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Cyprus amends IP regime to introduce OECD nexus approach

Changes to Cyprus' intellectual property (IP) regime that were incorporated into the Income Tax Law (ITL) and published in the official gazette on 27 October 2016 provide for the gradual phasing out of the current IP regime and the introduction of a new regime that is in line with the latest international developments on the taxation of IP income and recommendations under action 5 of the OECD's BEPS project. Regulations have been issued that contain detailed guidance on the application of the new IP regime.

Under the current IP regime, 80% of the net profit from the exploitation of IP is exempt from taxation. Net profit is calculated after deducting from the IP income all direct expenses associated with the production of the income, as well as capital allowances at a rate of 20%. Qualifying income includes royalties and gains derived from the disposal of IP; qualifying assets are defined broadly to include copyrights, patented inventions, trademarks and service marks.

Transition rules applicable for current IP regime

The main changes to the IP regime include the introduction of transition rules to limit entrants into the regime and ensure that the current regime is phased out by 30 June 2021. The current IP regime will continue to apply until 30 June 2021 with respect to IP that:

- Qualified for the current regime before 2 January 2016;
- Was developed or acquired from a related party during the period from 2 January 2016 through 30 June 2016, where the IP qualified for the benefits of the current regime before the acquisition or qualified for a similar regime in another country, and the IP was not acquired for the main purpose (or one of the main purposes) of avoiding tax; or
- Was acquired from an unrelated party or was self-developed during the period from 2 January 2016 through 30 June 2016.

A shorter transition period will apply to IP developed or acquired from a related party during the period from 2 January 2016 through 30 June 2016 that does not otherwise fall within the scope outlined above; in this case, benefits under the current regime will apply only through 31 December 2016.

New IP regime

The new IP regime is fully compliant with international developments relating to the tax treatment of IP income and the recommendations under the OECD's BEPS project. In brief, under the new regime, 80% of qualifying profits generated from qualifying assets (QA) will be deemed to be tax-deductible expenses.

QA are those acquired, developed or exploited by a person in the course of its business and that relate to IP, are a result of R&D expenditure and for which the person is the economic owner, excluding any IP relating to marketing (trade names, brands, trademarks, image rights, etc.).

Qualifying profits are calculated based on the "nexus approach." More specifically, the level of profits eligible for the 80% tax exemption will depend on the level of R&D expenditure incurred by the taxpayer to develop the QA. The qualifying profits are calculated based on the following fraction:

$$OI \times (QE+UE)/OE$$

Where:

- OI is the "overall income derived from the QA";
- QE is the "qualifying expenditure on the QA";
- UE is the "uplift expenditure on the QA"; and
- OE is the "overall expenditure on the QA."

Overall income (OI) derived from qualifying assets is defined as the gross profit from the assets (i.e. gross income, less any direct expenditure). OI includes, but is not limited to:

- Royalties or any other amounts relating to the use of QA;
- Any amount for the grant of a license for the exploitation of the QA;
- Any amount relating to the insurance or compensation of the QA;
- Trading income from the disposal of the QA; and
- Embedded income on QA derived from the sale of goods, the provision of services or the use of any processes that are directly related to the QA.

Capital gains arising from the disposal of a QA under the new IP regime are not included in qualifying profits and are fully exempt from income tax.

Qualifying expenditure (QE) relating to a QA is the sum of all R&D expenditure incurred in any tax year wholly and exclusively for the development, enhancement or creation of a QA and that is directly related to that asset.

QE includes, but is not limited to:

- Salary and wages;
- Direct costs;
- General expenses associated with R&D activities;
- Commission expenditure associated with R&D activities; and
- R&D expenditure outsourced to unrelated parties.

QE does not include:

- The acquisition cost of a specific intangible asset;
- Interest paid or payable;
- Expenditure relating to the acquisition or construction of immovable property that has been paid, or is payable, directly or indirectly to a related person carrying out R&D, regardless of whether the amounts relate to a cost-sharing agreement; and
- Costs that cannot be shown to be directly associated with a specific QA.

Expenditure for the assignment of R&D activities to unrelated persons, as well as expenditure of a general and theoretical nature for R&D, that cannot be allocated to the QE of a specific QA with which it has a direct connection, may be allocated proportionately to the QA or products. QE is included in the nexus fraction in the year in which the expenditure was incurred, regardless of its accounting or tax treatment.

Uplift expenditure (UE) of a QA is the lower of (i) 30% of the QE, or (ii) the total acquisition cost of the QA and any R&D costs outsourced to related parties.

Overall expenditure (OE) of a QA is the sum of (i) QE, and (ii) the total acquisition cost of the QA and any R&D costs outsourced to related parties incurred in any tax year.

The following applies for purposes of calculating the nexus fraction:

- Direct costs include all expenditure incurred directly or indirectly, wholly and exclusively, for the production of the OI;
- The deduction granted under the relevant transfer pricing adjustment article of the ITL, which arises from the development or sale of a QA is treated as a direct expense.
- The deduction granted under the notional interest deduction provision in the ITL, which is attributable to a QA, is considered an indirect expense for purposes of calculating the profit.

