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In this issue:

Canada's 2016-17 federal budget affects back-to-back arrangements 1
2016 Singapore budget announced 6
Belarus: Changes to tax code affect multinationals 8
Brazil: Capital gains tax and CFC rules modified 10
Colombia: Guidance issued on tax treatment of transportation services
provided by nonresidents 11
Japan: Tax reform enacted 12
Luxembourg: Two-year tax amnesty in effect 12
Panama: Expanded information requirements to avoid application of alternative
minimum tax 13
Switzerland: House of Representatives modifies proposals for Corporate Tax Reform III 14
In brief 16
BEPS corner 17
Are You Getting Your Global Tax Alerts? 18

Canada's 2016-17 federal budget affects back-to-back arrangements

On 22 March 2016, Canada's Minister of Finance introduced the first budget of the new Liberal government. The budget contains limited measures with respect to international tax, including a modest response to the OECD's base erosion and profit shifting (BEPS) project. However, certain measures that are proposed to be effective in 2017 are particularly important since they will require foreign parent companies of Canadian subsidiaries to examine the cross-border arrangements for financing and licensing property to those subsidiaries. In addition, new shareholder loan rules that are proposed to be effective immediately require an examination of the use of the excess cash of the subsidiaries through arrangements such as cash pooling, as well as the security provided by the subsidiaries to third-party lenders in respect of group finance arrangements. These "back-to-back" measures are discussed below.

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Response to BEPS proposals

The government outlined its intentions with respect to the BEPS project, although the government response was restrained (for coverage of the proposed country-by-country reporting requirements, see Canada global transfer pricing alert, 24 March 2016). The government will adopt the minimum standards recommended in the report on action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances). In particular, to address treaty shopping, tax treaties should include either a principal purpose test or a limitation on benefits rule. This will be achieved through bilateral treaty negotiations or the proposed multilateral instrument that is being negotiated by a working group, of which Canada is a member. There was no mention of the prior government's proposals to introduce a domestic anti-treaty shopping rule, which had been placed on hold pending the outcome of the BEPS initiative, although it is possible this proposal could reappear if no agreement can be reached on a multilateral instrument. Note, however, that the budget proposals to significantly expand the existing back-to-back rules are effectively anti-treaty shopping rules.
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-010-24-march-2016.pdf

Canada will adopt the minimum standard for the exchange of certain tax rulings. Following the budget announcement, the Canada Revenue Agency stated that such exchanges would begin as from 1 April 2016. A revised information circular will be released in the near future.

No other BEPS actions were specifically mentioned – the budget documents simply stated that "the government is continuing to examine the recommendations pertaining to the other aspects of BEPS."

Back-to-back proposals

Expansion of existing back-to-back loan rules: The existing back-to-back loan rules address loans to, or debts owing by, a Canadian taxpayer where the creditor is an "intermediary," and the intermediary is itself indebted to a nonresident or has been provided with certain "specified property" by a nonresident because it entered into the arrangement with the Canadian taxpayer. If the rules apply, the Canadian taxpayer may be deemed to be indebted to the nonresident for purposes of the thin capitalization rules, and may be deemed to have paid interest to the nonresident in circumstances where the withholding tax rate in respect of interest paid to the nonresident is higher than the rate applicable to interest paid to the intermediary.

The withholding tax rules are proposed to be expanded as follows:

- The rules would apply to rents and royalties (royalties) where there is sufficient connection between each "leg" of the transaction, where (1) the amount paid by the intermediary to the nonresident is computed by reference to the royalty paid to the intermediary or the value or financial performance of the property that is the subject of the royalty; or (2) one leg of the transaction generally would not have been entered into or permitted to remain in effect without the other. The fact that both legs of the transaction are in respect of the same property, however, generally would not be sufficient to cause this test to have been satisfied.

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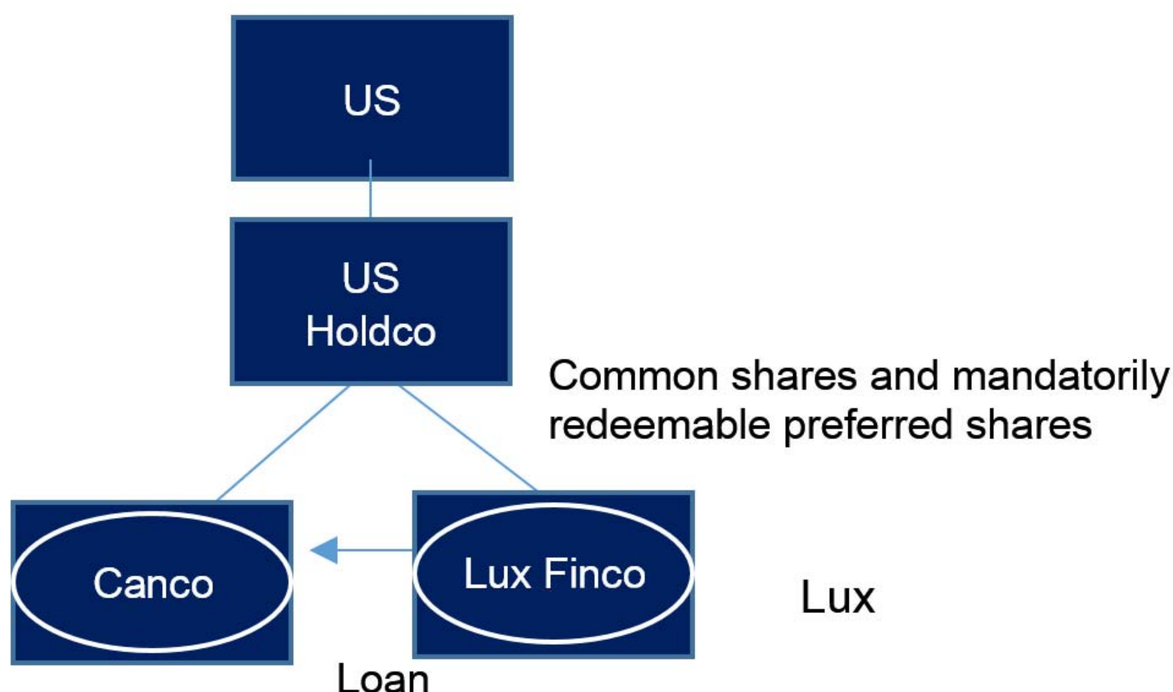
- The rules would apply to arrangements where the legal nature of the payments is not the same, such as an interest payment made to the intermediary and a royalty paid to the nonresident, or vice versa. The proposed rules also could apply where interest or a royalty is paid to the intermediary and the intermediary has been funded by equity issued to the nonresident, rather than by debt or a license. This may be the case if the intermediary has an obligation to pay dividends or if the shares are redeemable or cancellable. The objective may be to target arrangements in which the equity return is deductible, since that may effectively avoid material taxation in the intermediary foreign jurisdiction.
- The application of the rules in the context of multiple intermediaries would be clarified. It is proposed that the rules would deem a payment from the taxpayer to the ultimate nonresident recipient in such cases.

