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Modernized EU customs rules to enter into effect

On 1 May 2016, new customs legislation, the Union Customs Code (UCC) will introduce fundamental and substantive changes to the customs rules in the EU and will replace the existing Community Customs Code (CCC) that dates back to 1994. EU member states will need to amend their national legislation to reflect the changes to the rules. The new era of customs law will usher in changes to the way in which goods move across EU borders and will have a major impact on supply chains (with some transitional rules applying until 2020).

The CCC, which is the current basis for customs law throughout the EU, sets out the rules and procedures to ensure the implementation of tariff and other measures in connection with trade between EU member states and third countries, and is supplemented by a regulation (the CCCIP) that lays out implementing provisions. The UCC, adopted in 2013, is supplemented by delegated and implementing regulations published in 2015 – together, these form the "UCC legal package." A core principle of the UCC is that all customs declarations should be electronic rather than paper-based.

The main objectives of the UCC legal package are as follows:

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- Modernize customs legislation and procedures and the use of customs information systems to facilitate doing business with customs and ensure the safe and secure trade of goods in the EU;
- Take into account the evolution of policies and legislation in other fields that might affect customs legislation, such as safety and security in the field of transport;
- Make customs business processes more streamlined and adequate in terms of increased clarity and coherence of customs legislation;
- Reduce the administrative burden for economic operators through the use of electronic procedures and storage facilities that will reduce reporting formalities and pave the way for further modernization and better coordinated border management;
- Fully align EU customs rules with global standards, as well as other international and global developments (including developments in the EU major trading partners), which will facilitate and streamline trade, thus increasing export opportunities for EU economic operators; and
- Protect EU financial resources and fraud-proof European customs legislation by closing loopholes, prevent the inconsistent interpretation and application of rules and provide electronic access to relevant information without creating an additional burden for trade.

The significant changes under the UCC legal package can be divided into two main categories – modernizations and measures with a potential financial impact.

Modernizations

The modernizations under the UCC legal package cover two areas: electronic customs procedures and legislation.

Electronic customs is seen as the main driver to promote the competitiveness of the EU and economic growth. To achieve these goals, customs clearance systems must be made accessible and interoperable throughout the European single market.

The targeted modernization includes several components, including centralized clearance procedures, electronic entries in the declarant's records and self-assessments, which will be developed in the coming years:

- **Centralized customs clearance:** This procedure will enable businesses to submit customs declarations for all member states from a single member state. Economic operators will be allowed to declare goods electronically to a single customs office, irrespective of where the goods actually enter or exit the EU. This should result in supply chain efficiencies and in lowering the costs of a supply chain, as well as enhancing the central management of the supply chain.
- **Electronic entries:** Electronic entries in the declarant's records are another improvement that will streamline the customs declaration process. A customs declaration will be able to be filed directly through the declarant's records, which will be electronically accessible at all times by the customs authorities, rather than by physical presentation to the authorities. This approach will result in faster import and export movement.

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- **Self-assessment:** This procedure will allow an economic operator to make customs entries in its records that currently can be carried out only by the customs authorities, such as the determination of the amount of import duties payable and certain other controls under customs supervision.

The UCC provides that these simplifications will be available only to companies that have met the criteria to obtain "authorized economic operator" (AEO) status. AEO status is an accreditation issued by the customs authorities to operators that have demonstrated that they are trustworthy and compliant. AEOs are entitled to simplified and speedier customs controls and procedures. Although AEO status is not mandatory, if a market operator is not recognized as an AEO, it will not be able to benefit from the simplifications under the UCC.

The UCC legal package's plan relating to electronic customs systems is ambitious. Since there are no uniform information technology (IT) systems and no uniform working methods within the EU, the European Commission has developed a program to roll out uniform and interconnected IT systems between the member states. Thus, certain provisions of the UCC will be implemented at the time the required IT system is either deployed or upgraded – complete deployment of all of the electronic systems required by the UCC must be carried out by 31 December 2020.

Measures with a financial impact

Several measures under the UCC legal package will affect the financial position of economic operators, among others, those affecting the point of determination of the customs value, the valuation of goods with respect to royalties and the establishment of the exporter of record. Some of these measures likely will increase the tax burden on economic operators.

Point of determination of customs value: The primary basis for determining the customs value of goods is the transaction value. This is the price actually paid or payable for the goods when sold for export to the EU customs territory, adjusted when necessary.

Under the current rules, importers may use the "first sale" for export customs value if certain requirements are met. That is, in the case of successive sales, the value of a sale that occurs before import into the EU may be used as the basis for the customs value if it is determined that the earlier sale took place with the intent to export the goods to the EU customs territory. For example, if a Chinese manufacturer sells goods to a Hong Kong trading company, which, in turn, sells the goods to an EU importer, the transaction between the Chinese and Hong Kong entities may be used to determine the customs value if the intent underlying that sale was to export the purchased goods to the EU customs territory.

The UCC, however, provides that the transaction value of the goods sold for export to the EU customs territory will be determined at the time of acceptance of the customs declaration, on the basis of the sale occurring immediately before the goods were brought into the EU customs territory. In other words, importers will have to use the "last sale for export," rather than the first sale for export, as the transaction value. This implies that the customs value that must be used in the example above will be the value of the transaction between the Hong Kong entity and the EU importer. The change in the definition of transaction value likely will

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significantly increase the duty costs for importer companies that, until now, have relied on the first-sale principle in a chain of transactions.