The taxpayer may choose to forego all or part of the deduction and, where the calculation of qualifying profits results in a loss, only 20% of the loss may be carried forward or group-relieved under the ITL.

Qualifying taxpayers that are eligible for the IP regime include Cyprus tax resident persons, permanent establishments (PEs) of nonresident persons and foreign PEs that are subject to tax in Cyprus. Amending provisions have been introduced into the ITL to ensure that a taxpayer can elect whether a foreign PE is taxable in Cyprus, so that the PE can be classified as a qualifying taxpayer. Qualifying taxpayers are required to keep track of the relevant income and expenditure to be able to accurately calculate the nexus fraction.

Where the intangible asset qualifies for both the current and the new IP regimes, the current regime will apply until that regime is fully phased out.

Other changes relating to intangible assets

The amendments to the ITL also include the introduction of capital allowances for all intangible assets (except goodwill and assets qualifying for the current IP regime). As a result, the capital costs of such intangible assets will be tax deductible and will be spread over the useful economic life of the asset, as determined by generally acceptable accounting principles (up to a maximum useful life of 20 years). Upon disposal of such an intangible asset, a balancing statement will need to be made, with any balancing addition being subject to income tax and any balancing deduction being tax deductible. The taxpayer has the option not to claim capital allowances for such intangible assets in a particular tax year.

Comments

The new IP regime should incentivize businesses to set up and/or enhance their R&D activities in Cyprus to benefit from Cyprus' preferential tax regime on IP income, which is in line with the internationally agreed tax framework. With a low corporate tax rate of 12.5% and an exemption on qualifying IP income of 80%, businesses can achieve an effective tax rate as low as 2.5% when all R&D expenditure is incurred by the Cyprus entity benefiting from the regime. Furthermore, since an overseas PE of a Cyprus entity also may qualify for the IP regime, all qualifying expenditure incurred by such a PE is taken into account in the nexus fraction calculation, thus increasing the tax benefit.

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Irish finance bill 2016 presented

The Finance Bill 2016, presented by the Irish government on 20 October, contained few surprises and largely represented the measures announced by the Minister for Finance in the budget that was presented on 11 October 2016, in addition to some measures that would affect the financial services sector. The finance bill passed through its second stage on 26 October 2016 and is expected to pass through the third and fourth stages by 15 and 23 November, respectively. Once passed by both houses of parliament, the bill is expected to be signed into law by 3 January 2017. Many of the measures included in the finance bill would be effective as from 1 January 2017 (with some exceptions, as noted below).

Measures announced in the budget that were provided for in the finance bill include the following:

- A capital gains tax relief scheme for entrepreneurs, which would provide for a tax rate of 10% (reduced from 20%) on gains of up to EUR 1 million arising from disposals of qualifying businesses after 1 January 2017;
- Changes in the foreign earnings deduction and special assignee relief program;
- A reduction of the lower universal social charge (USC) rates of 1%, 3% and 5.5% by 0.5%, respectively, following the stated intention by the Minister for Finance to phase out the USC; and
- A provision that offshore tax defaulters no longer would be able to use the qualifying disclosure regime after 1 May 2017; interestingly, this would cover not only jurisdictions commonly regarded as offshore, but any country outside Ireland, so EU countries would be included for this purpose.

In addition to the measures announced in the budget, the finance bill includes a number of additional/amended provisions worthy of comment:

- Changes relating to country-by-country (CbC) reporting to transpose the EU directive regarding the mandatory automatic exchange of information into Ireland's domestic law. The changes would give Irish Revenue the power to issue regulations in relation to the appointment of an EU-designated entity that could file a CbC report on behalf of all EU constituent entities of a non-EU-parented group. In addition, Irish Revenue would be given the power to make regulations in respect of notification requirements for such an EU-designated entity that is tax resident in Ireland.

- With respect to the automatic exchange of advance cross-border rulings, the finance bill would permit the Irish competent authority to disclose certain supplementary information to other EU member states along with advance cross-border rulings or advance pricing arrangements (APAs). Advance cross-border rulings and APAs would have the same meaning as defined in the relevant EU directive.

  The supplemental information that could be provided in this regard would include:

- The main business activity;
- Annual turnover;
- Annual profits or losses;
- The address of the taxpayer; and
- In the context of APAs, where more than one transfer pricing methodology is used, an explanation as to why more than one methodology was used.

These changes would have an impact on multinational groups with APAs or advance cross-border rulings that are subject to the automatic exchange of information provisions. Companies affected by the changes should consider any increased tax risk resulting from the additional information likely to be disclosed along with advance cross-border rulings and APAs; the latter change would enter into effect on the date that the Minister for Finance may appoint by order.

- Amendments to offshore trust legislation with regard to the taxation of capital gains have been included in the finance bill. The relevant sections (sections 579 and 579A) of the Taxes Consolidation Act 1997 would be amended to include a subsection, under which those sections would not apply if the settlement was created for *bona fide* commercial reasons and did not form part of an arrangement where the main purpose, or one of the main purposes, was the avoidance of capital gains tax. The proposed amendment highlights Irish Revenue's fondness of "*bona fides*" tests. A similar amendment was included in the 2015 finance act in connection with the section governing share for undertaking transactions (three-party swaps).

