Deloitte.

International Tax

World Tax Advisor

10 April 2015

In this issue:

United Kingdom diverted profits tax now in effect

Diverted profits tax (DPT) applies at a rate of 25% from 1 April 2015 to profits of multinationals that are considered to have been artificially diverted from the UK (and at a rate of 55% to oil and gas companies operating inside the "ring fence"). The DPT is intended to encourage companies to adjust their corporate tax position to reflect the expected outcomes from the G20/OECD base erosion and profit shifting (BEPS) project. DPT is distinct from corporation tax, and the UK considers it will fall outside the scope of the UK's existing bilateral tax treaties.

The revised legislation on the DPT received Royal Assent on 26 March 2015, with the UK tax authorities (HM Revenue and Customs (HMRC)) publishing detailed interim guidance on 30 March 2015 setting out further commentary and including examples.

Scope of DPT

DPT applies in two distinct situations: (i) where a group includes a UK company (or UK permanent establishment (PE) of an overseas company) and there is a tax mismatch as a result of an entity or transactions that lack economic substance; and/or (ii) where a foreign company has artificially avoided having a taxable presence (PE) in the UK. In either situation, there is a requirement that there must be activity (people) in the UK.

Broadly speaking, a tax mismatch exists where the overseas tax is less than 80% of the UK tax that would have applied (with an exclusion for cases where the overseas tax rate is low because of losses). As a result, income taxed in high-tax countries will not be subject to DPT.

An exemption from DPT is available for small and medium-sized businesses (based on the existing interpretation of the EU limits used in UK transfer pricing legislation). For avoidance of UK PE cases, there are further exemptions (revised in the final legislation and now broader) where either (i) total UK sales made by the group that are not within the corporation tax net are less than GBP 10 million per annum, or (ii) UK expenses of the group are less than GBP 1 million per annum.

Loan relationships (financing arrangements) and their derivatives are excluded from the scope of DPT.

Intragroup transactions involving a lack of economic substance: DPT applies to cases where a UK company is party to arrangements involving transactions between it and another group company, where:

- A material provision has been made (a transaction or series of transactions) between connected parties;
- A tax mismatch arises (as described below); and
- There is insufficient economic substance (as described below).

This approach is extended to situations where a non-UK resident company trades through a UK PE.

Artificial avoidance of a UK permanent establishment: DPT applies to cases where foreign companies are trading and there is substantial activity in the UK in connection with the foreign company's supplies of goods, services or other property, but creation of a UK PE has been avoided – for example, where there is significant sales activity in the UK, but no conclusion of contracts. A PE will be considered to have been avoided if:

- A connected party is carrying on activity in the UK in connection with the supply of goods, services or other property by a foreign company;
- It is reasonable to assume that the arrangements are designed so that the foreign company does not have a UK PE (it is irrelevant whether there are any commercial or other objectives); and
- Either or both of (i) a tax mismatch condition (which includes a requirement for there to be a lack of economic substance), or (ii) a tax avoidance condition are fulfilled:
    - The tax mismatch condition is described below;
    - The tax avoidance condition is that the main purpose, or one of the main purposes, of the arrangements is to avoid the charge to UK tax.

Tax mismatch: Certain conditions must be fulfilled for a tax mismatch to arise (in relation to either situation). There must be a deductible expense or a reduction in taxable income for either (i) the UK company or UK PE, or (ii) the foreign company that has avoided a UK PE.

Broadly, a tax mismatch relates to the tax reduction calculated by comparing the rate of tax that would have applied to (i) the UK company/UK PE, or (ii) the foreign company (depending on the circumstances) with the tax actually paid in other countries on the diverted profits, including any withholding tax suffered or supplementary charge in respect of oil and gas ring-fence trades. In calculating this reduction, losses utilized in the overseas jurisdiction are disregarded, but all other claims and deductions are assumed to have been made. There also are exemptions where the mismatch relates to pension contributions, payments to charity, payments to those with sovereign immunity from tax or payments to widely-held offshore funds or authorized investment funds.

A “hurdle test” applies – there will not be a tax mismatch unless the tax paid elsewhere on the diverted profits is less than 80% of the equivalent actual tax payable (again excluding the effect of losses).

Insufficient economic substance: The insufficient economic substance requirements have three updated tests – and only one needs to be satisfied for a tax mismatch to arise. Each of the three tests can apply where it is reasonable to assume that the transaction(s) were designed to secure the tax reduction, unless:

- Under the first two, transaction-based tests, looking at all accounting periods on a group basis, the nontax benefits exceed the financial benefits of the tax reduction applied to (i) a single transaction, or (ii) a series of transactions. HMRC’s guidance says that these tests apply primarily to transactions designed to shift profits within a group, and account will be taken of the ongoing activity of the company (per the entity-based test).
- Under the third, entity-based test, either of two conditions is fulfilled. For the low-tax entity, either (i) looking at all accounting periods, the nontax benefits of staff contributions exceed the financial benefit of the tax reduction, or (ii) for an accounting period, the income attributable to staff contributions (excluding holding, maintaining or protecting assets) exceeds other income referable to the transactions.

In relation to avoidance of PE cases, the insufficient economic substance requirements also look at onward payments by the foreign company to a low-tax jurisdiction. They are aimed at situations where one company may be avoiding a PE in the UK, but itself has only a small margin as a result of “on-payments” to low-tax countries where there is little substance.

Notification requirements

A company must notify HMRC if it is potentially within the scope of DPT within three months of the end of the accounting period. A penalty may apply if there is a failure to make this notification. As a transitional measure, for accounting periods ending on or before 31 March 2016 (i.e. the first period subject to DPT) the notification deadline is extended to six months from the end of the accounting period.