Valuation of goods with respect to royalties: The conditions under the UCC requiring the inclusion of royalties in the customs value of goods are much broader than those under the current legislation. The basic requirements as to whether a royalty payment is dutiable under the CCC are that the royalty must relate to the imported goods and *must be paid as a condition of sale* of the imported goods. Under the UCC, the condition-of-sale requirement will be deemed to be met if the purchaser of the goods is unable to buy them without paying royalties. Once a royalty becomes payable in relation to a sale of goods, it will be considered a condition of sale and will have to be included in the customs value of the goods.

Royalties paid to an entity that is not involved in the physical trade of the goods currently may be excluded in determining the customs value. For example, if an EU company imports goods from China, and the EU company makes royalty payments to an Irish entity, the royalty payments may be excluded from the customs value if certain conditions are fulfilled. However, under the UCC, all royalty payments that can be linked to the trade of goods will fall within the scope of the customs value.

Establishment of exporter: Export procedures must ensure that all formalities concerning the export of goods are respected. These formalities include export controls, and relief from VAT and excise duties. The UCC will introduce changes to the definition of “exporter.”

Under the CCCIP, the following persons may act as the exporter:

- A person on whose behalf the export declaration is made and that is the owner of the goods, or has a similar right of disposal over them, at the time when the customs declaration is accepted; or
- A contracting party established in the EU, where the ownership or a similar right of disposal over the goods belongs to a person established outside the EU pursuant to the contract on which the export is based.

Under the UCC, the exporter is defined as follows:

- A person established in the EU customs territory that, at the time the customs declaration is accepted, holds the contract with the consignee in the third country and has the power to determine that the goods are to be brought to a destination outside the EU customs territory;
- A private individual carrying the goods to be exported, where these goods are contained in the private individual’s personal baggage; or
- In other cases, a person established in the EU customs territory that has the power to determine that the goods are to be brought to a destination outside the EU customs territory.

Thus, it appears that, under the UCC, only EU entities will be able to be exporters. The impact of this change can be shown in an example: assume a US company stocks goods in Belgium and it sells and ships goods from the Belgian warehouse to a Chinese company. Under the CCCIP, the US company could act as the exporter because it has a right of disposal over the

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goods. However, under the UCC, in principle, it would not be possible for the US company to act as the exporter because the company cannot be considered as established in the EU customs territory.

This change may be linked to the OECD's base erosion and profit shifting (BEPS) project. For example, BEPS action 7 focuses on preventing the artificial avoidance of permanent establishments (PEs) where there is significant activity in a country. Warehousing goods could, under certain conditions, create a PE. Thus, for both direct and indirect tax purposes, businesses may be required to set up establishments in countries with logistics activities and/or involve such establishments in their transactions, which may affect how foreign entities will have to organize their businesses in Europe.

The change in the definition of an exporter has been heavily debated at the European Commission and it seems likely that, at least for a transitional period (the dates of which are not yet clear), the change in definition will not be applied, so non-EU companies will be able to act as exporters of goods out of the EU; however, they likely will be required to appoint a customs representative that will be identified as being responsible for complying with the export procedure.

Comments

The UCC will have a considerable impact on most businesses involved in importing into, or exporting from, the EU. For example, AEO status will play a more important role, since the ability to avoid the requirement to present goods under a local clearance procedure will not be available unless a company has obtained an AEO certification. Since the first-sale principle will be abolished, and most royalty payments will need to be included in the customs value, this will affect the duty burden.

The UCC legal package will implement rules to further its aims to modernize EU customs law and to improve safety and security, as well as increasing and improving the collection of customs duties. However, many open questions remain on the upcoming changes. The European Commission is drafting guidance notes to answer these questions and is expected to publish them in the near future.

To achieve the intended harmonization of customs rules, the important task remains for all national customs authorities to implement the new legislation. Hopefully, this will be accomplished by taking into account the intent and spirit of the new legislation. The EU must closely follow the interpretations of the new law by all member state competent authorities to prevent competition between member states. This will further the image of the EU as a single trading bloc in which the movement of goods is treated in the same way in all member states.

The introduction of new or modified concepts for customs purposes, following the implementation of the UCC, will require new interpretations of customs terms for purposes of other taxes, such as VAT (e.g. the party that can claim an export exemption will be affected). This inevitably will affect how foreign companies will have to organize their business in Europe, due to changes in the relevant requirements. These changes will need to be properly reflected in systems, on invoices and in intercompany agreements.

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All companies that are involved in international trade should be considering and assessing how the changes under the UCC will affect their business and their supply chain. Time is pressing, as the UCC will become fully applicable as from 1 May 2016 – little time is left to assess its impact.

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European Commission proposes public reporting requirements for multinationals

On 12 April 2016, the European Commission proposed measures that would require the largest companies operating in the EU to publish annually a report disclosing the profits earned and tax paid in each member state, as well as other information, on a country-by-country (CbC) basis. An aggregated reporting obligation would apply with respect to operations conducted outside the EU, and if the group includes a company incorporated in a listed tax haven, the information would have to be disclosed on an individual country basis.

In the Commission's view, "greater transparency of companies is needed to enable public scrutiny of whether tax is paid where profits are produced." Although the G20/OECD's base erosion and profit shifting (BEPS) project includes a requirement to implement CbC reporting to tax authorities (BEPS action 13), which the Commission intends to adopt on a pan-European basis though an EU directive, the new proposal is separate and would require public reporting for companies operating in the EU (for coverage of the proposed EU anti-avoidance package that includes the directive, see *World Tax Advisor*, 12 February 2016). The new proposal for public reporting states that "information should be based on the reporting specifications of BEPS' Action 13 and should be limited to what is necessary to enable effective public scrutiny."
URL: http://newsletters.usdbriefs.com/2016/Tax/WTA/160212_1.html

Assuming the European Commission's proposal is adopted, it will be implemented through amendments to the existing EU accounting directive governing the disclosure of income tax information. As such, the proposed measures do not relate to the harmonization of tax rules, which would require the unanimous agreement of the 28 EU member states; instead only qualified majority approval would be needed – broadly, approval of 16 member states representing at least 65% of the European population. The approval of the European Parliament also is required.