- The employment and investment incentive scheme (which provides a deduction from taxable income where an individual invests in a relevant company – subject to certain conditions being fulfilled) would be amended to remove it from the high income earner restriction.

- New anti-avoidance provisions would be put in place to prevent the avoidance of tax by failing to vest personal retirement savings accounts (PRSAs). As from the date the finance bill is passed, where a PRSA remains unvested at the individual's 75th birthday, the benefits would be treated as having been taken on the date of that birthday and, thus, would be subject to the imputed distribution rules that apply to vested PRSAs. The purpose of this amendment appears be to target situations where an individual may have had more than one PRSA.

Financial services measures

In recent months, "S110 companies" and funds that derive profits directly or indirectly from Irish property and land have received significant media and political attention. As a result, a proposed draft of changes to section 110 of the Taxes Consolidation Acts 1997 (which contains the taxation regime for special purpose vehicles) was published in September 2016. The finance bill includes an amended version of the previous draft legislation and proposes amendments to the existing funds legislation.

S110 companies: The effect of the change to the proposed amendment to section 110 would be to treat the holding and/or managing of assets ("specified property business") held by a securitization vehicle that derive their value directly or indirectly from Irish land and property ("Irish property-related assets") as a separate business within the vehicle. This would mean apportioning income, profits, gains and expenses to that separate business on a just and reasonable basis.

The revised draft of the proposed legislation includes a specific exclusion from the amended legislation for collateralized loan obligation transactions, commercial mortgage-backed security and residential mortgage-backed security transactions and loan origination business (as defined).

The proposed exclusions are welcome and should assist in removing a number of genuine securitization transactions from the revised provisions.

The amendments would apply to accounting periods commencing after 6 September 2016; where a company's accounting period begins before that date and ends after that date, the accounting period would be divided into two parts.

Irish real estate funds: New legislation is being introduced to amend the existing funds tax regime, broadly, to provide for a 20% withholding tax on payments to certain persons by an IREF (Irish real estate fund). An IREF is a fund or subfund of a fund that derives 25% or more of its market value from Irish land and property (or assets that derive their value from Irish land or property) or, if the latter is not applicable, where it would be reasonable to consider that one of the main purposes of the fund was to acquire Irish land and property (or assets that derive their value from Irish land or property).

The 20% tax would apply on the making of a relevant payment by the IREF or on the redemption of units, to the extent that the amount of the redemption is attributable to IREF profits. Certain unit-holders would be excluded from the provisions, including certain Irish pension arrangements or PRSAs, Irish funds and life funds and EU/European Economic Area-regulated funds, pension funds and life funds.

Some amendments would appear to be necessary to ensure that other investors that previously were not subject to tax on fund investments (such as the National Treasury Management Agency, Ireland Strategic Investment Fund, charities, S110 companies and credit unions) are not affected by the new provisions. The funds provisions generally would be applicable for accounting periods commencing on or after 1 January 2017.

Comments

Tax directors of listed companies and multinationals are clearly focused on a rapidly changing global tax landscape, the complex sets of interacting new laws and the more challenging tax audit and regulatory environment. The inclusion of supplemental information along with the automatic exchange of advance cross-border rulings and APAs highlights the importance of ensuring consistency between the information exchanged by Irish Revenue under the automatic exchange of information provisions, the transfer pricing documentation to be prepared for the relevant countries, the CbC report (if applicable) and all other publicly available sources of information (such as the company website, publicly available company filings and other publicly available data). The changes proposed regarding the supplementary information that could be provided are reflective of the increased desire for transparency globally, which, in turn, is compelling businesses to adopt a centralized transfer pricing documentation approach and to examine transfer pricing on a unified, consistent global/regional basis.

The Minister for Finance has acknowledged the importance of Ireland's financial services sector. The minister stated that the proposed amendments are not designed to attack the sector, but merely to ensure that certain financial services vehicles are being used in the areas that originally were envisioned. The proposed draft amendments were carefully drafted to provide as much certainty as possible to the sector, while still ensuring the Irish tax base is protected from erosion. The changes in the S110 and fund legislation outlined above are significant where the assets of the entity or subfund derives its value from Irish property and land.

S110 companies and funds that do not invest in Irish real estate-related assets would not be affected by these changes.

In defending the decision not to eliminate section 110 altogether from the Irish tax legislation, the Minister for Finance pointed out that, in Ireland's domestic legislation and its tax treaties, the right to tax land in the state is maintained. The proposed amendments are consistent with this treatment. To eliminate the regime altogether would not be consistent with existing principles of Irish tax.

While the proposed draft amendments to section 110 represent the government's efforts to create certainty in the financial services sector as a result of recent media and political attention, changing the rules for investors at this stage has created uncertainty. Where such investments were acquired by investors, the prices that they would have paid for those investments have been set on the basis of the tax legislation that existed prior to such amendments; now that investors have taken on such investments, they would be faced with an unexpected tax on the investments.