The requirement to notify is predicated on the financial benefit of the tax reduction being significant relevant to the nontax benefits of the transactions, or, where the avoided PE is in scope because of the tax avoidance condition, that there is an overall reduction in the amount of tax that otherwise would have been payable.

There are a number of situations in which the notification requirement does not apply:

- If it is reasonable to conclude that no DPT charge will arise for the accounting period;
- If HMRC has confirmed that there is no duty to notify because sufficient information has been provided by the company and examined by HMRC;
- If it is reasonable to conclude that sufficient information has been provided by the company and examined by HMRC; or
- If nothing has changed from the previous period (where notification or sufficient information has been given).

The interim guidance from HMRC includes a template for notification and a mailbox for the preferred electronic notification.

Calculation of the DPT

HMRC calculates DPT in two stages. First, HMRC will make an initial estimated charge based on its best estimate of the DPT due (although there is a presumption that where HMRC considers that expenses are or may be inflated (to create the tax mismatch), the expenses should be reduced by 30% in calculating the DPT). During this estimation stage, it is not necessary for HMRC to determine whether the transactions are on arm's length terms under transfer pricing rules. The initial charge is designed to require an initial DPT payment.

In the second stage, HMRC will calculate DPT based on the facts and circumstances, by reference to the relevant alternative provision that it is "just and reasonable" to assume would be substituted for the actual provision undertaken. In some cases, the actual provision will be the one used to calculate DPT, where the matter relates to expenses that would still be deductible in the UK under the relevant alternative provision (and the DPT calculation therefore is solely in relation to the pricing).

In avoided PE cases, it is assumed that there is a "notional PE" of the foreign company in the UK, and the usual rules for the attribution of profits to PEs apply (the HMRC guidance makes it clear this includes the OECD's internationally agreed approach). As such, it is necessary to consider "significant people functions" in relation to activities inside and outside the UK. In addition, transactions of the foreign company with other entities will be relevant to the analysis, because a "look-through" rule will negate the effects of any excessive expenses paid by the foreign company to a low-tax jurisdiction where there is little or no substance. This is achieved by reference to the relevant alternative provision as for UK-based lack of economic substance cases.

The calculation of DPT will include a credit for any UK corporation tax, any overseas tax (that is similar to corporation tax) paid on the same profits by either the overseas company or another group company, withholding tax paid and controlled foreign company (CFC) charges paid in relation to the UK or any overseas CFC regime.

Administration of the DPT

As DPT is a new tax, it has its own administration system. It does not form part of the corporate tax self-assessment system, and is an assessed tax such that HMRC must issue a "notice" of the DPT charge.

- HMRC must issue a preliminary notice that there is a DPT charge within two years of the end of the accounting period (or four years if there has been no notification from the taxpayer).
- The company has 30 days to make representations on the preliminary notice.
- HMRC has a further 30 days to either issue a charging notice or confirm no notice will be issued.
- The company must pay the DPT in the charging notice within 30 days, together with any interest due from six months after the end of the accounting period. There is no right to defer payment. Penalties and interest for late paid tax will apply if the tax is not settled when due.
- HMRC has 12 months to review and potentially amend the charging notice.
- The company has 30 days to appeal the charging notice after the review period, or it will become final.

Final resolution of any disputed charge will occur through the UK tax tribunal and courts.

HMRC has confirmed that it will not be possible to obtain a clearance in respect of DPT, nor will DPT be formally included in advance pricing agreements (APAs). However, HMRC will be able to provide a view on the application of DPT to specific circumstances, as well as confirmation where there is no duty to notify in circumstances set out above.

Comments

DPT will apply where a multinational group enjoys a tax advantage and it is reasonable to assume that the alternative would be for additional profits to be taxed in the UK. The tax is focused on UK activity that is not properly remunerated when viewed through a BEPS lens.

It appears that the UK would like to encourage multinationals that have structures potentially affected by the BEPS project to change at least the UK aspects of those structures. The tax rate specifically encourages this, as DPT is 5% higher than the usual 20% corporation tax rate. However, before the G20/OECD agree upon revisions to the international rules for transfer pricing and PEs – due in September 2015 – companies may be concerned that they do not yet have sufficient information on which to make structural changes.

The final legislation is much improved in terms of clarity from the draft issued in December 2014, and the interim guidance and examples are helpful in providing insight into what HMRC sees as the scope of DPT. Questions remain, however, in relation to interpretation of areas such as what constitutes insufficient economic substance, the interaction of transactions-based and entity-based tests, how to compute "financial benefits" and how the value for staff contributions should be distinguished from other income.

Since DPT is designed to operate outside the UK's tax treaties, it will not be limited or supported by standard tax treaty provisions, such as those on PEs, the taxation of business profits, access to double tax relief and mutual agreement procedures and the exchange of information between governments.

The narrowing of the notification requirements in the final legislation is very helpful and will go some way toward reducing unnecessary compliance costs. Exempting multinationals with less than GBP 10 million UK sales (ignoring amounts already within the scope of corporation tax) also is helpful, although the new exemption for those with UK costs below GBP 1 million seems unlikely to help many.

Given the complexity of the new rules, companies will wish to analyze and understand the law and guidance before discussing their position with HMRC, either as part of an APA process in relation to transfer pricing, or separately to obtain some comfort on the application of DPT to their circumstances.

