the Digital PE rule raises questions about how it will be enforced. For instance, for the threshold based on the interaction of a number of users, calculating the number of users actually interacting with non-residents could be cumbersome. Among other things, this would require a robust audit trail to arrive at the number of users – especially in cases of business models where the user interaction is on a free-for-all basis.

Determining income attributable to digital PE could be complex

By its very nature and more so in the case of a Digital PE, computing the income attributable to the PE would be a complex and highly subjective exercise. For instance, where a Digital PE is triggered based on the threshold of the number of users the taxpayer interacts with, but the interaction does not result in significant revenue, the income attributable to the PE could be nil. Also, a formulatory approach may not be suitable and the government would need to specify robust guidance on profit attribution.

Conclusion

To summarize, India has taken the lead by carving out tax provisions to tax digital transactions. This provision is at a nascent stage and could evolve through stake-holder consultants. Businesses may not have to worry about Digital PE being created just yet. However, the government could move swiftly on deciding the coverage of Digital PE to provide stability to the Indian tax environment.

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Malta

The European Commission approves the Maltese tonnage tax scheme

The much-awaited European Commission decision on Malta's tonnage tax system was published on February 7 2018. The European Commission has conditionally approved under EU State aid rules the Maltese tonnage tax scheme for a period of 10 years. The scheme will ensure a level playing field between Maltese and other European shipping companies and will encourage ship registration in Europe.

Commissioner Margrethe Vestager, in charge of competition policy, said "Tonnage tax systems are meant to promote the competitiveness of the EU shipping industry in a global market without unduly distorting competition. I am pleased that Malta committed to adapt its tonnage tax system to achieve this. Moreover, by encouraging the registration of ships in the EU, the scheme will enable the European shipping industry to keep up its high social and environmental standards."

In 2012, the European Commission opened an in-depth investigation into the Maltese tonnage tax scheme to examine its compatibility with EU State aid rules. With today's decision, the Commission endorses the Maltese scheme, subject to the amendments introduced by Malta.

The Commission's in-depth investigation found certain features of the original scheme, such as tax exemptions applied to Maltese residents and the broad scope of the scheme extending to vessels not carrying out maritime transport activities, to be in breach of EU State aid rules.

Under the Maltese scheme, a shipping company is taxed on the basis of ship net tonnage (i.e. based on its volume) rather than the actual profits of the company. In particular, tonnage taxation is applied to a shipping company's:

- core revenues from shipping activities, such as cargo and passenger transport;
- certain ancillary revenues that are closely connected to shipping activities (which are, however, capped at a maximum of 50% of a ship's operating revenues); and
- revenues from towage and dredging subject to certain conditions.

If a shipping company wants to benefit from the scheme, a significant part of its fleet must fly the flag of a European Economic Area (EEA) Member State. In addition, any new entrant to the scheme must have at least 25% of its fleet subject to tonnage tax with an EEA flag.

The Commission assessed the amended measures under EU State aid rules, in particular, its Guidelines on State aid to maritime transport. It concluded that the amended Maltese scheme is in line with EU State aid rules, as the tax relief granted is an appropriate instrument to address global competition and will provide the right incentives to maintain maritime jobs within the EU, whilst preserving competition within the EU Single Market.

Essentially, nothing has changed with respect to the Maltese income tax exemption on core activities of maritime transport. Thus, the shipping industry in Malta welcomes the Commission's decision as providing the necessary legal certainty to the Maltese tonnage tax system especially since Malta leads the largest shipping register in Europe. Furthermore, the Commission agreed that the below mentioned activities are also exempt from Maltese income tax:

- Income from the bareboat out of vessels to group companies. Bareboat out to third parties is possible only in case of short term (three years) over-capacity and provided the amount chartered out does not exceed 50 per cent of the total fleet calculated on a group basis;

Income from cruises and services ancillary to the cruise – provided that such 'ancillary' services (e.g. spa, hairdressing services etc.) do not exceed 50 per cent of total revenue for each ship. Income from betting/gambling and luxury goods must be less than 25 per cent of total revenue of the ship;

- Income from yachts which are registered as 'commercial yachts' with Transport Malta;
- Tugs and dredgers provided that more than 50 per cent of their operational time represents maritime transport;
- Self-propelled barges that are designed and normally used for navigation in open seas;
- Time/voyage chartering in of vessels is also possible provided that the flag link requirements are met;
- Dividend distributions from shipping companies;
- Capital gains on sale of tonnage tax ships which are engaged in genuine shipping activities; and
- Interest derived from working capital of shipping companies.
- On the other hand, the following do not fall within the scope of the Maltese tonnage tax system:
- Fishing and fish factory ships;
- Private yachts and ships used primarily for sport or recreation;
- Fixed offshore installations and floating storage units;
- Non-ocean going tug boats and dredgers;
- Ships whose main purpose is to provide goods or services normally provided on land;
- Stationary ships employed for hotel and or catering operations (floating hotels or restaurants); and
- Ships employed mainly for gambling/as casinos (floating or cruising casinos).

Malta has committed to introducing a number of changes to its scheme to prevent any discrimination between shipping companies and to avoid undue competition distortions. In particular, Malta agreed to restrict the scope of the scheme to maritime transport and to remove those tax exemptions for shareholders which constitute State aid. Nexia BT in Malta are closely monitoring the issuance of the updates which shall be available in the coming weeks.