As a period approaches where there is real opportunity for Ireland to attract financial services companies that potentially may relocate from the UK as a result of Brexit, it is important that Ireland's tax offerings provide businesses and investors with certainty and a tax regime that is attractive when compared with other competing jurisdictions.

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Colombia:
Tax reform bill presented to Congress

Colombia's Ministry of Finance presented a tax reform bill to Congress on 19 October 2016 that contains extensive proposals that would affect both direct and indirect tax, as well as tax administration. Congress now must review the proposed bill; if approved, the changes generally would apply as from 1 January 2017.

The most significant proposals in the bill include the following:

Proposals affecting companies

- A new tax on the business profits of companies or other entities would be introduced to replace the income tax, the income tax for equality (CREE) and the CREE surtax. (The income tax rate currently is 25%, with a 9% CREE levied in addition to the corporate income tax and a 6% CREE surcharge levied on net income exceeding COP 800 million.) Under the new tax on business profits, the general tax rates for taxable years 2017 and 2018 would be 34% and 33%, respectively, reducing to 32% as from 2019. A temporary income tax surcharge would be levied for taxable years 2017 and 2018, at a progressive rate from 0% to 5% for 2017 and from 0% to 3% for 2018. For taxable year 2018, a 100% estimated tax payment would be due for the income tax surcharge, which would have to be paid at the time the corporate income tax return is filed.
- The tax rate for companies operating in free trade zones (currently 15%) would be increased to a rate equal to the general income tax rate, less 10 percentage points (e.g. 24% for tax year 2017).
- The presumptive minimum income calculated annually for income tax purposes would be increased from 3% to 4% of the company's net tax equity.
- Dividends and income from profit participations received by Colombian companies would be considered taxable income, regardless of whether they are paid from profits that have been taxed at the level of the distributing company (currently, dividends paid from previously-taxed profits are exempt).
- A controlled foreign company (CFC) regime would be introduced that would require resident companies and individuals that own a direct or indirect participation of more than 10% in the capital of a foreign company that qualifies as a CFC to be taxed currently on their proportionate share of the CFC's income (including passive income), costs, expenses and deductions. A foreign company would need to be a related party for purposes of Colombia's transfer pricing rules to constitute a CFC.
- Certain deduction limitations would be introduced for corporate income tax purposes. The deduction for gifts and entertainment expenses (e.g. for parties, meetings and celebrations) in relation to customers, suppliers and employees would be limited to 1% of the company's accrued net taxable income, and salary payments and labor contributions payable as a result of labor litigation would be nondeductible.

Proposals affecting individuals

- The maximum income tax rate for individuals would increase from 33% to 35%, and the method for calculating income tax would change – it would be computed by separating the income received from different sources (employment income, pensions, royalties, other nonemployment income and dividends and profit participations), and aggregating the tax payable for each source. Special rules would apply to stock-based compensation.
- Alternative income tax computation systems, such as the national minimum alternative tax and the simple minimum alternative tax, would be abolished.
- Paralleling the proposal relating to companies, the presumptive minimum income calculated annually for income tax purposes would be increased from 3% to 4% of the individual's net worth.
- Dividends and income from profit participations received by individuals would be taxed at progressive rates ranging from 0% to 10% (depending on the amount) when the distributions are made from profits that have been taxed at the corporate level; otherwise, the rate would be 35%.

Proposals affecting nonprofit entities

The special tax regime for nonprofit entities would be modified. By default, nonprofit entities would be considered income tax payers, subject to the same rules applicable to companies. To be considered eligible for the special tax regime for nonprofits, a nonprofit would have to request that status from Colombia's tax administration and meet specific requirements. An entity could be excluded from the special regime if the tax authorities can prove it made certain payments. Additionally, payments to persons in management positions could not exceed 30% of the total annual expenditure of the payer entity.

Proposals affecting indirect taxes

- The standard VAT rate would increase from 16% to 19%; newspapers and publications, which currently are exempt, would be taxed at a 5% rate.
- Annual VAT returns would be eliminated; instead, VAT payers would be required to file bimonthly or quarterly returns.
- The financial transactions levy would be extended permanently, at the current tax rate of 0.4%.
- A national carbon tax would be introduced that would tax the carbon content of all fossil fuels, including all derivatives of petroleum that are used for energy purposes.

Proposals affecting tax administration

- A mandatory disclosure regime for aggressive tax planning strategies would be introduced, which would require taxpayers to disclose strategies that could generate a tax advantage. The obligation would apply to the taxpayer's legal advisor or the scheme promoter, regardless of whether the advisor/promoter is Colombian or foreign. The strategies that would be subject to the regime would depend on the type and amount of the transaction.
- A "provisional tax calculation" would be introduced to identify taxes that have been inaccurately reported or that have not been reported by the taxpayer, as well as omitted or improperly computed penalties payable due to noncompliance with formal obligations. The Colombian tax authorities would determine the tax due. The statute of limitations for returns amended or filed with respect to the provisional calculation would be six months from the date of filing or correction.
- The general statute of limitations for returns would be increased from two to three years from the due date to file the return or the application of a balance in favor of a refund. Additionally, new provisions regarding the statute of limitations for returns that generate a tax loss, and returns of taxpayers that are subject to the transfer pricing regime, would be six years from the filing due date or the actual filing date.
- Persons that hide assets or that pretend to have debts to evade taxes for amounts higher than 7,250 minimum monthly wages could be sent to prison for a period between four and nine years. Persons that commit such offenses but do not meet the threshold amount would be subject to a penalty corresponding to 20% of the tax evaded.