Overview of proposal

Affected parties: The proposed rules would apply to EU-based parent companies of multinational groups (MNCs) that have more than EUR 750 million in net turnover. MNCs

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headquartered outside the EU would be subject to the rules where the group has more than EUR 750 million in net turnover and the group operates in the EU through medium or large subsidiaries or branches (based on existing EU thresholds). Accordingly, the Commission expects that companies accounting for about 90% of corporate revenue in the EU would be subject to the reporting requirements.

The proposal would apply to all industry sectors (including extractive and logging industries already subject to different rules on public reporting of payments to governments). However, an exemption clause would prevent double reporting for financial institutions already subject to the public reporting rules under EU banking legislation.

Reporting requirements: The report would have to include information relating to the ultimate parent undertaking of the MNC, including activities of all affiliated undertakings consolidated in the ultimate parent's financial statements. The information to be disclosed would include:

- The nature of the activities;
- The number of employees;
- The total net turnover, which would include turnover made with related and unrelated parties;
- Profit or loss before income tax;
- The amount of income tax accrued (current tax expense) as a result of profits made in the relevant year;
- The amount of income tax paid during the relevant year; and
- Accumulated earnings.

The information would have to be disclosed for each EU member state in which the company was active. Non-EU information would be able to be aggregated, except for information related to certain tax havens (i.e. information relating to operations based in third countries that the Commission considers "do not respect international tax good governance standards"). In the latter case, information would have to be provided on a CbC basis.

Further work will be undertaken to draw up a common list of tax jurisdictions that are considered not to comply with international tax good governance standards, with the final decision on whether a tax jurisdiction will be included in the list made following a consultation with the relevant jurisdictions. The criteria will be based on the External Strategy for Effective Taxation, released on 28 January 2016, and the European Commission intends that this work should be completed by the end of 2016. Tax jurisdictions will be assessed on compliance with the following:

- Transparency and exchange of information;
- Fair tax competition;
- Standards set by the G20 and/or OECD; and
- Other relevant standards, including international standards set by the Financial Action Task Force.

Information in the report would have to be provided in the currency used in the consolidated financial statements, and explanations would be required at the corporate group level where there are material discrepancies between the taxes actually paid and the taxes accrued.

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The consolidated report on income tax information would have to be published with a business register in the EU and made accessible to the public on the company's website in at least one of the official languages of the EU, although the proposals are silent as to when the report would have to be published. Reports would have to be accessible for at least five consecutive years.

Reporting party: If the ultimate parent company for the group is incorporated in an EU member state, that parent company would be the entity responsible for preparing and publishing the public information report. If the ultimate parent company for the group is situated outside the EU, but the group has qualifying subsidiaries and branches in the EU, the non-EU parent would have the option of publishing its report on income tax information on its website and allowing one of its EU subsidiaries to file the report with an official business register in the EU. Alternatively, the EU-based medium and large subsidiaries (or branches of a comparable size where no such subsidiaries exist) each would be required to publish the report of the ultimate parent.

Compliance: The disclosure would have to be reviewed by the reporting entity's statutory auditors to assess compliance, and comment by exception in audit reports. It does not appear that an audit of the underlying information would be required.

Penalties for failure to comply with the directive are left to member states, in accordance with the accounting directive. National authorities would be permitted to impose fines on noncomplying companies, provided the penalties are "effective, proportionate and dissuasive."

Comments

In 2015, the Commission conducted a public consultation on corporate tax transparency in the EU. It is fair to note that the businesses, professional firms and professional bodies responding did not favor public CbC reporting. However, equally unsurprisingly, nongovernment organizations did favor its introduction, as does the European Parliament, which has an equal role with the Council of Ministers in legislating in this accounting area. This proposal reflects the outcome of this work.

The Commission considers that the proposal is proportionate and will not jeopardize competitiveness. However, business likely will remain concerned that the reporting obligation would create a competitive disadvantage and additional administrative burdens.

Although separate from BEPS action 13 (and the draft directive that would implement action 13 throughout the EU), alignment of the data points to most of those required by action 13 is helpful; it is to be hoped that the first publication date will be after the action 13 report is delivered.

MNCs would need to carefully consider whether to provide additional information to explain the tax position set out in their report more completely. Some MNCs may prefer public information to be subject to some form of external scrutiny.

The council of ministers is expected to discuss the proposal in June, and it also will need approval of the European parliament. If the public reporting proposal is adopted, EU member

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states will have to transpose the changes into their national legislation within one year following the entry into force of the amended accounting directive.

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Belgium:
VAT on directors' fees clarified

Belgium's VAT authorities issued guidance on 30 March 2016 that clarifies the new rules that will require incorporated directors to charge VAT on their fees. Originally scheduled to enter into effect on 1 January 2015, the VAT rules on incorporated directors have been postponed several times. They now will apply as from 1 June 2016 – as from that date, incorporated directors will be considered taxable persons for VAT purposes, meaning that they will have to register for VAT purposes and charge VAT on their services. The current optional regime, under which companies may consider their mandates as not being subject to VAT, will be abolished. The activities of individuals acting as directors will remain outside the scope of VAT.