— Bill Dodwell (London)
Partner
Deloitte United Kingdom
bdodwell@deloitte.co.uk

Alison Lobb (London)
Director
Deloitte United Kingdom
alobb@deloitte.co.uk

Australian government issues tax discussion paper to encourage dialogue on tax reform

On 30 March 2015, the Australian government released a broad-reaching tax discussion paper that aims to start a dialogue about a tax system for the future. Consistent with that aim, the paper places many tax and policy issues on the table and asks a number of open-ended questions, but does not offer any conclusions or proposals. A formal submissions process has commenced, with a closing date of 1 June 2015. Submissions will be taken into account in the government's tax Green Paper, which is expected to be released in the second half of 2015. Final policy proposals will be contained in an eventual tax White Paper, which will be taken as a policy platform to the next election.

The discussion paper addresses the main tax reform targets, such as the corporate tax rate, the goods and services tax (GST) and Australia's international arrangements, and recognizes that all elements in the mix of Australia's taxation system will need thorough examination and assessment to ensure a stable and sustainable taxation system for the future.

As a prelude to outlining areas for potential reform, the discussion paper surveys Australia's current federal and state tax system and how it compares to other tax systems internationally. Key points include:

- Australia's overall tax burden is relatively low, compared to that of other developed countries.
- Australia relies heavily on income taxes, particularly company and individual income tax, compared to other developed countries and key regional competitors. This has remained unchanged since the 1950s, despite changes in the economy, and this

reliance is projected to increase further, largely as a result of wages growth leading to individuals paying higher average rates of tax.
- Much of the burden or incidence of corporate tax falls on Australian employees because, over time, a higher corporate tax rate results in lower amounts of capital investment, reducing the output or productivity of labor and the real wages of employees.
- Complexity and compliance costs are a growing problem in the tax system. Tax compliance costs are around AUD 40 billion per year.

The paper highlights several key corporate tax issues, including a possible reduction in the corporate tax rate, inbound and outbound investment, design of incentives for innovation, GST and other business tax issues, such as transfer pricing.

Possible reduction of the corporate tax rate

Corporate income tax currently is levied at a rate of 30% on taxable income earned by corporations. Australia's corporate tax rate is described in the discussion paper as being high relative to other countries in the Asia-Pacific region and OECD member countries, and the paper generally seems supportive of a reduction in the rate.

The discussion paper sets out a number of expected positive and negative impacts associated with a reduction in the corporate tax rate. A lowering of the rate would increase Australia's appeal as a place to do business and would encourage greater levels of investment. On the other hand, a reduced corporate tax rate would cause tax revenue to decline, although this negative impact would be partially offset by increased economic activity from new investment.

The paper highlights digitization and globalization of the economy as positive developments that have enabled businesses to innovate, increase productivity and develop sophisticated value chains across multiple countries. At the same time, however, the globalized economy has increased opportunities for multinational groups to minimize their tax liabilities through profit shifting. Notwithstanding recent reforms tightening Australia's thin capitalization, transfer pricing and general anti-avoidance rules, the discussion paper indicates that lowering Australia's corporate tax rate would reduce the underlying incentive for companies to engage in profit shifting, debt loading and tax avoidance.

Achieving any reduction of the corporate tax rate will be challenging in the context of the prevailing global and domestic economic conditions. Changes to the company tax rate cannot be viewed in isolation; rather, the White Paper process must address a comprehensive package of linked reform measures, and anticipate both short-term and long-term impacts.

Inbound investment

The discussion paper observes that there is a range of different tax treatments for inbound investment, depending on the nature of income derived; the main driver of these differences is the distinction between active and passive investment. A few examples given are:

- Business income from corporate tax entities is taxed at 30%;
- Interest under domestic law and tax treaties generally is taxed at 10%;

- Capital gains from land or land-rich assets are taxed at 30%;
- Rental income received through managed investment trusts generally is taxed at 15%; and
- Gains from disposals of certain assets by foreign funds under the investment manager regime are tax exempt.

The differing tax treatment of various categories of investment income may affect the activities that nonresidents choose to invest in, and the vehicles that they use to invest through. The discussion paper queries how the tax system should be designed to attract particular forms of inbound investment (e.g. by distinguishing active versus passive income or portfolio (i.e. less than 10% holding) vs. nonportfolio investments).

Outbound investment

As with inbound investment, there is a range of differing tax treatments for outbound investment income. Some examples include:

- Passive income (e.g. dividends, interest and royalties) from holdings of less than 10% is taxable;
- Dividends from holdings of more than 10% are tax exempt, subject to certain conditions;
- Income attributed under the controlled foreign companies rules is taxable;
- Foreign branch profits are potentially tax exempt;
- Capital gains on the sale of shares in a foreign company with active assets are tax-exempt; and
- Other capital gains are taxable.

The discussion paper asks whether these differing treatments distort investment decisions, and about the extent to which the tax system should encourage particular forms of outbound investment.

Designing incentives for innovation

The discussion paper proposes a review of the research and development (R&D) tax incentive within the broader context of tax incentives for innovation. The R&D tax incentive currently provides a 45% refundable tax offset for eligible entities with an annual aggregated turnover of less than AUD 20 million for expenditure on eligible R&D activities in Australia; the incentive provides a 40% nonrefundable tax offset for all other entities. The discussion paper suggests that the government should consider whether awarding direct grants would better achieve the objective of incentivizing innovation and whether the refundable R&D tax incentive should be available to a wider range of companies (other than those with annual aggregated turnover of less than AUD 20 million).