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Indonesia:
Clarifications on tax amnesty issued

Indonesia's Minister of Finance and the Directorate General of Taxes have issued several regulations that provide updates and clarifications to the July 2016 tax amnesty law and its implementing regulations (for prior coverage, see *World Tax Advisor*, 22 July 2016).
URL: http://newsletters.usdbriefs.com/2016/Tax/WTA/160722_5.html

Under the tax amnesty, taxpayers can report their undisclosed assets from fiscal years ending on or before 31 December 2015 and pay a special tariff on the net assets, rather than the unpaid taxes and penalties that otherwise would apply. The amnesty is available for the period from 1 July 2016 to 31 March 2017, with the tariff rate based on the type of assets (onshore assets, offshore assets repatriated or offshore assets not repatriated) and when they are reported to the Indonesian tax office during the amnesty period.

The new regulations cover the following topics:

- The implementation of the tax amnesty, including procedural matters relating to the documentation and reporting requirements;
- The tax amnesty provisions for taxpayers that own assets indirectly through special purpose vehicles;
- The policy on investigations in the framework of the tax amnesty, including instructions to tax officials not to commence investigations between the issuance of the regulations (22 August 2016) and the end of the tax amnesty, unless there are strong indications of criminal tax acts in relation to specified matters;
- The policy on tax audits during the amnesty period, including instructions to tax officials that audits for the period or fiscal year 2015 (or part thereof) should be initiated only in specified cases;
- The refund of an overpayment in relation to the tax amnesty; and
- The procedures for the repatriation of assets to be placed in investments in financial or nonfinancial assets.

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Malaysia:
2016 finance bill includes re-imposition of withholding tax on offshore services

Malaysia's Finance Bill 2016 was released on 26 October 2016, following the 2017 budget speech from the prime minister and minister of finance on 21 October 2016. The finance bill includes a number of significant proposals, including several that were not announced in the budget: a reduction of the corporate income tax rate in certain cases, the re-imposition of withholding tax on offshore services, an expansion of the scope of royalties and the introduction of CbC reporting in line with the OECD recommendations for financial years beginning on or after 1 January 2017. The bill must be passed by Malaysia's House of Representatives and Senate, receive royal assent from the king and be published in the official gazette as the finance act before it is enacted.

The key tax proposals of relevance for businesses include the following:

Corporate income tax rate

Companies and entities that are subject to tax at the standard corporate tax rate of 24% would be eligible for a temporary reduction in the rate applicable to a portion of their income. Specifically, if there is an increase of 5% or more in an entity's chargeable income, compared to the immediately preceding year of assessment (YOA), the portion of the income representing the increase would be subject to a reduced rate that would depend on the percentage increase in the chargeable income:

Percentage increase	Percentage point reduction in tax rate	Tax rate after reduction
Less than 5%	Nil	24%
5%-9.99%	1	23%
10%-14.99%	2	22%
15%-19.99%	3	21%
20% and above	4	20%

For example, if the chargeable income of a company (other than a small or medium-sized enterprise (SME)) increases from MYR 10 million for YOA 2016 to MYR 12 million for YOA 2017 (i.e. a 20% increase), the income tax payable for 2017 would be calculated as follows:

Chargeable income (MYR)	Tax rate (%)	Tax payable
10 million	24%	2,400,000
2 million	20%	400,000
Total		2,800,000

This measure would apply only for YOA 2017 and 2018.

As from the 2017 YOA, the income tax rate for SMEs capitalized at MYR 2.5 million or less that are resident and incorporated in Malaysia (as well as limited liability partnerships capitalized at MYR 2.5 million or less) on the first MYR 500,000 of chargeable income would be reduced from 19% to 18%, with any balance taxed at the standard 24% rate unless the conditions for the reduced tax rate mentioned above are fulfilled.

Withholding tax on offshore services

Income received by nonresidents from technical or installation services currently is deemed to be derived from Malaysia only if the income is attributable to services that are carried out in Malaysia. Under the finance bill, income of a nonresident would be deemed to be derived from Malaysia regardless of whether the services are carried out within or outside Malaysia. In other words, payments made by a resident to a nonresident for offshore services, as well as onshore services, would be subject to withholding tax. The prevailing withholding tax rate is 10%, except where a lower preferential rate is provided in an applicable tax treaty. This measure would apply as from the date the law enacting the finance bill enters into force.