The new guidance clarifies the following:

- All remuneration paid to legal entities for management services, including tantièmes (an annual fee awarded to directors), will be subject to the 21% VAT. The tax point for tantièmes will be deemed to arise on the date of the annual meeting in which the shareholders decide whether to grant the tantième (the date of the accounting year end is irrelevant).
- Where companies acting as directors are active in sectors where VAT exemptions apply (e.g. intermediaries in the insurance industry and banking and financial services), the director company will be permitted to allocate the remuneration between management services (subject to the 21% VAT) and exempt professional services. If the remuneration is not allocated, the VAT authorities will deem at least 25% of the total remuneration received to be subject to VAT.
- A VAT exemption will apply where management fees in certain sectors do not exceed EUR 25,000 per year.
- A VAT group between the incorporated directors and the company will be allowed if all of the management companies have shares in the operating company, they collectively hold more than 50% of the voting rights of shares in the company and they formally agree that every decision on the "orientation of the operating company's policy" will be unanimous. A financial link, other than through the managed company, between the management companies will not be required.

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France:
Panama re-added to list of noncooperative jurisdictions

On 8 April 2016, the French tax authorities reclassified Panama as a "noncooperative" country for purposes of France's list of noncooperative states or territories (NCSTs). Panama was removed from the list in 2012 following the conclusion of a tax treaty with France, but has been added back to the list as from 1 January 2016 because France did not consider that the exchange of information provision in the treaty was operating as it should.

An NCST is a jurisdiction that is not an EU member state and has not concluded a treaty with France (or with at least 12 other jurisdictions) that includes an administrative assistance provision regarding tax matters. A jurisdiction that has signed such an agreement with France still may be considered an NCST if the treaty is not ratified or if the administrative assistance provision is not effectively applied by the other contracting state.

Inclusion on the NCST list means that dividends, interest and royalties paid out of France to the NCST jurisdiction will be subject to a 75% withholding tax, and dividends received from entities located in the NCST jurisdiction and capital gains on the disposal of shares in companies located in the NCST jurisdiction may not benefit from the French participation exemption. (However, as provided in the amended finance law for 2015, the participation exemption for dividends will apply if the French recipient company can demonstrate that the distributing entity carries on real activities and that the location of the entity does not aim at, or result in, the entity benefiting from a favorable tax regime in the NCST.) The measures increasing the tax burden on payments from/to NCSTs will apply with respect to payments between France and Panama as from 1 January 2017.

The French government publishes the list of NCSTs on an annual basis. The list now includes seven jurisdictions: Botswana, Brunei, Guatemala, Marshall Islands, Nauru, Niue and Panama.

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India:
ITAT clarifies tax treatment of software supply

The Mumbai Income Tax Appellate Tribunal (ITAT) issued a decision on 24 February 2016 concluding that where software is supplied predominantly as a part of a supply of equipment/machinery and the software is embedded in the equipment/machinery that is the main object of the transaction, the transaction constitutes a sale of equipment/machinery,

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rather than a sale of software. Hence, the payment for the supply cannot be considered a royalty subject to withholding tax under India's domestic law.

The classification of software payments as royalties under India's Income Tax Act, 1961 (ITA) has been controversial and the subject of litigation before various Indian tribunals and courts, with decisions both in favor of and against the argument that a payment made for software/licensed products is not in the nature of a "royalty" under India's domestic tax law and tax treaties. The classification took on greater importance when the source rule for the taxation of royalties under the ITA was amended in 2012 (on a retroactive basis). The definition now clarifies that a royalty is deemed to arise in India if there is a transfer in respect of any right, property or information, including the right for the use of/to use computer software (and the granting of a license), regardless of the medium through which the right is transferred or where the property is situated. As long as the underlying rights, property, information or services are used in India, a royalty will be deemed to exist. However, the change in the ITA created a new controversy – whether the expanded definition of a royalty under domestic law prevails over the definition in India's tax treaties where royalties are defined narrowly (typically, to mean consideration for the use of, or the right to use, a copyright of a literary, artistic or scientific work), so that withholding tax is triggered only if there is a transfer of a copyright.

Another controversy relating to the classification of software payments involves the tax treatment of software that is embedded in hardware/equipment and sold with the hardware/equipment as a single package. This issue also has been subject to inconsistent rulings. Taxpayers typically argue that since the software is embedded in hardware, the software is an integral part of the hardware and has no purpose other than to make the hardware operational; hence, the transaction should be taxed as income from the sale of goods (i.e. the hardware). This argument is based on the premise that a customer would not be able to use the software independently without the hardware/equipment, and no copyright/license in the software passes to the customer. Accordingly, income from the sale of software along with hardware should be characterized as a single source of income, i.e. income from sale of goods, and not split into two parts as income from the sale of goods (hardware/equipment) and royalty income (software). However, the Indian tax authorities have taken the position that a sale of software embedded in hardware, even though it is part of the hardware/equipment sold, gives rise to a transfer of a license/copyright and, hence, the relevant income constitutes a royalty.

In the case before the Mumbai ITAT, an Israeli company sold a diamond and gem scanning machine to customers in India. Software was an integral part of the equipment that was needed to make the machinery operational. However, the value of the software and the value of the machinery were separately quoted by the taxpayer. The Indian tax authorities determined that the payments received for the software component were taxable as royalties. However, the taxpayer argued that there was no separate transaction involving a sale of software and that the transaction predominantly was a sale of the equipment, so it could not be subject to tax as a royalty. The ITAT agreed with the taxpayer and held that the customer had no interest in the software except to the extent it enabled the equipment to function. Thus, the transaction had to be treated as a sale of equipment and the amount allocated to software could not be treated differently as consideration in the nature of a royalty.