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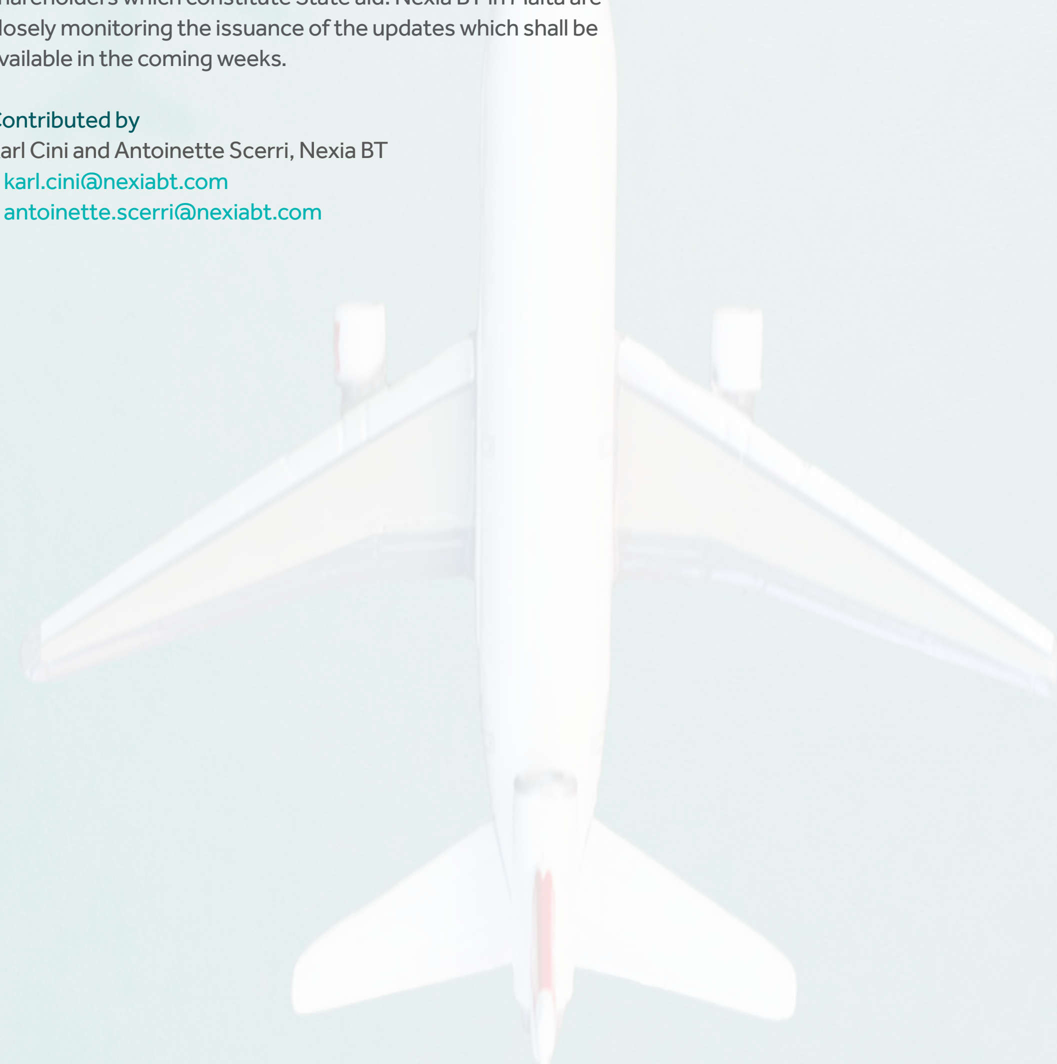

Poland

Polish tax authorities will be entitled to block taxpayers' bank accounts – introduction of so called STIR in Poland

Since January 2018, so-called STIR - Information System of the Reconciliation Chamber - has been introduced in Poland. The system is a set of algorithms, introduced with the aim to analyze data provided obligatory by financial institutions (including banks) to the Polish tax authorities. The purpose of implementing this system is to identify taxpayers avoiding taxation and as a result to reduce the VAT gap by counteracting fiscal crimes committed with the participation of the financial sector.

The system will capture abnormal transactions and provide information about them to tax authorities. In order to do so, an analysis of taxpayers' activities through financial institutions will be performed, in order to identify tax frauds on the basis of the following criteria:

- economic - assessment of transactions in terms of justification from the perspective of taxpayer's business;
- geographical – concluding transactions with entities from countries in which there is high threat of committing a tax fraud;
- objective - conducting business activity with a high risk from the point of view of vulnerability to tax extortion;
- behavioral - unusual, in a given situation, behavior of the entrepreneur;
- links - existence of links between the entrepreneur and entities that are at risk of being involved in activities related to tax frauds or organizing such activities.

Based on the obtained information, it will be possible for Polish tax authorities to block the entrepreneur's account for 72 hours, as well as to extend this blockage for up to 3 months - when there is a risk of extortion of the amount higher than 10,000 euros. In practice, the application of such a mechanism may result in insolvency of the entrepreneur and the necessity to terminate his business activity.

In case of blocking the account, with the permission of the head of National Treasury Administration, the entrepreneur will be able to use the funds from his bank account for limited purposes only, including among others:

- payment of salaries to employees (this applies to employment contracts concluded at least 3 months before the date of blocking the account);
- for maintenance or disability benefits;
- payment of other tax liabilities.

The option to block a bank account will not apply to private individuals' accounts. However, if a given entrepreneur runs only one account for both business as well as for private purposes, these regulations will apply to such persons.

Although the act itself has been in force since January 2018, the possibility of blocking amounts on bank accounts will materialize from the end of April 2018.

What is interesting, taxpayers do not have the opportunity to learn how algorithms of STIR function – it is known only to the National Treasury Administration. As a consequence, taxpayers will not be able to verify why their transaction was deemed abnormal.