No draft legislation was released with the budget, and the proposals are stated to be generally applicable to payments made after 2016, which should provide time for comment once the legislation is available, and for the restructuring of certain arrangements. For example, consider the following arrangement:



In this example, interest paid by Canco to Lux Finco is subject to a 10% withholding tax under the Canada-Luxembourg tax treaty. In addition, given the existence of the preferred shares of Lux Finco, the proposed rules may deem Canco to have paid interest to US Holdco. Under the Canada-US treaty (article IV(7)(b)), such an interest payment would be disregarded and US Holdco would not be eligible for treaty benefits in respect of the payment. An additional 15% withholding tax would be required in respect of the deemed interest payment, resulting in a

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total withholding tax rate of 25%, the maximum rate provided for under Canadian domestic law.

All inbound finance and royalty structures should be examined before 2017 to determine whether the back-to-back rules may apply, and whether a higher withholding rate would apply if the interest or royalty payment made by the taxpayer were made to the ultimate nonresident recipient of the back-to-back payments or arrangements.

Extension of the back-to-back rules to shareholder loans: Under current rules, where a Canadian corporation makes a loan or a nonresident shareholder becomes indebted to a Canadian corporation, the amount of the loan or debt may become a deemed dividend to the shareholder, subject to withholding tax. In addition, where insufficient interest is charged, a deemed dividend may arise in respect of a shareholder benefit. The rules apply quite broadly to debts owed by certain persons connected to shareholders. The budget proposes to extend the rules further to debts owed by a person that is not connected to the shareholder (an intermediary) where, generally:

- The intermediary is owed an amount by the shareholder or a connected person (the shareholder debt);
- The intermediary owes an amount to the Canadian resident corporation (the intermediary debt) and either recourse in respect of the intermediary debt is limited to amounts recovered on the shareholder debt, or the shareholder debt became owing or remained owing because the intermediary debt was or was anticipated to be entered into; or
- The intermediary has a “specified right” in respect of property granted by the Canadian corporation.

If the rules apply, the shareholder would be deemed to be indebted to the Canadian company in an amount equal to the lesser of the amount of the shareholder debt and the amount of the intermediary debt, plus the fair market value of the property subject to the specified right.

In contrast to the financing and licensing proposals described above, the proposed changes in respect of outbound debt would apply to arrangements that exist on 22 March 2016, with the deemed debt considered to have become owing as of that date. No deemed dividend of the amount of the debt would arise under the shareholder loan rules if the debt is repaid by the end of the next taxation year after the taxation year of the creditor in which the debt arose. Many loans and debts existing as of the budget date would be affected by the proposals, but there still is time to restructure.

In the example, below, Canco has advanced funds to a bank (the intermediary), which has advanced funds to US Holdco. This may have occurred under a cash pooling arrangement, for example, where Canco is a lender into the cash pool and related nonresidents are borrowers. Alternatively, Canco has provided security to the intermediary in respect of the US Holdco loan, and such security meets the definition of a “specified right.” If the rules apply, Canco may be deemed to have made a loan to US Holdco, which may result in a deemed dividend to US Holdco.