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The ITAT went on to note that changes to domestic law cannot automatically be read into tax treaties unless the relevant treaty is renegotiated and revised. Hence, the expanded domestic law definition of a royalty will not override the royalty article (article 12) of India's tax treaties. The ITAT decision somewhat parallels a recent decision issued by the Delhi High Court in the New Skies Satellite case, in which the High Court held that the domestic law definition of the term royalty, as expanded in 2012, will not override the definition of royalties under a relevant tax treaty.

Comments

The ITAT decision should be beneficial to foreign companies that sell equipment to Indian customers where software is an integral part of the supply of the equipment/machinery, as well as in cases involving the expanded definition of royalties (e.g. payments for the use of telecommunication services, such as bandwidth and transponders). It will add further credence to the position taken by various courts that the tax authorities' broader interpretation of the definition of a royalty goes too far.

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Mexico: New protocol signed to tax treaty with Spain

On 17 December 2015, Mexico and Spain signed a protocol to amend the existing tax treaty between the two countries dating back to 1992, after almost a year and a half of negotiations. The amending protocol is expected to enter into force three months after the exchange of diplomatic notes between the contracting states on the fulfillment of the necessary domestic ratification requirements. Among other measures, the protocol will implement recommendations under action 6 of the OECD's base erosion and profit shifting (BEPS) action plan (treaty abuse) (including the first principal purpose test to be introduced into a Mexican treaty); modify the withholding tax provisions for dividends, interest and capital gains; change the anti-deferral rule for intragroup reorganizations; and make certain other modifications.

The most relevant changes to the treaty are detailed below:

Treaty abuse

In line with BEPS action 6, the preamble to the tax treaty will be modified to reflect that it is not the intention of the parties to create opportunities for nontaxation as a result of tax evasion or tax avoidance practices.

Additionally, following the proposals under BEPS action 6 almost to the letter, a new limitation on benefits (LOB) provision will be introduced in the form of a "principal purpose test." The test provides that the benefits of the treaty will not be granted for an item of income if, taking into account all relevant facts and circumstances, it is reasonable to consider that the agreement or

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transaction that directly or indirectly resulted in the right to claim the treaty benefit had among its principal purposes the obtaining of that benefit, unless it is determined that, under the circumstances, the obtaining of the benefit is in accordance with the object and purposes of the tax treaty.

As a consequence of the new LOB, the targeted anti-avoidance rules included in the interest and royalties articles of the current treaty (article 11(9) and 12(8), respectively, will be eliminated).

Withholding taxes

The protocol will modify the source-country withholding tax provisions for dividends, interest and capital gains (the withholding tax on royalties will not be affected by the protocol).

Dividends: The source-country withholding tax rate on dividends currently is 5% where the beneficial owner is a corporation that owns directly at least 25% of the shares of the company paying the dividends; otherwise, the rate is 15%. The protocol will provide an exemption from source-country taxation where the dividend recipient is:

- A corporation whose capital is divided into shares or participations and that owns at least 10% of the shares of the payer company; or
- A pension fund resident in the other contracting state.

The rate will be 10% in all other cases, regardless of whether the recipient is a corporation or an individual, and there will be no minimum holding requirement.

Interest: The interest article currently provides that interest income derived by a resident of one contracting state and arising in the other contracting state is subject to tax in the source country at a rate of 10% where the interest is paid to a bank that is the beneficial owner, and at a 15% rate in all other cases (although no source-country taxation is triggered on certain loans targeted to promote exports, or when interest is paid by or to the contracting states, their subdivisions or local authorities).

A most-favored nation clause in the current treaty that applies to the interest article (as well as the royalties article) provides that if Mexico subsequently concludes a treaty with another OECD member country that provides for tax rates lower than were agreed in the Mexico-Spain treaty, the lower tax rate will apply automatically. (For example, the tax rate is reduced to 5% where interest is paid to a bank of the other state or derived from securities publicly and substantially traded in recognized markets by virtue of Mexico's tax treaties with Denmark, the Netherlands and the UK.)

The amending protocol will provide a new exemption from source-country taxation where the beneficiary of the interest is a pension fund and will reduce the withholding tax rate to 4.9% where interest is paid to a bank or other financial institution of the other contracting state, as well as where interest is paid on securities publicly and substantially traded in recognized markets; a 10% tax rate will apply in all other cases.

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Capital gains: The *de minimis* rule under the current treaty that eliminates source-country taxation in the case of direct share disposals where the seller's shareholding does not exceed 25% of the company's capital in the 12 months before the sale will be eliminated; however, the source-country tax on direct disposals of shares will be reduced from 25% to 10% of the net gain. Additionally, a new source-country taxation exemption will apply where the seller of the shares is a financial or insurance institution or a pension fund, or where the shares are publicly traded in a recognized market (except for certain real estate shares).

Intragroup reorganizations

The tax deferral provision for certain reorganizations that currently is available for mergers, spinoffs or share-for-share exchanges will be limited to share-for-share exchanges that comply with the following conditions:

- The consideration received by the transferor consists solely of a participation or other rights in the capital of the transferee or of another company that, before the transfer: (1) owns, directly or indirectly, 80% or more of the transferee; or (2) is owned, directly or indirectly, 80% or more by the transferee;
- Immediately after the transfer: (1) the transferor owns, directly or indirectly, 80% or more of the voting rights and capital of the transferee; (2) another company owns, directly or indirectly, 80% or more of the voting rights and capital of both the transferor and transferee; or (3) the transferor owns 80% or more of the voting rights and capital of the company that previously was owned by the transferee; and
- All corporations involved are residents of one of the contracting states or of a country with which the source state has a treaty or an effective information exchange agreement at least as broad as article 27 of the Mexico-Spain treaty (as amended by the new protocol).