Other business tax issues

The discussion paper also solicits feedback on a number of broader business tax issues, including:

- Suggestions as to how to simplify the corporate tax system;
- Transfer pricing;
- The tax treatment of returns to debt and equity;
- The distinction between revenue and capital;
- Improvement of the regime for the taxation of financial arrangements; and
- The ability to better align tax and accounting definitions of income.

GST

The discussion paper focuses on ways to broaden the GST base. While not specifically a business tax, the 10% GST is Australia's third largest tax source, representing 16% of total government revenue (in 2013/14). The state and territory governments receive all of the GST revenue collected by the federal government.

With GST being paid on only 47% of the consumption of all goods and services (in 2012), the discussion paper suggests applying GST to the main categories of consumption currently attracting GST-free treatment (i.e. fresh food, health, education, childcare, water, sewerage and drainage services) and input taxed treatment (i.e. residential rent and financial supplies). Apart from an implicit GST revenue boost, the discussion paper also emphasizes the reduction in complexity and distortions that would come from eliminating GST exemptions.

In terms of the distributional effects of the GST exemptions, the discussion paper points out that the exemptions are available to all households, regardless of income level, potentially making them less effective as a means of targeting assistance to lower-income households.

The paper also recognizes the pressure being placed on the GST base by the digital economy – specifically, the growth in online retail spending by consumers and the resulting increase in importations of goods, services and intangibles, most of which are exempt from GST under current arrangements.

Changes (if any) to the GST rate, base and administration should aim to achieve the following goals:

- Provide a larger and more sustainable source of GST revenue as part of an overall approach aimed at ensuring that the state and territory governments have sufficient funding to finance the services and functions for which they are responsible.
- Reduce complexity and compliance costs for suppliers, particularly small businesses. A single rate of GST, applied to the broadest range of goods and services, with minimal exemptions, would contribute substantially to achieving this objective.

Changes to the design of the GST would need to be accompanied by an adequate and appropriately structured compensation package for lower-income households.

A national conversation

The discussion paper is the first step in a long journey of tax reform. The purpose of the paper is to provide a platform for a broad debate about tax design, in conjunction with principles of equity, efficiency and simplicity. Whether the issues raised in the paper result in a change in significant tax policy or in the tax mix remains to be seen, and will be based on the strength of submissions and debate.

— Julian Cheng (New York)
Client Service Executive
Deloitte Tax LLP
julicheng@deloitte.com

Albania:
Foreign individuals exempt from social/health insurance contributions

A decision published in the official gazette on 3 February 2015 and that applies retroactively as from 1 January 2015 expands the group of individuals who are exempt from contributing to Albania's social and health insurance systems.

Under the new rules, an individual employed by a foreign entity that is not required to register for tax purposes in Albania and who is seconded to Albania to carry out a specific service is exempt from making contributions to Albania's social and health insurance system, provided the foreign employer has concluded a contract with an Albanian legal entity that is not a branch or subsidiary of the foreign entity and the following criteria are met:

- There is a tax treaty between Albania and the country in which the foreign employer is resident;
- Certain registration and work permit requirements are met;
- The foreign individual has fulfilled his/her tax obligations in Albania; and
- The Albanian entity requests on a quarterly basis that the foreign employer provide a list of seconded employees and a document confirmed by the competent authorities in the home country that certifies that the social security contributions are being paid for the foreign individual in the home country.

— Olindo Shehu (Tirana)
Partner
Deloitte Albania
oshehu@deloitteCE.com

Czech Republic:
Electronic filing mandatory

As from 1 January 2015, certain taxpayers in the Czech Republic are required to submit specific documents electronically to the tax authorities. The new filing obligation applies to entities that are required to have their financial statements audited and entities that have a "data box," or representatives of such entities (a data box is a means of communicating with the Czech government that does not require an electronic signature or other means to validate an electronic filing). Documents that fall within the scope of the electronic filing requirement include tax returns (e.g. income tax, VAT, real estate tax returns) and registrations, as well as changes to registration data.

The Czech tax authorities have published an electronic corporate income tax return that includes appendices relating to certain accounting documents, such as the balance sheet and profit and loss account (as well as an appendix on related party transactions). As a result, certain accounting information will have to be uploaded to the government's web application that contains all of the electronic filing forms (the EPO). If a taxpayer files the documents in another format (e.g. by attaching a PDF copy of the financial statements signed by the statutory body or by submitting a hard copy of the financial statements to the tax authorities), the taxpayer will be deemed not to be in compliance with the electronic filing requirement. In such a case, the tax authorities will request that the taxpayer rectify the deficiency, and if taxpayer fails to provide the appendices in the prescribed format by the deadline stipulated by the authorities, the tax return will be treated as invalid.

Failure to comply with the electronic filing requirement will result in a fine of CZK 2,000, which may be increased by the tax authorities to CZK 50,000 if the noncompliance causes "substantial complications" for the authorities.

— Jaroslav Škvrna (Prague)
Partner
Deloitte Czech Republic
jskvrna@deloittece.com

Vlastimil Rehak (Prague)
Manager
Deloitte Czech Republic
vrehak@deloittece.com

Korea:
2015 tax law reforms in effect

Korea's Ministry of Strategy and Finance promulgated the 2015 tax law reforms on 3 February 2015; the reforms generally are effective from 1 January 2015 (for previous coverage, see the *World Tax Advisor*, 24 October 2014). Additional measures in the reform that affect companies include the following:
URL: http://newsletters.usdbriefs.com/2014/Tax/WTA/141024_6.html

- The transfer pricing threshold for reporting cross-border service transactions with foreign related parties is increased from KRW 500 million to KRW 1 billion for service transactions with foreign related parties in general, and from KRW 100 million to KRW 200 million for service transactions with an individual foreign related party. In addition, a penalty of KRW 10 million applies for failing to submit the required documents by the submission due date (under prior law, a penalty applied only if documents were not submitted after a request by the Korean tax authorities).
- An advance pricing adjustment system is introduced between the National Tax Service (NTS) and the customs service, under which a taxpayer may simultaneously request a unilateral advance pricing agreement and an advance customs valuation arrangement (rather than having to request separate agreements from both the NTS and the customs service). The NTS will make a decision on the request within 90 days from the date the application is received.