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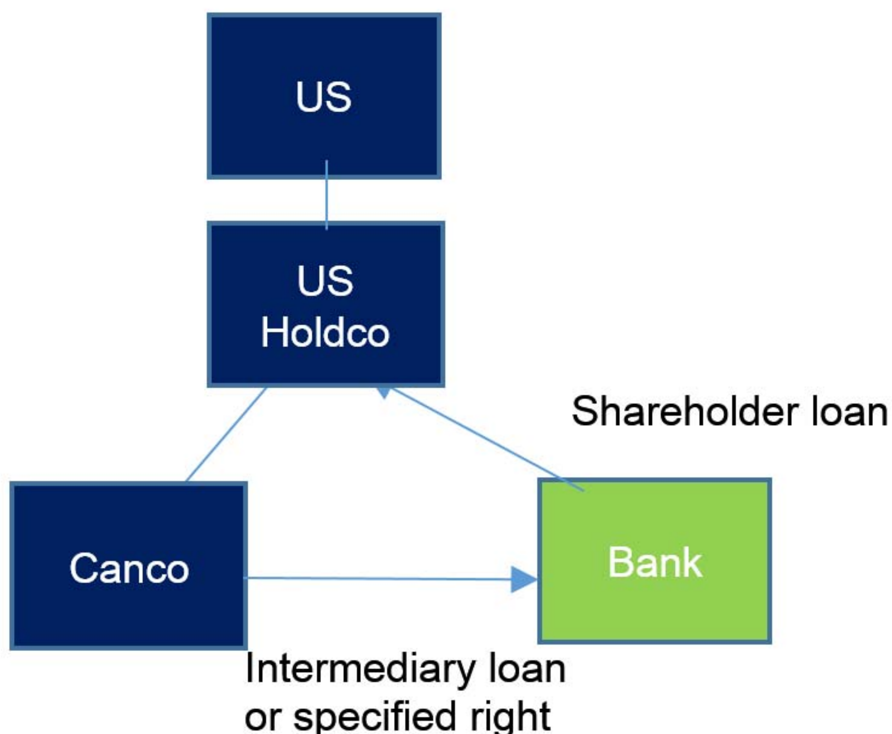

No draft legislation has been released, but the budget notes that the current definition of specified right, which applies for the thin capitalization and back-to-back loan rules, would apply to these provisions. The specified right definition initially was very broad, and would have applied to most security provided under group financing arrangements. However, it ultimately was limited to situations where, in very general terms, property is provided to the intermediary that can be dealt with by the intermediary as its own, such as funds placed on deposit with the intermediary. Nevertheless, all group financing arrangements should be reviewed to ensure that cash pooling arrangements and security provided by Canadian subsidiaries in respect of group debt do not cause a deemed dividend to arise under these proposals.

PUC planning: The budget proposes to amend the cross-border anti-surplus stripping rules to prevent the application of an exception to the rules where nonresident taxpayers seek to increase the paid-up capital (PUC) of shares of Canadian subsidiaries through certain acquisition and reorganization transactions. PUC can be returned tax-free to nonresident shareholders. The context in which the exception has been relied on applies in situations where there is a “sandwich” structure, namely, a Canadian corporation owns shares of a nonresident corporation that owns shares of a Canadian corporation, and the exception is used to unwind the structure without triggering withholding tax. In the government’s view, the exception has been misused to obtain an artificial increase in the PUC of Canadian companies. A number of such cases have been challenged under the general anti-avoidance rule, and those challenges will continue for pre-budget transactions. The proposed rules appear to be too broad in a number of circumstances and no doubt will be the subject of consultations.

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2016 Singapore budget announced

Singapore's Minister for Finance delivered the 2016 budget statement on 24 March 2016. The budget's goals include transformation of the economy through enterprise and innovation. A number of measures would benefit small and medium-sized enterprises, including an enhancement of the corporate income tax rebate. The relevant tax proposals that would affect businesses also include changes to tax incentives (including the expansion and extension of several incentives) and measures affecting intellectual property rights. The budget does not include any measures addressing the OECD base erosion and profit shifting (BEPS) initiative.

Corporate income tax rebate: No changes are proposed to the corporate income tax rate (17% with a partial tax exemption on a company's first SGD 300,000 of normal chargeable income), but the corporate income tax rebate would be raised from 30% to 50% of tax payable for year of assessment (YA) 2016 and YA 2017, subject to a cap of SGD 20,000 per YA.

Tax incentives: While a new automation support incentive would be introduced and several existing incentives would be expanded and extended, the cash payout rate under the productivity and innovation credit (PIC) scheme would be reduced and the scheme would be allowed to expire after YA 2018. This exemplifies the government's shift away from broad-based support for businesses to more targeted assistance.

- An automation support package would be introduced to support companies' efforts to automate, increase productivity, scale up and expand overseas. It would offer a 100% investment allowance for qualifying capital expenditure of up to SGD 10 million per project, and grants of up to SGD 1 million and enhanced financing support also would be available. It is unclear if all the proposed benefits could be applied at the same time, and the effective date for the measures is yet to be announced.
- The PIC scheme would not be extended beyond its scheduled expiration date of YA 2018. The cash payout rate under the PIC scheme (i.e. the rate for businesses that choose to convert qualifying expenditure into cash rather than claiming a tax deduction or allowance under the scheme) would be reduced from 60% to 40% (which would limit the maximum cash payout to SGD 40,000) for qualifying expenditure incurred as from 1 August 2016.
- The mergers and acquisitions (M&A) scheme available for qualifying companies incorporated and tax resident in Singapore that acquire a stake in another company would be enhanced. Qualifying M&A transactions executed between 1 April 2016 and 31 March 2020 would be eligible for the following revised tax benefits:
    - An M&A allowance at a rate of 25% of up to SGD 40 million (increased from SGD 20 million) of the acquisition value of all qualifying M&A transactions per YA (i.e. a maximum M&A allowance of up to SGD 10 million), which would be claimable over five years on a straight-line basis; and