Definition of royalties

The definition of royalties under the Income Tax Act (ITA) would be broadened to include payments for the use of, or the right to use, software, among other items (e.g. items relating to technologies such as satellite, cable, fiber optics and the radiofrequency spectrum). This measure would reduce the ambiguity regarding the application of withholding tax on royalties, particularly by clarifying that payments in relation to software would be treated as royalties, which would be subject to withholding tax at the prevailing rate of 10% (unless a lower rate is provided under an applicable tax treaty). The new definition would apply as from the date the law enacting the finance bill enters into force.

CbC reporting

In line with the OECD BEPS action 13 recommendations on transfer pricing documentation to be prepared by multinational enterprises, Malaysia is set to introduce rules and guidelines on the preparation and submission of CbC reports for financial years beginning on or after 1 January 2017, with the first submissions being due by 31 December 2018. The finance bill does not provide details on the CbC reporting requirements, but it includes the penalties proposed for failure to file a CbC report or for filing incorrect information (a fine ranging from MYR 20,000 to MYR 100,000, or imprisonment for up to six months, or both), which would apply as from the date the law enacting the finance bill enters into force. Additional guidance on CbC reporting is expected in early 2017.

Other proposed measures

- The corporate tax deduction limitation for expenditure incurred by a company to sponsor certain arts, cultural or heritage activities would be increased from MYR 500,000 to MYR 700,000 as from YOA 2017. Out of the MYR 700,000, the deduction limit for sponsorship of foreign activities would be capped at MYR 300,000 (increased from MYR 200,000).
- The tax exemption for interest income paid in respect of specified Islamic finance instruments would be eliminated in certain cases, including cases where interest is paid or credited to a company in the same group. This measure would apply as from YOA 2017.
- Several tax incentives would be extended, including certain incentives for new four and five-star hotels, which would be extended by two years to cover applications received by the Malaysian Investment Development Authority by 31 December 2018.
- The Minister of Finance would be authorized to impose fees for advance pricing agreements (currently, no fee is charged).
- The definition of a "public entertainer" would be broadened considerably to bring more nonresidents (including lecturers) deriving remuneration or other income from services provided in Malaysia within the scope of the

Malaysian tax net (i.e. subject to a final withholding tax of 15%). This provision would apply as from the date the finance act becomes effective.

- Penalties similar to those for failure to comply with the CbC reporting obligation would be imposed for submitting an incorrect tax return, information return or report.
- A "Collection Intelligence Arrangement" would be established under the Ministry of Finance, which would involve the Malaysian Inland Revenue Board, the Royal Malaysian Customs Department and the Companies Commission of Malaysia. Under the arrangement, these agencies would share data to enhance efficiency in tax collection and compliance.

Comments

One of the most significant changes proposed in the finance bill, which caught many by surprise, is the re-imposition of withholding tax on offshore services, which may give rise to uncertainty in the case of a tax treaty that does not have an article on technical service fees. The nonresident service provider could face challenges in obtaining a foreign tax credit. Questions also would arise as to whether the payment for offshore services to a nonresident would still be subject to withholding tax in cases where the nonresident does not have a permanent establishment in Malaysia.

The inclusion of a lecturer in the definition of a public entertainer also is unexpected. It would seem that services rendered by a lecturer would more properly be regarded as technical services under section 4A of the ITA, which attracts a 10% withholding tax rather than 15%, or as dependent or independent personal services under the provisions of an applicable tax treaty. Where a treaty applies, the Inland Revenue Board could take the view that such income is nonbusiness income and section 4A of the ITA may apply; in that event, the nonresident lecturer would have to apply for relief under the treaty on the basis that the income is business income and that the nonresident has no permanent establishment in Malaysia.

Another significant proposal is the broadening of the scope of royalties to include payments in relation to software, among other items. To some extent, this change could alleviate uncertainties as to whether a payment to a nonresident is subject to withholding tax. However, the proposed change may not necessarily be in line with the position adopted by various advanced countries and/or provisions in various tax treaties.

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Mexico:
Congress approves 2017 tax package

The Mexican Senate approved the 2017 tax package on 26 October 2016, and the package has been sent to the president for enactment and publication in the official gazette. The tax measures, which generally would apply as from 1 January 2017, reflect some additions and modifications to the package originally submitted by the president (for prior coverage, see *World Tax Advisor*, 23 September 2016), which were made during discussion by the House of Representatives and approved by the Senate. The key modifications relevant to nonresidents are described below; the other measures from the original package were approved, with some adjustments.
URL: http://newsletters.usdbriefs.com/2016/Tax/WTA/160923_3.html

Subcontracting of services

The documentation requirements would be increased for a taxpayer to be able to deduct payments for the subcontracting of services for income tax purposes, as well as to be able to credit the input VAT paid on the services for VAT purposes. This measure would affect nonresident companies that set up a service company in Mexico to manage the labor force, as well as obligations relating to mandatory profit sharing with employees. The modifications generally are intended to further regulate the structures frequently used to manage such arrangements, and to encourage operating companies to hold service companies accountable for properly fulfilling their compliance obligations.

An additional requirement would apply for a taxpayer to be able to take a deduction for income tax purposes – the taxpayer would have to obtain from the service provider (and the service provider would be required to supply) copies of the following documentation: (i) documents that demonstrate that salaries were paid by the service provider to its employees; (ii) the income tax withholding returns for the payment of salaries by the service provider to its employees; and (iii) documents that demonstrate that social security contributions were paid on the services provider's employee salaries.