Other provisions

- **Residence tiebreaker rule for corporations:** Where the application of the "place of effective management" test for tax residence results in dual residence, the competent authorities will, via the mutual agreement procedure, determine the country of residence of the corporation for purposes of the application of the treaty by considering where the delegated council and high executives habitually carry on their functions, where the day-to-day upper management decisions take place and other similar factors.
- **Transfer pricing:** A new provision will be included in the associated enterprises article of the treaty (article 9) on secondary adjustments in the case of double taxation resulting from an assessment by the tax authorities in transactions between related parties.
- **Technical assistance payments as business profits:** Similar to the protocol of the Mexico-Netherlands tax treaty, a clarification will be included regarding the treatment of technical assistance payments under the business profits article (article 7) or independent personal services article (article 14) of the Mexico-Spain treaty.
- **Permanent establishments for oil and gas exploration and production industry:** In line with the provisions of the Mexican Hydrocarbons Law and Hydrocarbons Revenue Law, a new article 22 will be included in the treaty, which will provide that a resident of one contracting state carrying on exploration, production, refinement, processing,

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transportation, distribution, warehousing or trading of hydrocarbons in the other contracting state for a period exceeding 30 days in any 12-month period will create a permanent establishment in the other contracting state. For purposes of the 30-day term, the activities carried on by associated enterprises may be aggregated, if such activities are identical or substantially similar. A similar provision will be included for purposes of the taxation of wages and salaries of employees carrying on the relevant activities.

- **Elimination of double taxation:** The protocol includes a provision that Mexican corporations may credit the underlying corporate income tax paid by Spanish subsidiaries where the Mexican corporation holds at least 10% of the Spanish subsidiary. The provision is in line with article 5 of the Mexican Income Tax Law. (In the case of Spain, Spanish residents are able to deduct the corporate income tax paid in Mexico by Mexican subsidiaries paying dividends, as well as the applicable taxes withheld by Mexico, in accordance with the domestic legislation.)
- **Tax arbitration:** A new mutual agreement procedure (article 26) will be included in the treaty. Mexico agreed that if, in the future, a tax treaty with an arbitration provision similar to the one included in the OECD model treaty is concluded with a third state, the provision will apply automatically between Spain and Mexico as from the date of entry into force of the treaty between Mexico and the third state.
- **Exchange of information and assistance in collection of taxes:** The exchange of information article (article 27) will be modified to align with article 26 of the OECD model treaty, since its scope will be extended to other taxes not covered by the treaty. Additionally, a new article 28 will be introduced regarding assistance in the collection of taxes.

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Zimbabwe:
Transfer pricing rules introduced

A transfer pricing framework introduced into Zimbabwe's tax laws as from 1 January 2016 broadly follows the OECD transfer pricing guidelines (although the UN practical manual on transfer pricing for developing countries also is mentioned in the legislation). The main features of the new rules are as follows:

- Where a person engages in a controlled transaction (i.e. a transaction with a related party), the amount of taxable income derived must be consistent with the arm's length principle, i.e. the conditions that would have applied between independent parties under comparable circumstances.
- Comparability will be determined by taking into account the characteristics of the property/services, functions performed, assets owned and risks borne, contractual terms, economic circumstances and business strategies of each of the associated parties.

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- Documentation supporting the arm's length nature of intercompany transactions must be prepared and maintained, to enable the Zimbabwe tax authorities to ascertain whether a transaction was conducted in accordance with the arm's length principle.
- In accordance with OECD principles, the supporting documentation must contain a detailed "functional analysis" and an "economic analysis," including information on how the most appropriate transfer pricing method was selected and the application of the method, to demonstrate the arm's length nature of the transaction and price.
- Traditional transaction methods (comparable uncontrolled price, resale price and cost plus methods) and profit-based methods (transactional net margin method and profit split method) may be used.
- Although the transfer pricing rules typically apply only with respect to foreign related parties, the legislation indicates that, in line with Zimbabwe's anti-avoidance legislation, domestic transactions also may be subject to the rules.
- The transfer pricing principles also will apply where a Zimbabwe-resident person engages in a transaction with a person (whether or not related) resident outside Zimbabwe in a jurisdiction considered by the Commissioner General to provide a tax benefit in relation to the transaction. It appears that the aim of this section is to "red-flag" cross-border transactions between Zimbabwe and a low-tax jurisdiction (tax haven), particularly if the overseas entity lacks substance and significant "people functions."

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In brief

Bosnia and Herzegovina: A new corporate income tax law, which became effective on 5 March 2016, contains changes to the transfer pricing rules and introduces thin capitalization rules. A person engaged in transactions with related parties must have transfer pricing documentation in place by the time the tax return is due, and the documentation must be presented to the tax authorities within 45 days of a request. A 4:1 debt-to-equity ratio applies for purposes of the thin capitalization rules, i.e. interest expense on related party loans and other financial instruments is deductible up to four times the amount of registered capital. Excess interest is nondeductible. The thin capitalization rules do not apply to banks or insurance companies. Rulebooks on the application of the new law should be published within six months of the effective date.

China: The State Administration of Taxation (SAT) recently launched an initiative under which approximately 1,000 taxpayer groups (both China-owned groups and multinational groups with Chinese subsidiaries) with annual tax revenue exceeding RMB 300 million were asked to provide certain financial information to the Chinese tax authorities, using a data retrieval tool developed by the SAT. The goal of the initiative is to build a database to enable the SAT to use data analytics to better understand the impact of taxation on economic development, and to equip the tax authorities with information and insight to allow them to manage tax collection risks in a self-assessment environment (the type of system to which China wishes to move). Many of the selected companies were requested to provide the data by 31 March 2016, but not

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all were able to meet the deadline (likely because the manner in which the financial data was stored did not allow for quick extraction of the requested data).