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    - Stamp duty relief on the transfer of unlisted ordinary shares for qualifying M&A transactions of up to SGD 40 million (increased from SGD 20 million), i.e. maximum stamp duty relief of up to SGD 80,000 per financial year.
- The double tax deduction for internationalization that permits companies to deduct up to 200% of certain qualifying expenditure incurred on a range of qualifying market expansion and investment development activities would be extended by four years, until 31 March 2020.
- The land intensification allowance (25% of qualifying capital expenditure initially and 5% annually) that is available for the approved construction or renovation of a building or structure where certain conditions are satisfied would be extended more broadly as from 25 March 2016, to encourage higher industrial land productivity.
- The finance and treasury center (FTC) incentive scheme that encourages the establishment of treasury operations in Singapore would be extended until 31 March 2021 and would be enhanced as from 25 March 2016:
    - The concessionary tax rate on qualifying income would be reduced from 10% to 8%; however, the substantive requirements to qualify for the scheme would be increased;
    - The qualifying income eligible for the concessionary tax rate would be expanded to include funds obtained indirectly by FTCs from approved offices and associated companies, subject to certain safeguard conditions; and
    - The exemption from withholding tax on interest payments on certain borrowings by FTCs would be expanded.
- The types of income eligible for a tax exemption under the maritime sector incentive scheme available for ship operators and lessors would be expanded as from 25 March 2016. The expansion would broaden the scope of the exemption for income derived from the operation of qualifying offshore vessels beyond those vessels used for offshore oil and gas activities, and would include vessels used for exploration or exploitation of offshore energy and minerals. This could attract more international shipping players.
- The tax incentive scheme for trustee companies that was scheduled to lapse on 31 March 2016 would be subsumed under the financial sector incentive (FSI) scheme as from 1 April 2016. Current approved trustees could enjoy existing benefits until their expiration, and then could apply for renewal under the FSI scheme (under which the concessionary tax rate would be 12% on qualifying income, rather than 10%, but qualifying activities would be expanded).
- The qualifying activities eligible for a concessionary tax rate of 5% or 10% on certain income under the global trader program (structured commodity finance) scheme would be expanded as from 25 March 2016 to include consolidation, management and distribution of funds for designated investments; M&A advisory services; and streaming financing.
- Certain tax incentive schemes for insurance companies would be extended, streamlined and simplified (including the schemes for marine hull and liability insurance, specialized insurance business and captive insurance), with various effective dates.

Intellectual property rights (IPRs):

- An anti-avoidance mechanism would be introduced to authorize the Comptroller of Income Tax to adjust the transaction price in a transfer of IPRs if the price does not reflect the open market value. The measure would apply to acquisitions, sales, transfers

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or assignments of qualifying IPRs that are carried out as from 25 March 2016. The proposal does not appear to be limited to transactions between related parties; therefore, if it is adopted, taxpayers would need to ensure that any sale of IPRs is conducted at the open market value (e.g. by obtaining a valuation study).
- Companies or partnerships would be able to elect a period of five, 10 or 15 years (currently, the only option is five years) over which to claim the writing-down allowances on IPRs for qualifying IPR acquisitions made during the basis periods for YA 2017 to YA 2020.

Other measures:

- The safe harbor that provides certainty that gains on the disposal of shares by companies will not be subject to tax if certain conditions are satisfied would be extended by five years, until 31 May 2022.
- A pilot scheme would be introduced from 1 July 2016 to 31 December 2018 that would allow businesses a 250% tax deduction on wages and incidental expenses when they send their employees to volunteer and provide services to institutions of a public character, including secondments, subject to certain conditions and annual caps.
- Mandatory electronic filing for corporate income tax returns would be introduced in a phased approach: it would be required in YA 2018 for companies with turnover of more than SGD 10 million in YA 2017; in YA 2019 for companies with turnover of more than SGD 1 million in YA 2018; and in YA 2020 for all companies.

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Belarus:
Changes to tax code affect multinationals

Amendments to the Belarus tax code that became effective on 1 January 2016 include changes relating to permanent establishments (PEs), the withholding tax on interest paid to nonresident entities, the definition of beneficial ownership and the transfer pricing rules (see Belarus global transfer pricing alert, 5 April 2016 for coverage of the changes relating to the transfer pricing rules).
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-011-5-april-2016.pdf

Permanent establishment: The definition of a PE of a foreign entity has been amended to provide that a foreign company will be deemed to have a PE in Belarus if it carries out activities in Belarus for a period of at least 90 days, continuously or in the aggregate, in any 12-month period beginning or ending in the relevant tax period (previously, the determination was made on a calendar-year basis).

The rules for calculating expenses that may be deducted from the profits of a PE for Belarusian corporate income tax purposes also have changed. The new rules provide that both

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operating and nonoperating expenses incurred abroad (previously, only operating expenses were taken into account) may be deducted, provided the expenses are deductible under the Belarusian tax rules and the accuracy of the expenses (type, amount, dates) is confirmed by a foreign auditor.

Withholding tax on interest: Interest income received by foreign legal entities (FLEs) under syndicated loan agreements is no longer exempt from withholding tax; instead, such interest will be subject to the 10% withholding tax that generally applies to interest payments made to a nonresident company. However, a temporary exemption from withholding tax is granted for Belarus-source interest income received between 1 January 2016 and 1 January 2017 by FLEs without a PE in Belarus, provided the FLE is the beneficial owner of the interest, is not a resident in a listed offshore zone and is listed in the *Bankers' Almanac*.