Due to the strong interference of the new regulations with the right to property and the freedom to conduct a business, it is commonly upheld among tax advisers that they should be used prudently when there is no doubt that the transaction was used to commit a crime. Account blocking should be an exceptional action, used in special circumstances. However, the practice will show what the attitude of tax officials will be towards this issue.

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Slovakia

Positive and negative effects from the 2018 tax changes in Slovakia

In the second half of 2017, the Parliament voted for changes to the Income Tax Act, which came into force on January 1, 2018. Below we have selected for you a highlight of changes that have an international reach or can have an impact on your business strategies towards Slovakia.

Super deduction of R&D costs

Positive changes have occurred in the support of R&D. The amendment to the Income Tax Act has increased the deduction of tax costs from the current 25% to 100% of the R&D costs incurred. This so-called super deduction can be applied by legal persons as well as by natural persons. The condition is that taxpayers will define the subject of research and development, indicate the start date and expected end of the project, the project objectives and the estimated expenses (costs) for the implementation of the project.

Profits from sale of shares exempt from tax from now on

Another positive change, which concerns only legal persons, is the exemption from income tax on the sale of shares or business shares. Exemption from tax may be applied by legal persons, provided that the proceeds of the sale flow at the earliest 24 immediately following calendar months from the date of acquisition of shares or business shares and the taxpayer in the Slovak Republic has the necessary personal and material equipment. The last condition for the application of the tax exemption is that the company in which shares, or business shares are sold is not in liquidation, bankruptcy or restructuring.

Business combinations will be taxed!

Significant changes also occurred in business combinations. Since January 2018, valuation has been established exclusively at fair value for non-monetary deposits and mergers or divisions of companies and cooperatives. Taxpayers will only use valuation in real terms for those mergers or divisions of companies with a decisive date after January 1, 2018. In the case of non-monetary deposits, the limitation on the use of the original values will apply only to deposits redeemed after December 31, 2017. So from a tax point of view such business combinations will no longer be tax neutral!

Exit tax introduced

Since January 1, 2018, the so-called "Exit Tax" has been introduced, which in principle means the introduction of tax on the transfer of the taxpayer's assets, the taxpayer's departure or the transfer of a taxpayer's business from Slovakia abroad. The obligation to introduce Exit Tax resulted from Slovakia's implementation of the EU Directive against tax evasion practices. Exit Tax is calculated from the capital gains generated in Slovakia which were not taxed at the time of the transfer.

Conclusion

Slovakia might be no longer the pioneer in tax changes (the times of the 19% flat tax have been long gone), but there are still interesting aspects that can lower your tax burden. However, with the introduction of the exit tax and the abolishing of the tax neutrality of business combinations it will be clear that Slovakia might have fallen of the list of several potential foreign investors.

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Sweden

Sweden lowers its corporate income tax

The Swedish government presented a proposal for new tax regulations for the corporate sector. The right of deduction for future interest expenses is one of a number of proposals which will impact Swedish companies' tax situations. Sweden will also be more attractive to investors as the corporate income tax will be lowered to 20,6 percent as of jan 1 st 2021. An intermediary step will be taken 2019.

The proposal in brief

The proposal now presented by the Government is modified compared with the previous work undertaken in this context by the Ministry of Finance. Basically, the current proposal implies, as expected, that a new general limitation on the right of deduction is to be introduced for negative net interest in the corporate sector. This also includes interest expenses to external lenders. The right of deduction will be based on a so-called EBITDA rule and will be combined with a decrease in the corporate tax rate. The existing framework regarding deduction of intra-group interest expenses will, however, remain but the proposal implies modification of the rules.

In summary, the proposal implies the following:

- The limitation on the right of deduction is formulated as an EBITDA rule with a 30 percent deduction limit.
- Negative net interest which is not allowed to be deducted according to this EBITDA rule is to be carry forward during one period of a maximum of six years.
- The allowance is increased from the previously proposed SEK 100,000 to SEK 5,000,000, which implies that negative net interest up to SEK 5, 000,000 will not be covered by the EBITDA rule.
- The corporate tax rate will be decreased in two stages from the current 22 percent to 21.4 percent in 2019 and to 20.6 percent in 2021.
- The previous proposal to introduce further limitations on the right to utilise fiscal deficits from previous years is abolished.
- It is proposed that a so-called basic deduction be introduced for apartment houses for costs incurred in new construction, in making additions to existing buildings and in the reconstruction of buildings, to apply during the first six years.
- Rules against so-called hybrid mismatching are to be introduced to hinder international tax planning.
- Leasing rules are to be introduced addressing only the interest portion and not the right of depreciation.
- The new regulations are proposed to come into effect on 1 January 2019.

The proposed limitation on interest expense deduction implies that the EU Directive against tax avoidance and OECD's recommendation against base erosion and profit shifting (BEPS) are implemented on the basis of Swedish law.

Comments

The proposal presented by the Minister of Finance has been re-worked and in some aspects the Ministry of Finance has also taken into consideration the strong criticism which certain groups/associations. Amongst other things, the new proposal means that companies with negative net interest less than SEK 5,000,000 can, overall, be seen to benefit due to the reduced corporate tax rate. The same can be said about companies in the service sector.

Both national and international companies have all reason to monitor the continued legislation process in this context. A number of interpretation issues will arise and all companies should undertake a consequence analysis of how this proposal can impact precisely their operations.

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Switzerland

Update on tax proposal 17

After the rejection of the Corporate Tax Reform III (CTR III) on 12 February 2017, the Federal Council adopted the dispatch on the tax proposal 17 (TP 17) containing new measures on 21 March 2018.