- The criteria for classification of small and medium-sized enterprises (SMEs) have been simplified. The revised SME classification is based only on the sales revenue, eliminating the criteria regarding the number of employees or equity capital.

— Seung Chan Park (Seoul)
Partner
Deloitte Korea
separk@deloitte.com

Young Pil Kim (Seoul)
Director
Deloitte Korea
youngpkim@deloitte.com

Mexico:
Overview of requirements to deduct prorated expenses under shared expense arrangements

Mexico's Tax Administration Service (SAT) published regulations on 16 October 2014 that allow Mexican taxpayers to deduct shared expenses incurred on a pro rata basis with nonresidents, provided certain requirements are met, despite a specific prohibition on the deduction of such expenses in the Income Tax Law (ITL) (for prior coverage, see *World Tax Advisor*, 14 November 2014). This article summarizes certain requirements under the regulations.
URL: http://newsletters.usdbriefs.com/2014/Tax/WTA/141114_4.html

The October regulations were a consequence of the decision issued by the second Chamber of the Supreme Court of Justice on 19 March 2014, in which the court held that the prohibition under the ITL could not be justified, since Mexico's transfer pricing rules require taxpayers to adjust their transactions with nonresident related parties to arm's length terms. The Supreme Court decision does not include a specific date for the termination of the prohibition on the deduction of prorated expenses. This leaves open the possibility that prorated expenses incurred in previous years may be deductible for tax purposes if the requirements of the new regulations are met.

Requirements for deducting shared expenses

In addition to the general deductibility requirements contained in the ITL and other regulations, specific requirements must be met under the October regulations for shared expenses to be deductible; for example, such costs must be strictly necessary for the company to carry out its activities and there must be a reasonable connection between the expenses incurred and the benefit received, or expected to be received, by the company. Additionally, the taxpayer must demonstrate that the transaction was agreed upon at arm's length terms and must maintain documentation relating to transfer pricing.

Reasonable connection between expenses incurred and benefit received: It is necessary to demonstrate that there is a reasonable relationship between the expenses incurred and the benefit received, or expected to be received, by the taxpayer that incurred the expenses. The regulations emphasize the importance of the transfer pricing analysis for prorated expense transactions, and lay down the following specific requirements:

- Each party to the expense sharing arrangement must have access to the details of the transaction, how the anticipated profits will be determined, the prorated expenses incurred and the profits received.
- The participants must be companies that will mutually benefit from the agreement.
- The agreement must specify the nature and extent of the benefits that will be available at a global and an individual company level with respect to the expenses incurred and prorated among the members of the group.
- The agreement must provide for prorated expenses, using a method of allocation that reflects the costs in relation to the expected benefits.
- The agreement must specify the scope of the transactions covered and the term of the agreement.
- The following transfer pricing documentation must be retained for each transaction that takes place; otherwise, the shared expenses will not be deductible:
  - Name, country of incorporation, tax residence, country where the company has its main business administration or place of effective management, tax domicile and the tax identification number of each related party involved in the prorating of global expenses or that will benefit from the prorating;
  - Description of the transactions and the terms of the agreement;
  - Functions or activities performed by each related party involved in the transaction and, where appropriate, the assets used and risks assumed by each party;
  - Documentation supporting the global expenses incurred, including documentation indicating that the taxpayer confirms that an entity resident abroad effectively incurred such expenses;
  - Details on how the prorated expenses were paid and evidence of such payment (bank statement, record of wire transfer, journal entry, etc.);
  - Documentation demonstrating that the transaction was carried out on arm's length terms, the transfer pricing method used and how the method was developed;
  - Documentation showing how comparable operations or companies were determined for each transaction; and
  - Supporting documentation regarding future transactions and the projections used as a basis for calculating prorated expenses and expected benefits, as well as the prorated expenses effectively incurred and benefits actually received.

Actual provision of services to related parties: If an expenditure for services is incurred between related parties, the taxpayer is required to demonstrate that the services actually have been provided to be eligible to deduct the expenditure. Unless the taxpayer produces evidence to the contrary, services will be deemed not to have been provided if:

- Under the same conditions, an unrelated party would not have been willing to pay for such services or perform the services;
- A related party performed the services only because of its interest in one or more of the related parties;
- Services or transactions carried out by a related party involve duplication of a service performed by another related party or a third party; or
- An expenditure relates to "duplicated" services (e.g. services that could have been carried out by the taxpayer's own personnel), or is included in other costs, expenses or

investments made by the taxpayer (e.g. interest, royalties, technical assistance fees, commissions or advertising expenses).

Comments

The regulations have been well received by multinational groups, since historically it was not possible to deduct an allocation of shared expenses that benefited subsidiaries or affiliated companies in Mexico. Under the regulations, these groups may properly deduct expenditures that benefit their companies in Mexico, provided they meet the relevant transfer pricing and tax requirements.