Beneficial ownership: The new edition of the tax code introduces a definition of a "beneficial owner" (BO) of income and sets out the criteria to qualify as a BO:

- The entity conducts business activities related to income received from Belarusian sources and intends to claim a tax benefit available under an applicable tax treaty or Belarus law;
- The entity is the direct beneficiary of the income; and
- The entity has discretion to use and/or dispose of the income.

However, an FLE is not a BO of income if:

- The entity exclusively carries out intermediary services on behalf of another company;
- The entity does not assume any risks in relation to the relevant income; or
- The entity's right to use and/or dispose of the income is limited by contractual or other obligations requiring it to pay/transfer at least 60% of the income within a prescribed period (but no later than 12 months after the income is paid) to a nonresident that would not be entitled to the relevant tax benefits (or would be entitled to less favorable tax benefits) under an applicable tax treaty or Belarus domestic law.

The tax code also provides that if a tax agent (a Belarusian company that pays dividends, interest or royalties) has doubts as to whether an FLE obtaining income is the BO, the tax agent may ask the FLE to provide additional documentation demonstrating its beneficial ownership status, including:

- Documents confirming the FLE's unlimited right to use and/or dispose of the relevant income (i.e. that it has no obligations to third parties that are residents of jurisdictions that have not concluded a tax treaty with Belarus, or whose tax treaties with Belarus have less favorable terms that limit the FLE's right to use and/or dispose of such income for business purposes); and/or
- Documents demonstrating the FLE actually conducts business activities in the country in which it is tax resident.

An FLE also may provide documents issued by the tax authorities in the country in which the FLE is resident that support its status as a BO, as well as other supporting documents or information.

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The tax code does not specify a list of required information to support an FLE's status as a BO or the mechanism for the submission of information to the tax agent and/or authorities (except for dividends). However, if an FLE does not provide the required evidence of BO status, withholding tax on payments to the FLE is due at the regular rate.

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Brazil:
Capital gains tax and CFC rules modified

Law 13,259/2016, published in Brazil's official gazette on 17 March 2016, converts Provisional Measure No. 692/2015 (PM 692) into law, almost six months after its enactment in September 2015 (for prior coverage, see *World Tax Advisor*, 25 September 2015). Law 13,259/2016 contains changes to the capital gains tax modifications originally included in PM 692 and introduces some changes to the controlled foreign corporation (CFC) rules.
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/150925_3.html

PM 692 revised the income tax rates applicable to capital gains derived from the sale of assets by individuals from a flat rate of 15% to progressive rates ranging from 15% to 30%. Law 13,259/2016 further revises the progressive rates, to a range from 15% to 22.5%.

It should be noted that the rules for the taxation of capital gains derived by nonresidents from the sale of assets located in Brazil refer to the rules for the taxation of Brazilian residents, which could include Law 13,259/2016. However, the application of the progressive rates to nonresidents must be analyzed on a case-by-case basis, and the changes under Law 13,259/2016 should not modify any specific preferential rates that may apply to certain qualified foreign investors.

Although Law 13,259/2016 states that it is effective retroactively as from 1 January 2016, laws that increase taxes may enter into effect only in the year following the year of enactment. Therefore, in practice, the changes to the capital gains tax rates should not apply until 1 January 2017.

Law 13,259/2016 also introduces a new article (article 82-A) into the provisions governing Brazil's CFC regime. This provision was not included in PM 692.

Under the CFC rules, the taxation of profits of an "affiliated" entity (as opposed to a "controlled" entity) generally takes place at the time the profits are distributed to the Brazilian entity, provided the affiliated entity (on a cumulative basis): (i) is not subject to a nominal income tax rate lower than 20%; (ii) is not resident in a tax haven jurisdiction (a jurisdiction included on Brazil's "black list") or in a privileged tax regime jurisdiction (a jurisdiction on the "grey list"); and (iii) is not directly or indirectly controlled by a black or grey-list entity. Effective 1 January 2016, new article 82-A allows Brazilian taxpayers to elect to have the foreign profits of affiliated entities taxed on 31 December of each year (i.e. under the methodology applicable to

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controlled entities). However, the election will not be available where the affiliate is deemed a controlling entity under specific combined ownership circumstances provided under article 83 of Law 12,973/2014.

The Brazilian tax authorities still must issue specific guidelines regarding the election mechanism.

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Colombia:
Guidance issued on tax treatment of transportation services provided by nonresidents

The Colombian tax administration recently released a ruling that clarifies the tax treatment of transportation services provided by a foreign entity through a mobile "app," where the customer pays for the services electronically using a credit or debit card.

Under Colombia's tax rules, foreign companies are taxed only on Colombia-source income received directly or through a permanent establishment in Colombia, or where income is deemed to be Colombian-source income as a result of the provision of services in Colombia.

The tax authorities ruled that driver services provided in Colombia by a foreign company are transportation services provided within Colombia – the fact that the services are provided via a mobile app is irrelevant. As a result, the payments for the services are considered Colombia-source income taxable in Colombia, subject to a 25% income tax, the 9% income tax for equality (CREE) and the 6% CREE surcharge for taxable year 2016.

Nonresidents are required to file an income tax return in Colombia only if the total payments received have not been subject to final income tax withholding, so the tax authorities analyzed whether the payments made to the transportation company via credit or debit card should be subject to withholding tax. The authorities concluded that a 1.5% withholding tax will apply (unless domestic law provides for a lower rate on specific transactions), which must be withheld by the financial entity issuing the credit/debit. However, the withholding tax is not a final tax, so the foreign transportation service provider still must file an income tax return in Colombia.