Background and content

The process to reform the Swiss corporate tax system was initiated several years ago with the CTR III (cf. Taxlink – September 2016: Issue 112). After the CTR III was rejected by the Swiss voting population, the TP 17 was launched. At the same time, the current tax legislation remains in force and preferential tax regimes for holding companies, mixed companies and domiciliary companies are available until revised legislation enters into force. However, there is still agreement on the necessity of a tax reform. The purpose of the TP 17 is to abolish the preferential tax regimes and to introduce countermeasures to preserve the international competitiveness of Switzerland. Further, the requirements of the cantons must be taken into account, and the reform needs to generate sufficient tax revenues.

Against this background, several measures were published in a consultation proposal on 6 September 2017 (cf. Taxlink – February 2018: Issue 116). On 21 March 2018, the Federal Council adopted the dispatch on the TP 17. There are no major changes in the dispatch to parliament as compared to the consultation proposal. The tax proposal includes, but is not limited to the following measures (more details to the different measures can be found in Taxlink – February 2018: Issue 116):

- Abolishment of cantonal tax privileges for status companies (holding, mixed and domiciliary companies) as well as certain federal tax practices. After the abolishment, the realization of hidden reserves generated under a tax privilege can be taxed separately for a maximum of five years.
- Introduction of a mandatory patent box and optional R&D super deductions on cantonal level.
- Introduction of a tax-neutral step-up of hidden reserves upon migration (incl. transfer of businesses, operational units or functions) to Switzerland.
- Provision of support to the cantons so that they can afford to reduce corporate income tax rates (currently, effective tax rates between 12 and 18 percent are foreseen).
- Optional introduction of a reduction in the calculation of capital taxes on equity relating to participations as well as patents and similar rights.
- Increase of taxation of dividends from qualifying shareholdings of individuals to 70 percent on federal and to at least 70 percent on cantonal level.
- Extension of the entitlement to lump sum tax credit for Swiss permanent establishments of foreign companies.

Timetable

Now that the legislative proposal is submitted to parliament, it will be discussed by the Council of State during summer session and by the National Council during autumn session. A decision of the parliament shall be reached in autumn 2018. It is expected that the following subjects will be most controversial in parliamentary debate:

- The introduction of the notional interest deduction was removed from the TP 17 as compared to the CTR III. In particular, the canton of Zurich, as a financial center, is interested in the introduction of the notional interest deduction. Various cantons support this endeavor.
- The trade association is opposed to increased dividend taxation for individuals.
- Left-wing parties call for corrections of the capital contribution principle from the corporate tax reform II and even higher dividend taxation.

Hopefully, the initial reactions to the proposal are only political skirmishes and the politicians are aware of their responsibility and the importance of the tax proposal for Switzerland. First parts of the reform could - after the expiry of the referendum period or after the proposal has been accepted by the Swiss voters - enter into force in 2019. The major part would only be implemented in 2020.

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Tunisia

Corporate income tax incentives in Tunisia: interpretation issue as related to the International trade companies

As reminder, trade activity in Tunisia is restricted to foreign investors. Indeed, it's requested to get a prior authorization from Ministry of trade, unless to get a local partner having at least 50.1% of share capital. However, foreigner investors are allowed to set up and totally control an International trade company "ITC" in reference with the Law # 94-42.

When share capital is held by non-resident persons (juridical or individuals) for at least 66%, the ITC is considered as a

non-resident company towards the change legal frame and therefore it may open and manage foreign bank accounts (EURO, USD…).

Under law 94-42, and various amendments, a company is considered as an ITC only if it realizes at least 50% of its revenues from export of Tunisian products (either manufactured or natural ones). Based on such condition, an ITC may realize the following activities: imports, exports, international cross trade (to buy goods from a country A in order to resell it to a country B) and intermediation.

As precision, and according to Decree of Trade Minister dated on December 1998, such quota computation, when applicable to non-resident ITCs, shall not take into account the revenues generated from international cross trade activity.

If an ITC is set up under the totally exporting regime, therefore, it benefits from tax incentives granted by the State, amongst which in particular the favorable CIT rate (0% if the company is set up before end 2013 and 10% if it's set up after that date). As reminder, the common CIT rate in Tunisia is 25%.

In May 2015, the Tax administration has published an internal memo explaining that activities of cross trade and intermediation shall be done as secondary activities (in regards with export of Tunisian products) and therefore, in case an ITC realizes such activities as main ones, it tacitly loses the character of ITC. A direct consequence of such interpretation is that an ITC is tacitly converted to a common company and therefore it will pay the CIT at the full rate (instead of the incentive one), added to late penalties. Such Tax memo created a great confusion into the sector.

Our Firm is accompanying and assisting some of ITCs that have been object of tax audits which leaded to reassessments. For one of the files pending ahead the Court, the Judge rejected the Tax administration internal memo motivations and has asked an independent expertise about the mode of computation of the 50% quota as explained here above. Such expertise has proved that the ITC is respecting the quota of 50% since international cross trade revenues shall not be included into the computation basis.

To allow a better comprehension of such issue, we may take the following example. An ITC exports Tunisian olive oil for 100, realizes cross trade revenue for 300 and local sales of imported goods for 50.

In reference with Tax internal memo, the quota of Tunisian goods export will be 22% (100 out of 450), and consequently the company is not considered as an ITC.

However, if we strictly apply the law (particularly the Ministry decree of 1998), the quota of Tunisian goods export will be 66% (100 out of 150) and consequently the company is considered as an ITC.

We hope the final judicial decision will be on the right way. To be continued!