However, the complexities resulting from the number and nature of the requirements for the deduction may prevent taxpayers from benefiting from the deduction. In addition, some concepts included in the rules, such as a "reasonable relation between the expenses incurred and the benefit received" imply a subjective assessment, but the regulations do not provide procedures or guidelines that allow taxpayers to clearly establish they have fulfilled this requirement. Therefore, taxpayers should consider evaluating on a case-by-case basis the costs and benefits of claiming a deduction for expenses incurred pro rata with nonresidents.

The 2014 Supreme Court decision may allow taxpayers to pursue deduction claims for years before 2014 through the courts, so the availability of such deductions in prior years should not be dismissed. The regulations may provide taxpayers with some indication of the factors the tax authorities likely would consider in evaluating the deductibility of this type of expense.

— Miguel Llovera (Mexico City)
Partner
Deloitte Mexico
mllovera@deloittemx.com

Simón Somohano (Tijuana/Mexico City)
Partner
Deloitte Mexico
ssomohano@deloittemx.com

Namibia:
2015/2016 budget announced

The 2015/2016 budget announced by the Minister for Finance on 31 March 2015 includes a number of measures that would affect companies:

- The corporate tax rate for nonmining and nonmanufacturing enterprises would be reduced from 33% to 32% (the rate reduction previously was proposed and was expected to be enacted in 2014, but the effective date remains uncertain).
- The withholding tax on services would be reduced from 25% to 10%.
- The VAT registration threshold would be increased from NAD 200,000 to NAD 500,000, and criteria for voluntary VAT registration would be introduced.
- Proceeds from the sale of a petroleum license or rights to explore, develop and produce petroleum would be taxable.
- Transfer duties would be extended to apply to the sale of shares in companies and members' interests in close corporations owning property, commercial property, land and mineral licenses.
- A new presumptive tax would be introduced for small and medium-sized enterprises.

The Minister also announced that a commission would be set up to examine the equity and effectiveness of the Namibian tax system. The commission would examine, in particular, whether the tax base should be broadened, how the share of the tax burden could be better allocated and how to maintain the competitiveness and effectiveness of the system. He also confirmed the establishment of a revenue agency and the introduction of e-filing by 2016.

No changes have been proposed to the individual tax rates or exchange control regulations.

The enactment date for the proposed changes is uncertain.

— Gerda Brand (Windhoek)
Director
Deloitte Namibia
gbrand@deloitte.co.za

Nikia Bauernschmitt (Windhoek)
Senior Manager
Deloitte Namibia
nbauernschmitt@deloitte.co.za

OECD:
Discussion draft issued on mandatory disclosure rules

The OECD released a discussion draft on Action 12 (Mandatory Disclosure Rules) of the base erosion and profit shifting (BEPS) Action Plan on 31 March 2015. The purpose of Action 12 is to come up with recommendations for the design of disclosure rules, with a view to providing tax authorities with improved, early access to information on potentially aggressive or abusive tax planning strategies by multinationals, and to deter both the promotion and the use of such schemes.

Action 12 recognizes the benefits of an increased flow of tax information to authorities to better understand tax risks and potentially abusive tax planning strategies. The 83-page draft provides an overview and comparison of existing mandatory disclosure regimes (in Canada, Ireland, Portugal, South Africa, the UK and the US) and their interaction with other disclosure initiatives and compliance tools, possible options for a design of a mandatory disclosure regime, and discussion of how to identify and define international transactions that would be captured by a disclosure regime. The approach contemplated in the discussion draft focuses on both taxpayers and promoters of tax planning schemes, and includes the following recommendations on the design of a disclosure regime for international tax schemes:

- An arrangement that incorporates a cross-border outcome would be reportable if it involves a domestic taxpayer. A domestic taxpayer would be treated as involved in a cross-border arrangement where the arrangement will have a material impact on the taxpayer’s tax reporting position. This would include a transaction with a domestic taxpayer that has material economic consequences for that taxpayer or material tax consequences for one of the parties.
- Disclosure would be required if the cross-border outcome arises in the same controlled group or the taxpayer is party to the arrangement.
- Where the person making the disclosure does not have sufficient information to provide a clear understanding of the arrangement, he/she would be required to identify the person believed to hold the missing information and certify that requests for that information actually have been made to that person.

Action 12 also calls for the design and implementation of enhanced models of information sharing for international tax schemes, but these must be coordinated with other information exchange initiatives (e.g. Actions 5 and 13 (counter harmful tax practices more effectively, taking into account transparency and substance and re-examine transfer pricing documentation, respectively)), which are not yet completed.

A public consultation meeting on the discussion draft will be held on 11 May 2015. Action 12 is to be completed by September 2015.

— Bill Dodwell (London)
Partner
Deloitte United Kingdom
bdodwell@deloitte.co.uk

Susan Lyons (Washington, DC)
Director
Deloitte Tax LLP
slyons@deloitte.com

Vietnam: New guidance on corporate tax rules issued

A decree issued by Vietnam’s government on 12 February 2015 that applies as from 1 January 2015 amends and supplements provisions of various other decrees relating to corporate income tax, as follows:

- Certain rules are amended regarding the Vietnam-source income that is subject to corporate income tax for foreign enterprises.
- Guidance is provided on certain deductible expenses:
    - Expenses incurred for occupational education and training provided to employees are deductible for corporate income tax purposes.
    - Interest expenses capitalized in the investment stage are not deductible; however, interest expenses associated with loans used to invest in other enterprises are deductible if the charter capital has been fully contributed.
    - The cap limiting deductible advertising and promotion expenses to 15% of total deductible expenses is removed.
- Changes are made to certain corporate income tax incentives, including an amended definition of “new investment projects” entitled to incentives, the imposition of conditions to obtain certain incentives and the following provisions:
    - The types of projects eligible for the incentive granting a 10% corporate income tax rate for 15 years, a corporate income tax exemption for four years and a 50% corporate income tax reduction in the following nine years have been expanded to include the following:
        - New investment projects that manufacture products on the list of supporting industrial projects prioritized for development by the government; and
        - Investment projects in the manufacturing sector (other than projects subject to special sales tax or mining projects) with investment capital of at least VND 12 trillion and that satisfy certain other specified conditions.