To be able to credit the input VAT on the payment made by a taxpayer to a service provider for the latter's services, the taxpayer would have to obtain from the service provider (and the service provider would be required to supply) a copy of the following documentation for the month in which the taxpayer paid the service provider: (i) the service provider's monthly VAT return; and (ii) the service provider's receipt for the payment of VAT.

Additionally, the service provider would be required to inform the Mexican tax authorities (SAT) of the total amount of output VAT charged to its customers, as well as the amount of output VAT paid in the corresponding monthly return.

Refund of input VAT during preoperational periods

The rules set forth in the original proposal submitted by the president to Congress regarding the treatment of input VAT during preoperational periods would be modified as described below.

Input VAT on expenses incurred in the preoperational period would be recoverable either at the time the taxpayer files its first monthly VAT return for a period in which it carries out taxable activities (i.e. activities subject to VAT at the general 16% rate or a 0% rate) or during the preoperational period (the original proposal did not include the latter option).

If a taxpayer wishes to opt to recover input VAT during the preoperational period, the corresponding refund would be calculated based on an estimate of the portion of the expenses to be incurred in the preoperational period that would be used in carrying out taxable activities, compared to the total activities to be carried out. To elect this option, along with their first VAT refund request, taxpayers would have to file the following:

- An estimate and description of the expenses to be incurred in the preoperational period, as well as a description of the activities to be carried out. The following documentation would have to be provided: contracts, arrangements, authorizations, property deeds, licenses, permits, notices, registries, designs, public bids and other relevant information needed to demonstrate that the taxpayer will carry out taxable activities;
- An estimate of the ratio of the taxable activities to the total activities to be carried out;
- The financial mechanism through which the expenses will be funded; and
- The estimated date on which taxable activities will commence or on which an investment project will transition to carrying out taxable activities.

Since the refund of input VAT during the preoperational period would be made based on estimates of future taxable and exempt activities, an adjustment mechanism would apply if, after 12 months of regular activities (i.e. after taxable activities commence) more than a 3% variation exists between the estimated refundable input VAT calculated as described above and the actual amount that would be calculated for the 12 months. In such a case, the input VAT either would have to be increased or the refund would have to be repaid to the SAT (as adjusted for inflation and surcharges). This also would be necessary if a taxpayer that has claimed a refund during the preoperational period instead decides it wishes to recover input VAT with the first monthly VAT return in which it carries out taxable activities.

The preoperational period would be defined under the new tax package as the period during which expenses are incurred prior to the start of activities taxable under the VAT law, which generally would be no longer than one year, unless the taxpayer demonstrates that the period would be longer for its particular project.

If taxable activities are not carried out by the end of the preoperational period, the input VAT refunded would have to be repaid to the SAT (as adjusted for inflation, plus surcharges). This would not apply to companies involved in the oil and gas industry if taxable activities are not carried out because these activities become impossible to carry out, or effectively impossible to carry out due to economic circumstances. Otherwise, the VAT recovered would have to be repaid to the SAT.

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In brief

European Union: On 8 November 2016, the EU Council for Economic and Financial Affairs agreed on a proposal that would grant tax authorities in the EU member states access to information held by the authorities responsible for the prevention of money laundering, including information on the beneficial ownership of companies. Once agreed to by the European parliament, the directive will be adopted by the council and will apply as from 1 January 2018.

European Union: On 25 October 2016, the European Commission proposed a new directive on double taxation dispute resolution, which would improve the efficiency of the existing dispute resolution process (the EU arbitration convention) and extend its scope to matters beyond transfer pricing and the attribution of profits to permanent establishments. In particular, the directive would apply to all instances of double taxation of business income, explicitly require the elimination of double taxation and provide for the mandatory resolution of double taxation disputes through a binding arbitration or binding alternative dispute resolution process. The timelines for settlement also would be enforced. The proposal will be put forward for consideration by the European Council.

India: The Goods and Services Tax (GST) council finalized the applicable GST rates on 3 November 2016: the rates will be 0%, 5%, 12%, 18% and 28%. Now that the rate structure generally has been clarified, the laws to implement the GST can be taken up by the parliament and the state assemblies.

Oman: The government announced on 5 November 2016 that it will implement a 5% VAT by 1 January 2018. A draft law submitted to the legislative authorities is expected to be approved in the near future.

Singapore: The Inland Revenue Authority of Singapore (IRAS) has announced that it will step up goods and services tax (GST) audits on large businesses in 2016 and 2017. According to the IRAS, large businesses form 2% of the GST taxpayer population, although they contribute more than 50% of the total GST payable. In addition, the IRAS has found that large businesses generally have more complex business arrangements, and voluminous and high-value transactions. To save on compliance costs, more of these large businesses are outsourcing their finance functions to a shared service center located outside Singapore, which may not have a full understanding of Singapore's GST rules and regulations, and this increases the risk of GST errors being made. The IRAS does not define "large businesses," but it appears the term generally refers to multinational companies and local listed companies with annual turnover of SGD 100 million or more.