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Turkey

Electronic service providers have to be taxpayers in Turkey

With an amendment to the Turkish Tax Law as of 01.01.2018;

The requirement of "Declaration and payment of **VAT** by the tax service providers, r**elated to services provided electronically, to the non-taxpayer real persons** in Turkey with a price" has been brought by the ones that doesn't have a residence, office, legal center and business center in Turkey.

Any kind of service provided in electronic environment, for example; sales of software and all digitized products, subscription to web sites, access to music, movies, games, access to electronic books and publications, remote education services including remote maintenance of computer software and hardware, remote system management and online data storage services and accessing, downloading and updating and any services provided similar to these, are in this scope.

Electronic service providers that doesn't have an office in Turkey; they will declare and pay VAT in Turkey related to the electronic service transactions by establishing "Special VAT Liability for Electronic Service Providers" with VAT declaration number 3. For registration; first of all, the form, which is at the website (www.digitalservice.gib.gov.tr) of revenue administration of turkey, will be filled. After the approval of the form, VAT obligation will be established.

In this way, there is no obligation to sign the bookkeeping and declarations of professional VAT assigners to Electronic Service Providers.

The Value Added Tax calculated on these services, which is made monthly; will be declared monthly. VAT declarations for transactions made in January, February and March 2018 only during the transition period to application, can be made between 01.04.2018-24.04.2018.

Those who have transactions within the scope of the law are required to submit their registration application within April at the latest and submit a declaration for their quarterly transactions in January-February and March on 24.04.2018 at the latest.

Tax penalties will be applied for those who are engaged in the transaction as mentioned above and who do not submit their related declarations by not opening VAT registration in Turkey.

We remind you that the necessary obligations must be met to avoid any penalties.

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Ukraine

Legislative measures in order to stabilize and improve current economic situation

The National Bank of Ukraine, the Cabinet of Ministers of Ukraine, Parliament of Ukraine and local city councils apply a number of measures, especially in the fields of currency regulation and taxation, in order to improve the financial and economic situation of the country after the political crisis in 2014 and current military actions against Russian army forces in the Eastern part of Ukraine. At the same time new President and Government elaborate a number of changes to tax legislation in order to facilitate tax administration and improve economic situation.

As a result Ukraine improved its place in Worldwide Doing Business rating for the last 4 years on 36 (!) points, having 76 position in 2018 and making significant improvement (during the last 2 years) in the spheres of: Dealing with Construction Permits; Protecting Minority Investors; Paying Taxes; Enforcing Contracts. In the World Bank's tax payment index (part of Doing Business Ranking 2018) Ukraine holds 43-rd position among 190 countries. The main improvements include introduction of the automated on-line system of VAT administration and automatic VAT refund, significant decrease of the obligatory social insurance payments, introduction of the efficient tax anti-avoidance rules, moving more tax payments online which makes transactions more transparent. Ukraine has one of the lowest numbers of tax payments, however, it still takes significant time to pay taxes in Ukraine (according to the Doing Business Ranking 2018).

Corporate income tax (CIT)

As of January 1, 2018, the basic CIT rate is 18%. The reduced rates of 0% or 3% apply to qualified insurance activities.

In 2017-2021 0% CIT rate applies to the following taxpayer: whose annual income does not exceed UAH 3 mln., salary of its each employee is not lower than two minimum wages. Such rate applies to: companies registered after January 1, 2017, the average number of employees of which ranged from 5 to 20 people.

Taxation of individuals

Personal Income Tax (PIT)

The basic PIT rate is 18%. Dividends received by individuals: on shares and/or investment certificates, paid by joint investment institutions; on shares and/or corporate rights, accrued by non-residents; on shares and/or corporate rights, accrued by residents – non-payers of CIT – are taxed at the rate of 9% (previously – 18%).

Unified Social Contribution (USC)

USC is a consolidated insurance fee and is paid to the system of compulsory state social insurance.

The employer calculates the USC on the basis of payroll fund. USC rate is 22%; for disabled workers the rate is 8.41%. The USC accrued by the employer is deductible for CIT purposes. Employees are relieved from paying this contribution. The base for the USC is capped at fifteen minimum monthly salaries and equals to UAH 55,845 (approx. USD 2 000) from January 1, 2018 to December 31, 2018.

Minimum obligatory amount of USC per month is UAH 819.

USC is not payable on the wages of foreign citizens who work in the representative offices of foreign companies located in Ukraine.

Transfer pricing

If a Ukrainian company meets the following criteria (starting from January 1, 2017):

- has annual income from all activities (on the basis of financial accounting) that exceeds UAH 150 million for the reporting tax year; and
- has annual volume of business transactions with identified counterparty in the amount exceeding UAH 10 million
- it is required to comply with TP regulations.

Besides, since 1 January 2018 the following transactions qualify as controlled transactions for TP purposes:

- with related non-residents;
- with a non-resident, who is registered / a tax resident of a low tax jurisdiction and Crimea / special types of legal entities (regardless of relation with the Ukrainian company) (there are two lists effective as of January 1, 2018: list of low-tax jurisdictions and list of special types of legal entities);
- with non-resident commissioner, regardless of relation with the Ukrainian company;
- with related non-resident if between them a / several unrelated persons are interposed that do not perform significant functions/assume significant risks;
- between non-resident and its permanent establishment registered in Ukraine.

The transactions between non-resident and its permanent establishment in Ukraine qualify as controlled transactions if their volume exceeds UAH 10 million per year.

TP regulations apply to corporate income tax only.