— Tom McClelland (Ho Chi Minh City)
Partner
Deloitte Vietnam
tmcclelland@deloitte.com

Tuan Bui (Hanoi)
Partner
Deloitte Vietnam
tbui@deloitte.com

In brief

Czech Republic: The tax authorities have published new guidance that defines the supplies that are subject to the VAT reverse charge mechanism as from 1 April 2015, provides instructions for resolving ambiguous cases and explains the advance payment procedure and corrections of the tax base. The VAT reverse charge will apply to supplies of selected goods if the aggregate amount of the tax base of the supplied goods exceeds CZK 100,000.

Egypt: The conference brochure from Egypt's Economic Development Conference in Sharm el Sheikh indicates that the government will introduce a new, fully-fledged VAT system in 2015 to replace the existing general sales tax. The new VAT law is expected to maintain exemptions on vital goods and services. The government also has announced some changes in the existing sales tax regime, in particular, in relation to the situations in which sales tax refunds can be obtained.

El Salvador: The tax administration announced on 16 March 2015 that it has expanded the electronic filing requirement for annual income tax returns to include all companies; accordingly, companies must submit their returns though one of the available electronic methods (software DET or online processing), beginning with the annual income tax return corresponding to the 2014 tax period, which is due by 30 April 2015.

European Union: The European Commission announced on 27 March 2015 that the VAT ruling pilot project will be extended to 30 September 2018. The pilot, which was launched in 2013, allows taxpayers to obtain advance rulings on the VAT treatment of complex cross-border transactions involving any two or more of the 15 participating EU member states (Belgium, Cyprus, Estonia, Finland, France, Hungary, Latvia, Lithuania, Malta, Netherlands, Portugal, Slovenia, Spain, Sweden and the UK). Under the pilot program, taxable persons planning cross-border transactions to one or more of the participating member states can request a VAT ruling on anticipated transactions; the ruling request must be made to the tax authorities of the member state in which the person is registered for VAT purposes and the request must comply with any conditions governing national VAT rulings in that member state (for previous coverage, see *World Tax Advisor*, 25 July 2014).
URL: http://newsletters.usdbriefs.com/2014/Tax/WTA/140725_ib.html

India: The Central Board of Direct Taxes (CBDT) issued a circular on 26 March 2015 clarifying that dividends declared and paid by a foreign company outside India on shares that derive their value substantially from assets situated in India does not have the effect of a transfer of underlying assets located in India and, therefore, will not be taxable in India. According to the circular, such dividends will not be deemed to be income "accruing or arising in India." Considerable uncertainty had arisen following the introduction of the indirect transfer rules in the Finance Act 2012; under these rules, a nonresident would be subject to tax in India on a transfer of shares or an interest in a foreign entity if such shares/interest substantially derive their value from assets located in India. The CBDT circular should help to dispel concerns of foreign investors.

Italy: The Constitutional Court decision that repealed the energy tax surcharge (i.e. the “Robin Hood” tax) from 12 February 2015 (for prior coverage, see *World Tax Advisor*, 27 March 2015) has raised questions regarding the period from which the surcharge ceases to be payable, as well as on the accounting consequences of the repeal. The association of Italian joint stock companies has requested that the tax authorities provide timely clarification of the applicable rules.
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/150327_8.html

Italy: The standard 22% VAT rate and the reduced 10% rate are expected to increase as from 2016, unless specific measures are taken to allow the government to achieve the same effect on public finances through other means. The 22% rate would increase to 24% as from 2016, to 25% as from 2017 and to 25.5% as from 2018, while the 10% rate would increase to 12% as from 2016 and to 13% as from 2017.

Japan: The national standard corporation tax rate reduced from 25.5% to 23.9% on 1 April 2015. The maximum rate for the income portion of the factor-based enterprise income tax reduced from 7.2% to 6% on 1 April 2015 and will further reduce to 4.8% as from 1 April 2016. The effective tax rate for corporations (inclusive of the inhabitants and local enterprise taxes), based upon the maximum rates applicable in Tokyo to a company whose paid-in capital is over JPY 100 million, is approximately 33.06% (reduced from 35.64%) for fiscal years beginning in the period from 1 April 2015 to 31 March 2016 and will be approximately 32.26% for fiscal years beginning on or after 1 April 2016.

Malaysia: A 6% goods and services tax (GST) applies as from 1 April 2015. The GST replaces the sales tax (which applied at rates of 5%-10%) and the service tax (which applied at a 6% rate). GST must be paid to the authorities within one month of the end of the taxable period (which is one month if the total annual value of all taxable supplies is MYR 5 million or more, and three months otherwise).