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Japan:
Tax reform enacted

On 29 March 2016, Japan's National Diet enacted the 2016 tax reform proposals, which include the following major corporate tax changes:

- The standard effective corporate income tax rate is reduced to below 30%, specifically, to 29.97% for fiscal years beginning on or after 1 April 2016 and to 29.74% for fiscal years beginning on or after 1 April 2018. Additionally, there will be a further expansion of the factor-based enterprise tax and a broadening of the tax base through the revision of the depreciation system and other measures.
- The limitation on the utilization of net operating losses (NOLs) was reduced from 80% to 65% in the 2015 tax reform, and will be further limited to 60% for fiscal years beginning on or after 1 April 2016, 55% for fiscal years beginning on or after 1 April 2017 and 50% for fiscal years beginning on or after 1 April 2018.
- The extension of the NOL carryforward period from nine years to 10 years, which was determined in the 2015 tax reform, will be deferred for one year to fiscal years beginning on or after 1 April 2018.
- The consumption tax rate will be increased to 10% and a multiple-rate system under which a lower rate of 8% is applicable to food and beverages will be implemented on 1 April 2017. A qualified invoice system will be introduced on 1 April 2021.

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Luxembourg:
Two-year tax amnesty in effect

Luxembourg introduced its first-ever tax amnesty on 1 January 2016, providing taxpayers a two-year opportunity to declare certain previously undeclared income.

The tax amnesty is available to both corporate and individual taxpayers that have held undeclared assets and/or received undeclared income in Luxembourg and that wish to "regularize" their tax situations. Such taxpayers may file a "corrective tax return" and pay the tax due on the income; the tax due will be increased by 10% for corrective returns filed in 2016 and by 20% for returns filed in 2017. By filing a corrective return and paying the tax, a taxpayer can avoid prosecution for tax fraud, which entails a possible jail sentence of up to five years, as well as the imposition of monetary penalties of up to 10 times the amount of unpaid taxes.

It should be noted that the amnesty applies where a taxpayer intentionally or unintentionally failed to disclose assets or income, but not to nondisclosures due to activities such as money laundering, terrorism, etc. Taxpayers suspected of engaging in the latter types of activities will be reported to the Public Prosecutor's Department for prosecution.

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The Luxembourg tax administration has not issued a specific form for filing a corrective tax return. A taxpayer may submit the correction in a document accompanied by supporting documents, such as:

- A sworn statement certifying that the correction covers all income omitted for the past 10 years;
- A detailed description of the origin of the undeclared income, along with any relevant supporting documents;
- A certificate from any entity providing a detailed list of the taxpayer's deposited income (e.g. a bank certificate); or
- Amended annual accounts (for legal entities).

Although one corrective return should be filed for each tax year concerned, the tax administration may decide to relax this requirement and allow taxpayers to submit a single tax return/report for all of the tax years concerned.

Affected qualifying taxpayers should consider taking advantage of the opportunity to voluntarily rectify their tax affairs. It is likely that once the amnesty period expires, the tax administration will increase its audit activities, and, given the 10-year statute of limitations for issuing an assessment and the stringent potential penalties, the consequences for a taxpayer that has not standardized its tax affairs could be severe.

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Panama: Expanded information requirements to avoid application of alternative minimum tax

Panama's tax authorities issued an administrative decision on 2 March 2016, effective as from the following day, which requires taxpayers to submit additional information when requesting an exemption from the application of the alternative minimum tax (CAIR).

Corporate tax liability in Panama generally is assessed at the greater of a 25% flat rate on net income, or a 1.17% rate on gross taxable income under the CAIR. According to Panama's tax rules, companies are required to calculate their income under the normal rules (i.e. gross income, less nontaxable income and allowable deductions) and under the CAIR (calculated on a percentage of gross taxable revenue), with the higher result of the two calculations generally considered to be the income tax liability for the year. However, taxpayers with net operating losses or an effective tax rate higher than the standard 25% rate may submit a request to the tax authorities to avoid the application of the CAIR for corporate income tax purposes.

The administrative decision expands the type of information a taxpayer must provide in such a request. In determining whether to grant a request, the tax authorities will conduct a review similar to a comprehensive audit that will require the taxpayer to demonstrate full compliance

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with its withholding tax obligations (among other factors) and provide detailed information on certain costs and expense accounts. The tax authorities will have six months to evaluate a request and decide whether to grant it.

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Switzerland:
House of Representatives modifies proposals for Corporate Tax Reform III

The Swiss House of Representatives voted to approve the Corporate Tax Reform III (CTR III) on 16 and 17 March 2016, including some modifications to the draft legislation introduced into parliament on 5 June 2015 (for prior coverage, see Switzerland tax alert, 8 June 2015). The main objective of the CTR III is to align Swiss tax law with international standards (including developments under the OECD base erosion and profit shifting (BEPS) initiative) and enhance Switzerland's attractiveness as a location for multinational companies.
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-switzerland-08-june-2015.pdf

Among other items, the House of Representatives voted in favor of the following measures to compensate for the abolition of the special corporate income tax regimes (e.g. the mixed, domiciliary, holding and principal company regimes, as well as the Swiss finance branch regime) that the CTR III would phase out:

- Introduction of a notional interest deduction (NID) at the federal level – and at the cantonal/communal level, at the discretion of the individual cantons;
- Introduction of a patent box at the cantonal level, with an option for the cantons to offer full tax relief for qualifying income;
- Introduction of R&D incentives at the cantonal level in the form of excess R&D deductions (super deductions) for qualifying R&D expenditure, which would include foreign R&D activities; the super deduction would not be limited to 150% of expenditure, but would be set at the discretion of the cantons;
- Allowance of the tax-privileged release of hidden reserves for cantonal/communal tax purposes for companies transitioning out of tax-privileged regimes, and a step-up for direct federal and cantonal/communal tax purposes upon the migration of companies or activities to Switzerland;
- Reduction of the annual capital tax on participations, patented intellectual property and intragroup loans; and
- Introduction of a tonnage tax for maritime shipping companies.