South Africa: The Minister of Finance presented the medium-term budget policy statement on 26 October 2016, along with tax amendment bills that, among other things, would give effect to the special voluntary disclosure program that opened on 1 October 2016 (applications for the program, which will be accepted until 30 June 2017, will be processed on the basis of the final legislative framework for the program that is approved by parliament). The bills also would extend certain tax incentives. The carbon tax bill will be dealt with in 2017, and consultations on the proposed sugar tax are continuing.

BEPS corner

In each issue that provides updates on developments in the OECD's BEPS initiative, *World Tax Advisor* includes a "BEPS corner" covering these developments.

Brazil: The tax authorities and the Ministry of Finance jointly released a public consultation document on 7 November 2016 that contains measures to implement the OECD recommendations under action 13 (CbC reporting) of the BEPS project. The consultation document, which contains the text of a new Normative Ruling (NR), provides the framework to implement a requirement for certain multinationals to provide information to the Brazilian tax authorities through an annual CbC report. Consistent with the OECD guidance, the CbC reporting obligation would arise where the total annual consolidated revenue of a multinational group, as reported on the controlling party's financial statement for the previous calendar year, is less than: (i) BRL 2.3 billion for the Brazilian tax resident controlling party, or (ii) EUR 750 million in certain cases (e.g. when the controlling entity is non-Brazilian tax resident, but the responsibility to file the CbC report is attributed to a Brazilian tax resident entity, the party responsible for reporting the report would be released from the filing requirement). The Brazilian tax authorities intend to issue the NR after the public consultation procedure is completed on 21 November 2016, but before the end of 2016, since the CbC reporting requirements would apply for calendar year 2016.

Cyprus: The government has amended the intellectual property regime, in line with the recommendations under action 5 of the OECD's BEPS project. See the article in this issue.
URL: http://newsletters.usdbriefs.com/2016/Tax/WTA/161111_1.html

European Union: The European Commission has issued a proposal to amend the EU Anti-Tax Avoidance Directive; the proposed rules would be consistent with the rules recommended in the OECD's final report on BEPS action 2. See EU tax alert, 3 November 2016.
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-european-union-3-november-2016.pdf

Ireland: Certain changes relating to CbC reporting are proposed in the 2016 finance bill. See the article in this issue.
URL: http://newsletters.usdbriefs.com/2016/Tax/WTA/161111_2.html

Malaysia: The 2016 finance bill indicates that CbC reporting would be imposed for financial years beginning on or after 1 January 2017. See the article in this issue.
URL: http://newsletters.usdbriefs.com/2016/Tax/WTA/161111_5.html

OECD: The OECD has published the schedule for peer reviews relating to the operation of mutual agreement procedures (MAP) by the G20 and OECD countries. On 20 October 2016, the OECD released documents that will form the basis of the MAP peer review and monitoring process under BEPS action 14 (see Global Transfer Pricing Alert 2016-036, 2 November 2016). The peer reviews will be carried out in groups, starting in December 2016, with the first group covering Belgium, Canada, Netherlands, Switzerland, the UK and the US. The FTA MAP Forum is seeking taxpayer input on access to the MAP, clarity and availability of MAP guidance and the timely implementation of the MAP.
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-036-2-november-2016.pdf

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European Union
ATAD proposed to be broadened to address hybrid mismatches with third countries
On 25 October 2016, the European Commission issued a proposal to amend the EU Anti-Tax Avoidance Directive (ATAD) to prevent companies in the EU from using "hybrid mismatches" with non-EU member states to avoid being taxed in either country.
Issue date: 3 November 2016
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-european-union-3-november-2016.pdf

EU re-launches Common Consolidated Corporate Tax Base
On 25 October 2016, the European Commission released the revamped draft proposal for the Common Consolidated Corporate Tax Base, which includes two draft directives designed to operate as parts of a single package.
Issue date: 28 October 2016
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-european-union-28-october-2016.pdf

OECD

OECD issues guidance on action 14 peer reviews

On 20 October 2016, the G20/OECD and other countries participating in the inclusive framework on BEPS published key documents setting out the infrastructure for peer review and monitoring of mutual agreement procedures under action 14 of the BEPS action plan.

Issue date: 2 November 2016

URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-036-2-november-2016.pdf

United States

Final and proposed subpart F regulations addressing section 956 and the active rents and royalties exception

On 3 November 2016, the US Internal Revenue Service and US Department of the Treasury issued final subpart F regulations addressing Internal Revenue Code sections 954 and 956, which generally adopt, with amendments, previously issued temporary and proposed regulations. Additional proposed section 956 regulations also were issued.

Issue date: 3 November 2016

URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-united-states-3-november-2016.pdf

Transfer Pricing: Deadlines to preserve taxpayer rights to request competent authority assistance to relieve double taxation

Taxpayers should understand the timelines and actions required to preserve their right to request competent authority assistance under the mutual agreement procedure of a relevant tax treaty.

Issue date: 1 November 2016

URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-035-1-november-2016.pdf