Malta: The VAT rate applicable to books disseminated through electronic means has been reduced from 18% to 5%, to bring the rate in line with the VAT rate that applies to books published in paper format. The measure took effect retroactively, as from 1 January 2015. The reduced rate applies solely to books supplied on a physical means of support (e.g. audio books or books published on CDs, DVDs, SD cards or USB drives). In accordance with the provisions of the EU VAT Directive and the Court of Justice of the European Union’s decisions in the cases referred to it in connection with the application of a reduced VAT rate to e-books by Luxembourg and France (for prior coverage, see *World Tax Advisor*, 27 March 2015), the reduced rate does not apply to e-books downloaded/streamed from the internet or, more generally, to electronically supplied services.
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/150327_ib.html

Mexico: The Tax Administration Service (SAT) has again extended the deadline for reporting information on relevant transactions carried out during fiscal year 2014 on the SAT website through the official form (Form 76) (for prior coverage, see *World Tax Advisor*, 14 November 2014). The reporting deadline for 2014 transactions previously was extended to 30 April 2015 and has been extended to 31 December 2015. Taxpayers must begin submitting information

for fiscal year 2015 transactions on a quarterly basis from 31 May 2015. However, taxpayers will be exempt from the reporting requirement if they did not carry out one of the types of transactions described in the official form or if the cumulative amount of all relevant transactions during the fiscal year is less than MXN 60 million (around USD 4 million).
URL: http://newsletters.usdbriefs.com/2014/Tax/WTA/141114_5.html

United Kingdom: A number of tax changes became effective on 1 April 2015, including the following: (1) the main rate of corporation tax rate is reduced from 21% to 20%; (2) the new 25% diverted profits tax is introduced (see article in this issue); (3) the bank levy is increased from 0.156% to 0.21%; (4) the amount of annual profits of banks that can be offset by carried forward losses is restricted to 50%; (5) the VAT registration threshold is increased from GBP 81,000 to GBP 82,000, and the deregistration threshold from GBP 79,000 to GBP 80,000; (6) an investment allowance for North Sea oil and gas is introduced to replace the offshore field allowances and simplify the regime; and (7) the associated companies rules are replaced with simpler rules based on 51% group membership.
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/150410_1.html

---

BEPS corner

In the first issue of each month, the *World Tax Advisor* includes a monthly "BEPS corner" that provides updates on developments in the OECD's base erosion and profit shifting (BEPS) initiative.

Costa Rica: The draft income and sales tax reform bill proposes the introduction of "BEPS"-type rules that would disallow a deduction for expenses paid to a resident of a tax haven jurisdiction. See *World Tax Advisor*, 27 March 2015.
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/150327_3.html

New Zealand: On 11 March 2015, the Minister of Revenue announced the government's tax policy work program for 2015-2016. One of the three broad areas of focus will be BEPS and international tax reform. The BEPS activities will include the following: (1) addressing hybrid instruments and entities; (2) addressing issues with the application of nonresident withholding tax on interest on related party debt; (3) considering New Zealand's interest limitation rules in light of the OECD's recommendations due in September 2015; (4) domestic implementation of a new global standard on the automatic exchange of financial bank account information with treaty partners; (5) addressing possible tax avoidance areas with respect to the rules relating to companies becoming nonresident for tax treaty purposes; and (6) contributing to the OECD's work on goods and services tax on imports of services, intangibles and low-value goods and, in particular, purchases from offshore of services and intangibles, such as digital downloads and low-value goods.

OECD: The OECD released a discussion draft on BEPS Action 12 (disclosure of aggressive tax planning) on 31 March 2015 that considers the possible design options for a model mandatory disclosure rule. The discussion draft sets out recommendations on the design of a disclosure regime for international tax schemes. See article in this issue.
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/150410_8.html

OECD: On 3 April 2015, the OECD released a discussion draft dealing with Action 3 of the BEPS Action Plan that focuses on developing recommendations for the design of controlled foreign company (CFC) rules to combat BEPS. The discussion draft considers all the component elements of CFC rules and breaks them down into the “building blocks” that are essential to an effective CFC regime. The building blocks include the following: definition of a CFC; threshold requirements; definition of control; definition of CFC income; rules for computing income; rules for attributing income; and rules to prevent or eliminate double taxation. The building blocks include draft recommendations, except for the definition of CFC income, which outlines possible options for provisions that countries could implement to accurately attribute income that raises BEPS concerns. A public consultation on Action 3 will be held on 12 May 2015, and comments on the discussion draft are due by 1 May. The Action Plan calls for this work to be completed by September 2015.

UK: A 25% diverted profits tax applies from 1 April 2015 to profits of multinationals that are considered to have been artificially diverted from the UK, and is intended to encourage companies to adjust their corporate tax position to reflect the expected outcomes from the G20/OECD BEPS project. See article in this issue.
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/150410_1.html

UK: The 2015 budget announcement confirms that authority will be given to introduce country-by-country reporting in Finance Act 2015. See the United Kingdom tax alert, 18 March 2015.
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-unitedkingdom-18-march-2015.pdf

---

Are You Getting Your Global Tax Alerts?

Throughout the week, Deloitte provides commentary and analysis on developments affecting cross-border transactions on a free subscription basis delivered straight to your email. Read the recent alerts below or visit the archive.
Subscribe: http://www2.deloitte.com/global/en/pages/tax/articles/global-tax-newsletter-sign-up.html?id=us:em:na:wta:eng:tax
Archives: http://www2.deloitte.com/content/www/global/en/pages/tax/articles/global-tax-alerts.html?id=us:em:na:wta:eng:tax

No new alerts were issued this period. Be sure to refer to the archives to ensure that you are up to date on the most recent releases.

Have a question?
If you have needs specifically related to this newsletter’s content, send us an email at clientsandmarketsdeloittetax@deloitte.com to have a Deloitte Tax professional contact you.