New Zealand: The finance minister and revenue minister issued a joint media release on 11 April 2016 announcing that there will be an independent review of the disclosure rules covering foreign trusts registered in New Zealand. The foreign trust regime currently requires these trusts to be registered with Inland Revenue. Trusts also are required to maintain detailed financial and other records, but these records have to be disclosed to Inland Revenue only if so requested. The scope of the foreign trust regime review will be limited to the foreign trust disclosure rules as they apply to recordkeeping, enforcement and the exchange of information with other jurisdictions. The review is expected to be reported back by 30 June 2016.

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.

European Union: The European Commission has proposed measures that would impose public country-by-country (CbC) reporting requirements on certain multinationals. See the article in this issue.
URL: http://newsletters.usdbriefs.com/2016/Tax/WTA/160422_2.html

Ireland: The introduction of a formal advance pricing agreement program should be welcome news to taxpayers seeking certainty on transfer pricing arrangements in light of the BEPS project. See Global transfer pricing alert, 7 April 2016.
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-012-7-april-2016.pdf

Mexico-Spain: A protocol to amend the 1992 treaty will implement recommendations under action 6 of the BEPS action plan (treaty abuse). See the article in this issue.
URL: http://newsletters.usdbriefs.com/2016/Tax/WTA/160422_6.html

OECD: The OECD has announced the release dates for several discussion drafts it plans to issue for public consultation on topics identified as areas for additional work in relation to BEPS actions 2 (hybrid mismatch arrangements) and 4 (interest deductions): the discussion draft on elements of the design and operation of the group ratio rule in relation to interest deductions will be released on 22 June 2016; the discussion draft on hybrid mismatch arrangements and branches will be released on 30 June 2016; and the discussion draft on issues involving interest deductions in the banking and insurance sectors will be released on 6 July 2016.

OECD: On 19 April 2016, the International Monetary Fund, the OECD, the UN and the World Bank Group announced details of the "Platform for Collaboration on Tax," a collaborative effort to intensify cooperation on tax issues. The platform will formalize regular discussions between the four international organizations on the design and implementation of standards for international tax matters, and will enhance their capacity-building support, deliver jointly

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developed guidance and increase information-sharing on operational and knowledge activities. One of the first tasks of the platform will be to deliver a number of “toolkits” to help developing countries implement the measures developed under the BEPS initiative and on other international tax issues. Platform members will hold regular meetings with representatives of developing countries, regional tax organizations, banks and donors and consultations with business and the public will be organized as needed.

Portugal: A CbC reporting obligation has been introduced for multinational enterprises. See Global transfer pricing alert, 9 April 2016.
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-014-9-april-2016.pdf

Turkey: The tax authorities have proposed the adoption of a CbC reporting requirement. See Global transfer pricing alert, 7 April 2016.
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-013-7-april-2016.pdf

United States: Advance pricing agreements are playing an increasingly important role in transfer pricing risk management as countries adopt the BEPS final recommendations. See Global transfer pricing alert, 13 April 2016.
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-015-13-april-2016.pdf

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Tax treaty round up

At the end of each month, *World Tax Advisor* provides an update on recent tax treaty developments, with a focus on items that directly affect the withholding tax rates of the key jurisdictions covered by the Deloitte International Tax Source (DITS). Additional coverage may include stated negotiating priorities and other important tax treaty trends.
URL: http://www.dits.deloitte.com?id=us:em:na:wta:eng:tax

Unless otherwise noted, the developments discussed below are not yet in force.

China-Bahrain: The 2013 protocol to the 2002 treaty entered into force on 1 April 2016 and will apply as from 1 January 2017. When in effect, the protocol provides that a 10% withholding tax rate will apply to dividends. The withholding tax rates on interest and royalties will not be affected by the protocol.

China-Germany: The 2014 treaty to replace the 1985 treaty entered into force on 5 April 2016 and will apply as from 1 January 2017. When in effect, the treaty provides for a 5% withholding tax rate on dividends paid to a company (other than a partnership) that holds directly at least 25% of the capital of the payer company; a 15% rate will apply to dividends paid from income (including gains) derived directly or indirectly from immovable property by an investment vehicle that distributes most of the income annually and whose income from the immovable property is tax exempt; otherwise, the rate will be 10%. A 10% rate will apply to interest, with an exemption for interest paid in connection with the sale of commercial or scientific equipment on credit. A 10% rate will apply to royalties paid for the use of, or the right to use, a copyright of

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literary, artistic or scientific work (including film and television royalties); a patent, trademark, design or model, plan, secret formula or process; or for information concerning industrial, commercial or scientific experience. Royalties paid for the use of, or the right to use, industrial, commercial or scientific equipment will be taxable at a rate of 10% of the “adjusted amount” of the royalties, which is 60% of the gross amount.

China-Russia: The 2014 treaty and 2015 protocol to replace the 1994 treaty entered into force on 9 April 2016 and will apply as from 1 January 2017. When in effect, they provide for a 5% withholding tax rate on dividends paid to a company (other than a partnership) that holds directly at least 25% of the capital of the payer company and this holding amounts to at least EUR 80,000 or the equivalent in any other currency; otherwise, the rate will be 10%. The rate on interest will be 0% and that on royalties, 6%.