The List of Low Tax Jurisdictions

As of the beginning of 2018 the Cabinet of Ministers of Ukraine significantly extended the List of Low Tax Jurisdictions. If a non-resident company – counterparty of a Ukrainian company – is registered in the country/territory that is included in the list – the transactions with such non-resident shall qualify as controlled transaction (provided that the thresholds mentioned above are met, regardless of relation between a non-resident and Ukrainian company). If a transaction does not qualify as controlled transaction (when thresholds are not exceeded) a Ukrainian company shall adjust its financial result by 30% of the value of goods / works/ services purchased from such a supplier from low-tax jurisdiction or substantiate that the cost is at arms' length.

As of January 1, 2018 the list included 85 countries (22 jurisdictions were added as compared with 2017). Georgia, Dominican Republic, Republic of Estonia, Islamic Republic of Iran, Republic of Cuba, Republic of Latvia, Lebanese Republic, Republic of Mauritius, Republic of Malta, Kingdom of Morocco, Principality of Monaco, United Arab Emirates, Puerto Rico, Republic of Singapore, Hungary and some others are in the list. However, on January 31, 2018 the Cabinet of Ministers of Ukraine excluded Estonia, Georgia, Hungary, Latvia and Malta from in the list; the act became valid on March 8, 2018. Thus, from January, 1 till March, 7 (including) the latter mentioned countries were present in the list.

The List of Special Types of Legal Entities

In July 2017 the Cabinet of Ministers of Ukraine approved the List of Special Types of Legal Entities that do not pay CIT or are fiscally transparent entities. If a non-resident company – counterparty of a Ukrainian company – was established in a special legal form that is mentioned in the list – the transactions with such non-resident could qualify as controlled transaction (provided that the thresholds mentioned above are met, regardless of relation between a non-resident and Ukrainian company). If a transaction does not qualify as controlled transaction (when thresholds are not exceeded) a Ukrainian company shall adjust its financial result by 30% of the value of goods / works / services purchased from such a supplier from the List of Special Types of Legal Entities or substantiate that the cost is at arms' length.

As of January 1, 2018 the list includes, inter alia, Australia (GP, LP), Austria (OHG, OEG, KG, KEG, GesnbR), the United Kingdom (LP, LLP), Israel (GP, LP), Canada (GP, LP, EPC), Malta (Partnership en commandite, Partnership en nom collectif), Germany (GbR, KGaA, KG, OHG), USA (States of Delaware, California, Nevada, New Jersey, New York, Texas, Florida – GP, LLP, LLC), France (S.N.C., S.C.S., G.I.E., Societe civile, Societe en Participation, Fonds Commun de Placement a Risques).

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United Kingdom

Making tax digital

2017 saw some significant changes to the timetable for the UK's Making Tax Digital (MTD) programme. In this article we consider where MTD is now, and what we might expect to see in the near future.

Key dates

Businesses need to be aware of the following two key dates:

- April 2019 – digital reporting for VAT ('Making VAT Digital') becomes mandatory
- April 2020 – possible introduction of quarterly digital reporting for income tax and corporation tax.

Making VAT Digital

From April 2019, all businesses with turnovers over the VAT threshold (£85,000) will be required to use MTD-compatible software, rather than the current online service, to submit their VAT returns. This will include overseas businesses making supplies which are subject to UK VAT, although they will only need to consider the element of their turnover subject to UK VAT when considering whether they have reached the threshold.

Relatively few businesses – around 12% – currently file their VAT returns via a software package, and it is likely that the majority of these are straightforward. The complexities of the UK's VAT legislation means that many businesses, even if they use a software package for accounts purposes, will currently use spreadsheets or manual calculations to arrive at their VAT return figures. The shift to digital reporting will not change the information actually reported to HM Revenue & Customs (HMRC), but the changes to underlying record keeping requirements are likely to present a challenge for many businesses.

There will be no requirement to keep underlying records (invoices and receipts) in a digital format. Businesses will, however, need to store transactional information, including the time and value of each supply, together with the applicable VAT rate, digitally. Where a business uses a combination of software packages to keep the required records and generate their VAT return, HMRC's aim is that – with limited exceptions to take account of the complexities of the VAT regime - information should then flow directly from one software system to the next (ie there should be no manual re-entry of data), to reduce error. For some businesses, this will require a shift to keeping digital records for the first time; for others, the key issue will be ensuring that they can put in place the necessary digital links between their (and their agent's) software. In practice, this could prove complex for many businesses.

A trial of digital VAT reporting has just started, and we expect a range of different software options to become available over the next few months. Businesses should, therefore, talk to their advisers now to understand the specific steps they need to take and to identify both the best software options and any changes needed to current record keeping processes.

Quarterly reporting for income tax

Quarterly reporting for businesses within the charge to UK income tax was initially intended to be the first key milestone in the MTD for business programme, with a planned start date of April 2018. In July 2017, however, the UK government recognised that the timetable was too tight to guarantee successful implentation, and pushed back the start date until after the introduction of digital VAT reporting. Quarterly reporting for income tax will now not be mandated before April 2020 "at the earliest".

Once the new rules are introduced, businesses will have to keep records digitally and submit a quarterly update to HMRC, summarising their income and expenses for the quarter. There will be no requirement to include accounting or tax adjustments in these updates, which will need to be submitted within a month of the quarter end. Where a business has more than one trade or property business (or a combination of trading and property income), it will need to keep records and return quarterly information separately for each.

Following the year end, the business will have to submit an end of period statement which will incorporate relevant accounting and tax adjustments and will finalise the business' position for the year (again, with separate figures for each trade/property business).