Under the proposals approved by the House of Representatives, the combined tax relief available to a company from (1) the release of hidden reserves when transitioning out of tax-privileged regimes, (2) the NID, (3) the patent box regime and (4) R&D super deductions would be limited to 80% (of the cantonal/communal taxes), to ensure minimum taxation of companies that benefit from these measures.

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The abolition of the 1% capital issuance tax on equity contributions that was proposed in the June 2015 draft legislation would be postponed. While most of the parties involved agree conceptually on the abolition of the tax, the abolition was not included under the proposals approved by the House of Representatives because it was not considered a core part of the CTR III and it would have made the CTR III package more expensive.

Some of the modified proposals approved by the House of Representatives are described in further detail below.

Revival of NID

Although the Federal Council excluded the NID for imputed interest on equity (which was proposed under 2014 draft legislation on the CTR III) from the reform package presented to parliament and the Senate did not add back the NID regime when it considered the package, the House of Representatives has restored the proposed NID to the draft CTR III legislation, to ensure Switzerland will remain attractive for international financing activities.

The introduction of the NID, combined with the nontax advantages of Switzerland as a financing location (such as a strong financial services industry and infrastructure, political stability and a stable currency), should ensure that Switzerland remains a popular financing location in the age of BEPS, particularly for multinational enterprises that already have a clear operational presence and/or significant substance in Switzerland, or that plan to establish such presence and substance.

Reduced restrictions on patent box regime and R&D super deductions

The House of Representatives voted not to limit the relief that the cantons could provide from cantonal and communal income taxes to 90% of qualified patent income (as per the proposal by the Federal Council); instead, the cantons would be free to set the relief for qualified patent income at up to 100% of such income.

The R&D super deductions that cantons could offer would not be limited to 150% of qualifying expenditure for cantonal/communal tax purposes; the cantons would be free to set the extent of the R&D super deductions. In addition, R&D super deductions would be possible for R&D activities carried out abroad.

Through these measures, Switzerland could become a more attractive center for innovation, particularly in the life sciences, information and communications technology, mechanical and electrical engineering and clean-tech industries.

Next steps

The tax reform package voted for by the House of Representatives will now go back to the Senate, which previously proposed a more restrictive version of the package. The two parliamentary chambers will have to settle their differences in the summer 2016 session held between 30 May and 17 June 2016.

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In addition, there may be a referendum and a national vote on the legislation. Cantonal tax laws subsequently would have to be amended to reflect the changes, so the CTR III law likely would become effective no earlier than 1 January 2019.

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In brief

Cayman Islands: Reporting deadlines and other key compliance milestones are approaching for the three sets of information reporting rules that are applicable in this jurisdiction (i.e. FATCA (the US Foreign Account Tax Compliance Act), UK-CDOT (the crown dependencies and overseas territories reporting regime) and CRS (the Common Reporting Standards)). Given the specific notification to the Cayman Tax Authority requirement and the complexity of the key milestones, financial institutions that have a presence in the Cayman Islands should ensure they are familiar with the key dates under each set of rules. Notification to the Cayman Tax Authority of FATCA and UK-CDOT reporting needs to be completed by 30 April 2016, if not already completed.

Czech Republic: The tax authorities have been increasing their scrutiny of individual taxpayers, as well as employers (e.g. by increasing audits of payroll files). Specifically in relation to the taxation of foreign nationals, the tax authorities tend to restrict all potential tax allowances and deductions and challenge international assignment structures, e.g. credits for tax paid abroad, the calculation of Czech payroll tax advances or refunds of tax overpayments. Additionally, disputes have arisen over the determination of tax residence, especially if the position taken by the taxpayer results in lower taxation. The change in the tax authorities' approach may increase taxpayers' overall tax burden, as well as their administrative burden.

Poland: A tax on certain financial institutions entered into effect on 1 February 2016. The tax is levied at a monthly rate of 0.0366% of the taxable base, which is the total value of a taxpayer's assets that exceeds a specified threshold that varies depending on the type of institution: (1) assets exceeding PLN 4 billion for domestic banks, branches of foreign banks, branches of credit institutions and cooperative savings/credit unions; (2) assets exceeding PLN 2 billion for domestic insurance and reinsurance companies, and branches of foreign insurance and reinsurance companies; and (3) assets exceeding PLN 200 million for lending institutions. In the case of insurance and reinsurance companies and lending institutions, the thresholds are applied at the level of the relevant group, rather than to each company within the group. The tax is not deductible for corporate income tax purposes.

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United States: The Financial Crimes Enforcement Network (FinCEN) issued proposed regulations on 2 March 2016 that are intended to revise and clarify certain rules regarding the filing of Reports of Foreign Bank and Financial Account (FBARs) by US persons. The proposed regulations would have two major impacts: (1) reduce FBAR filing burdens on certain employees and officers who currently have filing obligations arising from their signature authority over accounts of their employers; and (2) increase the amount of information required to be included on FBARs for filers with a financial interest in, or signature authority over, 25 or more financial accounts (currently, the information required to be reported is limited where there are 25 or more relevant accounts). If adopted, the proposed regulations would be effective for 2016 FBARs due 15 April 2017. Comments on the proposed regulations may be submitted until 9 May 2016.