Croatia-India: The 2014 treaty entered into force on 11 February 2015 and applies as from 1 January 2016 for Croatia and as from 1 April 2016 for India. The treaty provides for a 5% withholding tax rate on dividends paid to a company (other than a partnership) that holds directly at least 10% of the capital of the distributing company; otherwise, the rate is 15%. A 10% rate applies to interest and royalties (as well as technical service fees).

France-Panama: See article in this issue.
URL: http://newsletters.usdbriefs.com/2016/Tax/WTA/160422_4.html

Hong Kong-Italy: The 2013 tax agreement entered into force on 10 August 2015 and applies as from 1 April 2016 for Hong Kong and as from 1 January 2016 for Italy. The agreement provides for a 10% withholding tax rate on dividends, a 12.5% rate on interest and a 15% rate on royalties.

Hong Kong-Latvia: When in effect, the tax agreement signed on 13 April 2016 provides for a 0% withholding tax rate where dividends are paid to a company (other than a partnership) or to a pension fund or scheme; otherwise, the rate will be 10%. A 0% rate will apply to interest paid by a company to a company (other than a partnership) or paid to a pension fund or scheme; otherwise, the rate will be 10%. A 0% rate will apply to royalties paid by a company to a company (other than a partnership) for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience; otherwise, the rate will be 3%.

Hong Kong-South Africa: The 2014 tax agreement entered into force on 20 October 2015 and applies as from 1 April 2016 for Hong Kong and as from 1 January 2016 for South Africa. The agreement provides for a 5% withholding tax rate on dividends paid to a company that holds directly at least 10% of the capital of the payer company; otherwise, the rate is 10%. The rate on interest is 10% and that on royalties, 5%.

Hong Kong-United Arab Emirates: The 2014 tax agreement entered into force on 10 December 2015 and applies as from 1 April 2016 for Hong Kong and as from 1 January 2016 for the United Arab Emirates. The agreement provides for a 5% withholding tax rate on dividends, interest and royalties.

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India-Korea: When in effect, the treaty signed on 18 May 2015 to replace the 1985 treaty provides for a 15% withholding tax rate on dividends and a 10% rate on interest and royalties (as well as technical service fees).

India-Thailand: The 2015 treaty to replace the 1985 treaty entered into force on 13 October 2015 and applies as from 1 April 2016 for India and as from 1 January 2016 for Thailand. The treaty provides for a 10% withholding tax rate on dividends, interest and royalties.

India: See article in this issue.
URL: http://newsletters.usdbriefs.com/2016/Tax/WTA/160422_5.html

Mexico-Spain: See article in this issue.
URL: http://newsletters.usdbriefs.com/2016/Tax/WTA/160422_6.html

Portugal-Saudi Arabia: When in effect, the treaty signed on 8 April 2015 provides for a 5% withholding tax rate where dividends are paid to a company (other than a partnership) that holds directly at least 10% of the capital of the payer company; otherwise, the rate will be 10%. A 10% rate will apply to interest, and an 8% rate to royalties.

Slovenia-Morocco: When in effect, the treaty signed on 5 April 2016 provides for a 7% withholding tax rate where dividends are paid to a company that holds directly at least 25% of the capital of the payer company; otherwise, the rate will be 10%. The rate on interest and royalties will be 10%.

Spain-Andorra: The 2015 treaty entered into force on 26 February 2016 and applies as from that date for withholding tax purposes. The treaty provides for a 5% withholding tax rate where dividends are paid to a company (other than a partnership) that holds directly at least 25% of the capital of the payer company; otherwise, the rate is 15%. The 15% rate also applies to dividends paid by a Spanish corporation listed on the real estate investment market to an Andorra resident. The rate on interest and royalties is 5%.

Turkey-Ivory Coast: When in effect, the treaty signed on 29 February 2016 provides for a 5% withholding tax rate where dividends are paid to a company (other than a partnership) that holds directly at least 10% of the capital of the payer company; otherwise, the rate will be 10%. The rate on interest and royalties will be 10%.

United States: An intergovernmental agreement (IGA) to improve international tax compliance and to implement the Foreign Account Tax Compliance Act was signed with Thailand on 4 March 2016. An IGA also has been signed with Vietnam; however, according to the US treasury department website, the IGA is not treated as in effect and financial institutions will not be treated as covered by the IGA (including for withholding or registration purposes) until the IGA has entered into force.

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Ireland

Irish Revenue announce formal APA program

At the 2016 Global Tax Policy Conference held in Dublin in March 2016, a representative of the Irish Revenue Commissioners indicated that a formal bilateral advance pricing agreement program would be introduced in Ireland in the near future.

Issue date: 7 April 2016

URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-012-7-april-2016.pdf

Portugal

Portugal introduces country-by-country reporting requirement

The budget law for 2016, approved on 16 March 2016, introduced a country-by-country reporting obligation for multinational enterprises (MNEs) that is intended to provide the Portuguese tax authorities with additional information on the MNE's activities for risk assessment purposes.

Issue date: 9 April 2016

URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-014-9-april-2016.pdf

Turkey

Turkey proposes adoption of country-by-country reporting requirement

On 16 March 2016, the Revenue Administration released a proposed transfer pricing communiqué relating to the adoption of the country-by-country reporting requirement under the OECD's base erosion and profit shifting action 13 recommendations.

Issue date: 7 April 2016

URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-013-7-april-2016.pdf

United States

2015 US APA report shows interest in APAs has never been higher

On 31 March 2016, the Internal Revenue Service released the advance pricing agreement annual report covering the activities of the Advance Pricing and Mutual Agreement (APMA) Program during calendar year 2015.

Issue date: 13 April 2016

URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-015-13-april-2016.pdf

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