The deferral of mandatory quarterly reporting was a welcome step, but has meant that businesses face continued uncertainty about the best way to prepare. Much of the focus – from both software developers and the government – has, understandably, shifted to ensuring that systems are ready to support Making VAT Digital reporting. There has, therefore, been limited progress in the rollout of software packages to support quarterly income tax reporting. A trial has been in progress since last year, and we would expect more software to become available over the coming months, but it is likely that we will only see a strong takeup of these once the government confirms the start date for quarterly reporting.

Corporation tax

It seems likely that the UK government will also bring in similar quarterly reporting requirements for corporation tax, perhaps also from as early as 2020. However, to date, there has been no formal consultation on how MTD for corporation tax would work in practice. Companies, therefore, need to continue to watch this space – and be prepared to engage with government once proposals are published.

Digital tax for individuals

Quarterly reporting as outlined above will only apply to an individual's business income. However, the MTD project aims to digitise other aspects of tax reporting. Individuals can already access a Personal Tax Account, which brings together information such as employment income and state pension details, and which allows the individual to update certain information. Over time, the intention is to feed more data through to these accounts – including details of any partnership income and bank account interest. At the same time HMRC are making more use of data in real time, to – for example – adjust tax codes to take account of changes in-year, meaning that those in employment are more likely to have the correct amount of tax deducted by the Pay As You Earn (PAYE) system.

In summary, the UK may not quite be on track to realise the government's initial vision of "the death of the tax return" by 2020, but it is on the cusp of significant change in tax reporting and record keeping. Taxpayers need to make sure that they are prepared for the changes ahead.

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United States

IRS provides guidance on section 965 transition tax

On December 22, 2017, President Trump signed "an Act to provide for reconciliation pursuit to Titles II and V of the concurrent resolution on the budget for fiscal year 2018" (a.k.a. the "Tax Cuts and Jobs Act")("the Act") into law. The Act is the most significant overhaul of America's tax system in decades and includes fundamental changes to international taxation in the U.S. The vast majority of the statutory changes impact 2018 filing years, and beyond. The most significant component of the Act that impacts 2017 income tax filings is the deemed repatriation of deferred foreign income. The deemed repatriation of deferred foreign income statute is a one-tax tax on certain income earned outside the U.S. The one-time income inclusion related to offshore earnings denotes a point of demarcation from the historic taxing regime to the new taxing regime.

Deemed repatriation of deferred foreign income

Under pre-Act law, U.S. persons were generally not taxed in the U.S. on foreign subsidiary income until it was repatriated in the form of a dividend. Under section 965 of the Act, U.S. shareholders are required to pay a "transition tax" on the untaxed foreign earnings of specified foreign corporations as if those earnings had been repatriated to the U.S. The term "transition tax" is a reference to the aforementioned transition from the old regime to the new regime. Some of the most salient considerations of the new statute include:

- Deferred income held in cash would be effectively taxed at 15.5 percent and any remaining amounts at 8 percent. (Section 965(c)). "Cash" is a defined term and includes other liquid assets.
- An election is available to pay the tax liability over an eight-year period. (Section 965(h)).
- Special rules exist for S-corporations that would allow for continued deferral. The available deferral would generally end when a "triggering event" occurs. "Triggering event" is one of many newly defined terms. A triggering event for section 965 deferral generally occurs when the structure or ownership of the S-corporation is altered in some way.
- The income inclusion amount can be reduced by earnings and profits (E&P) deficits. There is now even greater pressure to be able to document the global E&P position of U.S. taxpayers.
- A reduced foreign tax credit applies to the inclusion. (Section 965(g)). This generally relates to C-corporation taxpayers.

The statute, as drafted, left many significant outstanding questions that needed to be addressed in calendar year 2017 income tax filings. Additionally, the impact of section 965 appears to be wildly inconsistent between the types of U.S. taxpayers (individuals, C-corporations, S-corporation shareholders, etc.). It is unlikely that technical corrections will be available soon and it is equally unlikely that full-blown regulations are in the foreseeable future. Therefore, the Internal Revenue Service ("IRS") has been working to provide additional guidance in the form of notices. Notices 2018-07 and 2018-13 were issued by the IRS in January. These notices provided some of the much-needed guidance related to the following section 965 application issues:

- Details were provided on how to calculate the potential income inclusion amount, including the measurement of E&P as well as the process to allocate deficit E&P pools against positive E&P pools.
- Details were provided related to the participation exemption amount. The participation exemption will reduce the inclusion amount such that the effective tax rate on the gross inclusion amount will align with the aforementioned 15.5 percent and 8 percent effective tax rates.
- Details were provided on how to measure cash. Cash includes cash, net accounts receivables, the fair market value of actively traded personal property, commercial paper, certificates of deposit, governmental securities, short-term obligations and foreign currency. The cash date of measurement is either the last day of the 2017 year or the average balance of the prior two yearends (whichever amount is higher).
- "Specified Foreign Corporations" ("SFC") is another newly defined term. SFCs are the entities whose earnings are potentially pulled into the one-time income inclusion amount. SFCs include controlled foreign corporations as well as any foreign corporation with respect to which one or more domestic corporations is a U.S. shareholder (10 percent corporations).

On March 13, 2018, the IRS issued a series of frequently asked questions (FAQs) that outlined how taxpayers subject to the Section 965 transition tax should report and pay the tax liability on their 2017 income tax returns. The FAQs also include information on various elections taxpayers can make under section 965. The FAQs include, in part:

- Which U.S. taxpayers are required to report amounts under section 965 on a 2017 income tax return
- How, and in what format, amounts are reported on 2017 income tax returns
- What elections are available, who can make those elections, how the elections are made and election due dates with respect to section 965 on 2017 income tax returns
- How should a taxpayer pay the tax resulting from section 965 for 2017 income tax returns?
- Expanded Form 5471 filing requirements and disclosure statement guidance.