Vietnam: The Ministry of Finance issued a circular on 5 February 2016 that applies as from 1 April 2016 and provides detailed guidance on the VAT declaration and corporate income tax incentives for organizations and individuals having income from supporting industries (i.e. industries that manufacture materials, components and spare parts for manufacturing finished products). The list of products in supporting industries is provided in Decree 111/2015, dated 3 November 2015. The circular supplements this decree, which announced the incentives, including a reduced corporate income tax rate of 10% (rather than the standard 20% rate) for 15 years from the first revenue-generating year, and a four-year corporate income tax exemption as from the first profit-generating year (or fourth revenue-generating year, whichever comes first), followed by a 50% corporate income tax reduction in the next nine years. The circular clarifies the conditions for applying the incentives and provides that taxpayers with qualifying income may declare VAT on a quarterly basis (rather than monthly).

BEPS corner

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

Canada: The 2016-2017 federal budget proposes new country-by-country (CbC) reporting requirements for large multinational entities. See Canada transfer pricing alert, 24 March 2016 and the article in this issue.
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-010-24-march-2016.pdf
URL: http://newsletters.usdbriefs.com/2016/Tax/WTA/160408_1.html

OECD: On 24 March 2016, the OECD released a public discussion draft on the treaty entitlement of non-CIV funds (i.e. investment vehicles that do not qualify as "collective investment vehicles" within the meaning of the 2010 OECD report on the topic). The discussion draft was issued as part of the follow-up work on BEPS action 6 (preventing the granting of treaty benefits in inappropriate circumstances) after the October 2015 release of the final reports on the BEPS actions (for prior coverage, see OECD tax alert, 5 October 2015). Comments are requested by 22 April 2016 and will be discussed by the relevant working party at its May 2016 meeting.
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-oecd-5-october-2015.pdf

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Switzerland: The House of Representatives has voted to approve the Corporate Tax Reform III, which, among other things, would align Swiss tax law with international standards (including developments under the BEPS initiative). See the article in this issue.
URL: http://newsletters.usdbriefs.com/2016/Tax/WTA/160408_9.html

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Belarus
Belarus refines transfer pricing regulations
Changes to the Belarusian tax code introducing more detailed and stricter transfer pricing rules entered into effect on 1 January 2016. Although these changes generally are aimed at harmonizing the transfer pricing legislation with the OECD transfer pricing guidelines, many of the changes appear to impose more restrictive rules on taxpayers.
Issue date: 5 April 2016
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-011-5-april-2016.pdf

Canada
Canada announces proposed country-by-country reporting requirements
Canada's 2016-2017 federal budget, released 22 March 2016, proposes new country-by-country (CbC) reporting for large multinational entities. While draft legislation is not yet available, indications in the 2016 budget are that the CbC rules will be consistent with the OECD recommendations in the 5 October 2015 final report on action 13 of the BEPS initiative.
Issue date: 24 March 2016
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-010-24-march-2016.pdf

Italy
Authorities clarify tax treatment of LBO transactions
Italy's tax authorities issued guidance on 30 March 2016 that clarifies the tax treatment applicable to the acquisition of Italian targets by private equity funds through leveraged buyout (LBO) and merger leveraged buyout transactions. In a welcome move, the authorities confirmed that interest expense related to loans granted to an Italian special purpose vehicle incorporated for the purpose of acquiring the target is deductible under the ordinary rules. This has been an area fraught with controversy and challenges by the tax authorities on the grounds that the transactions were abusive and lacked a business purpose. The clarification likely should end most of the current tax litigation and prevent further challenges to LBOs.
Issue date: 6 April 2016
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-italy-6-april-2016.pdf

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United States

Anti-Inversion Guidance: Treasury Releases Temporary and Proposed Regulations

On 4 April 2016, the US Treasury and the IRS issued temporary regulations under Code sections 304, 367, 956, 7701(l) and 7874 to address certain inversion and post-inversion transactions. The temporary regulations include rules previously described in Notice 2014-52 and Notice 2015-79. The temporary regulations also provide: (i) rules for identifying a foreign acquiring corporation when a domestic entity acquisition involves multiple steps; (ii) rules that disregard stock of the foreign acquiring corporation that is attributable to certain prior domestic entity acquisitions; (iii) rules that require a CFC to recognize all realized gain upon certain transfers of assets described in section 351 that shift the ownership of those assets to a related foreign person that is not a CFC; and (iv) rules clarifying the definition of group income for purposes of the substantial business activities test.

Issue date: 6 April 2016

URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-united-states-6-april-2016.pdf

Proposed Regulations Addressing Treatment of Certain Interests in Corporations as Stock or Indebtedness

On 4 April 2016, the US Treasury and the IRS published broadly applicable proposed regulations under Code section 385 that would (i) authorize the IRS to treat certain related-party interests as part stock and part debt for federal tax purposes; (ii) establish contemporaneous documentation requirements that must be satisfied for certain related-party debt to be respected for federal tax purposes; and (iii) treat certain related party debt as stock for all purposes of the Code when issued in connection with certain distributions and acquisitions.

Issue date: 6 April 2016

URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-united-states-6-april-2016-proposed-regulations.pdf

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