Also, the FAQs provide several disclosure and election templates for taxpayer reference.
The IRS has promised to continue issuing section 965 guidance throughout the 2017 tax filing season. Additional guidance related to the post-2017 application issues of the Act is also forthcoming.

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United States

Tax reform complicates things for foreign partners in US businesses

The new law upends the Grecian Magnesite decision. Foreign partners structuring an exit of a U.S. partnership interest need to reconsider their strategies.

Like all those subject to the U.S. tax system, foreign partners of U.S. businesses have long had to navigate a difficult set of rules and regulations when the time comes to divest of their ownership. But just when these partners seemed to have been granted some clarity in the landmark 2017 Grecian Magnesite Mining tax court case, new tax reform legislation reversed these hard fought gains and added new layers of complexity.

As part of the Tax Cuts and Jobs Act, Congress passed two significant provisions:

- First, the proportion of any gain attributable to a U.S. trade or business resulting from the direct or indirect sale, exchange, or other disposition of a partnership engaged in a U.S. trade or business, is subject to U.S. taxation. The gain is reduced by any gain from the sale of a U.S. real property interest subject to taxation under the Foreign Investment in Real Property Act of 1980 (FIRPTA).
- Second, the purchaser or other withholding agent of an interest in a partnership engaged in a U.S. trade or business is required to withhold and remit 10 percent of the gross sale price that is attributable to a nonresident alien's proportional gain or loss of the sale unless: the purchaser receives an affidavit that the seller is a U.S. person; it is determined that no portion of the gain or loss is attributable to a U.S. trade or business; the IRS agrees to a lower withholding amount; or the partnership is publicly traded.

Before we get to the unanswered questions and difficulties these new provisions impose on foreign partners in U.S. partnerships, it's helpful to review the previous tax treatment and related rulings that brought us to where we are today.

Resolving the debate over tax-triggering "effectively connected income"

The sale or exchange of a partnership interest in a business is generally treated as the sale or exchange of a capital asset, so any gain or loss will also result in a capital gain or loss. Nonresident aliens are only subject to U.S. income tax on capital gains if those gains are treated as U.S. source income "effectively connected" with a U.S. trade or business. Although there is no strict definition of what constitutes a U.S. trade or business, U.S. courts have defined it as a profit-oriented activity conducted in the United States by a taxpayer (or his or her agents) that is "considerable, continuous, and regular." This activity must transcend mere ownership of private property. Nonresident aliens owning an interest in a partnership that does business in the United States are considered to be engaged in a U.S. trade or business; this subjects the foreign partner to U.S. taxation on his or her share of allocable income.

In 1991, the IRS released Revenue Ruling 91-32, which concluded that any gain resulting from the sale or exchange of an interest in a partnership with a U.S. trade or business that operated through a U.S. fixed location would result in U.S. effectively connected income (ECI). This was deemed so to the extent of the partner's distributive share of unrealized gain or loss of the partnership that is attributable to property used (or held for use) in the partnership's U.S. trade or business.

To arrive at this conclusion, the IRS applied an "aggregate" theory approach to partnership taxation. First, the IRS reasoned that a foreign partner is treated as engaged in a U.S. trade or business through his or her ownership in a partnership engaged in a U.S. trade or business. It then reasoned that the fixed place of business of the partnership is attributed to the foreign owner. As a result, the IRS took the position that any gain attributable to the U.S. trade or business resulting from the sale or exchange of the partnership would be U.S.-sourced ECI via the partnership's fixed place of business. This would then subject the foreign partner to U.S. taxation on the sale of the partnership interest.

From the outset, Rev. Rul. 91-32 proved largely ineffective and unenforceable, mainly because, at the time, the U.S. tax code did not contain any provision that expressly states that gains from the sale or exchange of a partnership interest by a nonresident alien individual or foreign corporation is treated as ECI of a U.S. trade or business.

Undeterred, the IRS continued to enforce Rev. Rul. 91-32, which culminated in the landmark 2017 case Grecian Magnesite Mining, Industrial & Shipping Co., SA v. Commissioner (Grecian Magnesite). Contrary to the IRS's position, the tax court applied the general partnership rule, which is to treat the sale or exchange of partnership interest as a sale of personal property. The sale of personal property is sourced based on the residence of the seller; therefore, a foreign owner would not be subject to U.S. tax on any gain from the sale or exchange of a partnership interest engaged in a U.S. trade or business. However, if a portion of the gain is attributable to U.S. real estate, the FIRPTA rules apply, subjecting the foreign partner to U.S. tax on that piece of the gain. The purchaser of the partnership interest would be required to withhold 15 percent of the gross purchase price associated with the U.S. real property interest. The tax court's rejection of Rev. Rul. 91-32 seemed to finally put an end to this long-standing dispute.

Tax reform legislation leaves us with many unanswered questions

Unfortunately, the beneficial Grecian Magnesite ruling was short-lived. As part of the recent passage of tax reform legislation, Congress effectively codified Rev. Rul. 91-32, giving the IRS long desired tax law, and puts those involved in these types of transactions back in the difficult position to comply.

There are several other issues that need to be resolved:

- How to value a partnership's proportional share of its U.S. trade or business
- How to value assets attributable to a U.S. trade or business
- How the IRS will be able to identify and enforce certain transfers of foreign partnership interests with an active U.S. trade or business
- How the new law will affect current and future income tax treaty negotiations.

Foreign partners structuring an exit from a U.S. partnership interest should carefully consider how to treat any gain and make sure the new provisions are appropriately applied.

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