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Germany publishes draft decree on attribution of profits to a PE

German's Ministry of Finance published a draft decree on 5 August 2013 that details its views on the functionally separate entity approach to the attribution of profits to a permanent establishment (PE). Germany implemented the Authorized OECD Approach (AOA, as set out in article 7 of the 2010 OECD model treaty and commentary) into its domestic law in the Tax Act on the Implementation of the Administrative Assistance Directive and the Amendment of Other Tax Regulations that was passed on 30 June 2013. Under the AOA, the arm's length principle must be applied to the cross-border profit allocation between a PE and the enterprise of which it is a part; for this purpose, the PE must be treated as a separate and independent entity. The draft decree is aimed at ensuring that the principles of the AOA are applied properly. Both domestic enterprises that maintain a foreign PE and foreign businesses with a German PE will be subject to the decree. Once adopted by the Bundesrat (upper house of parliament) and published in the Federal Gazette, the decree will apply retroactively as from 1 January 2013.

The draft decree covers the following topics:

- Allocation of assets, chances and risks to a PE;
- Attribution of capital and the funding of the operations of a PE;
- Recognition of dealings between a PE and other parts of the enterprise (with a focus on financing activities); and
- Special rules for PEs of banks and insurance companies and for construction/assembly and exploration site PEs.

The draft decree also describes situations in which rebuttable presumptions would apply when a clear allocation of assets, chances and risks within one enterprise based on legal reasons is not feasible, to avoid creating difficulties for the taxpayer in proving such allocations.

The most important features of the draft decree are as follows:

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General approach to attribution of profits

Based on the AOA, profits to be attributed to a PE are the "profits that the PE would have earned at arm's length, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the PE and through the other parts of the enterprise." The draft decree describes a two-step approach to apply the AOA: first, the activities of the PE must be analyzed based on the functions and risks assumed by the PE; and then the intercompany transactions (including dealings between the different parts of the enterprise) must be determined and an arm's length remuneration applied.

Step 1: Analysis of the functions and risks and asset allocation The analysis of the functions and risks assumed by the PE must start with the determination of the (significant) people functions at the level of the enterprise as a whole and the level of the PE. Based on the result of the (significant) people functions analysis, the assets of the company must be allocated to the PE as follows:

- Tangible assets are to be allocated based on the place where they are used;
- Intangible assets are to be allocated based on the people function that created or purchased the assets;
- Shareholdings are to be allocated based on the functional relationship with the PE; and
- Any other assets are to be allocated based on the people function that created or purchased the assets.

Risks and chances that are directly connected to an asset follow the allocation of the asset; otherwise, risks/chances follow the people function that created the risk/chance. In cases where other people functions, such as administration or the controlling of risks/chances are unambiguously more important than the people function that created the risk/chance, these other people functions determine the allocation of the risk/chance.

Transactions with third parties and dealings between the PE and the other parts of the enterprise also are allocated based on the people function that is responsible for the relevant transaction, i.e. the people function that has concluded the transaction and assumed the related risks.

The draft decree includes an "escape clause" that allows a taxpayer to apply different allocation criteria for the above-mentioned assets if it can demonstrate that a different approach is justified.

The draft decree provides for different approaches for allocating capital to German PEs of foreign enterprises and to foreign PEs of domestic enterprises:

- For a German PE of a foreign enterprise, the "capital-allocation methodology" must be applied, according to which the capital of the entire foreign enterprise must first be determined based on German tax principles. (This step may be omitted if the taxpayer makes a reasonable case that the equity shown in the foreign balance sheet does not substantially deviate from the equity based on German tax principles, or if appropriate adjustments easily can be made.) The equity determined then must be split between the PE and the foreign enterprise based on the significant people functions, assets and chances and risks.
- For a foreign PE of a German enterprise, the "minimum equity method" or "thin capitalization method" must be applied, i.e. equity can be allocated to a foreign PE only to the extent the enterprise can provide adequate reasons that such an amount of capital must be allocated to the foreign PE (e.g. based on regulatory or other legal reasons). A higher equity amount can be attributed to the foreign PE only if this is in accordance with the arm's length principle.

The allocation of interest expense generally follows the allocation of the relevant liabilities that gave rise to the expense. Different rules exist for German PEs of foreign enterprises and for foreign PEs of German enterprises. For German PEs of enterprises that are not required to prepare a balance sheet, interest expense can be allocated only to the extent an arm's length profit remains in the PE. For foreign PEs of domestic enterprises that are not required to prepare a balance sheet, a minimum amount of interest expense must be allocated to the PE based on the PE's relevant share in the outside sales of the group.

Step 2: Arm's length remuneration for dealings between the PE and other parts of the enterprise One of the main purposes of the draft decree is to ensure that a PE is treated in the same way as a separate and independent legal entity. To achieve this goal, the decree treats business relationships between a PE and the enterprise as "deemed contractual

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relationships” to which the arm’s length principle applies. The decree provides some examples in which deemed contractual relationships exist (e.g. if the asset allocation changes or if third parties that are involved in a business transaction would have concluded a contract in such a situation).

The draft decree confirms that the deemed contractual relationship approach does not apply to financing transactions; loan transactions are regarded as a service for which arm’s length remuneration must apply.

Special rules

As noted above, the draft decree provides special rules for PEs of bank and insurance companies and for construction/assembly site and exploration site PEs.

For financial institutions, the asset allocation must be based on the “key entrepreneurial risk-taking functions” (KERT functions) rather than the significant people functions. This approach is in line with the description in the 2010 OECD report, and any other approach would be permitted only in very limited circumstances.

For construction/assembly sites and exploration sites, the draft decree provides for a rebuttable presumption that the activities of such a PE must be treated as a service rendered by the PE to the other parts of the enterprise. Routine functions carried out by the PE must be remunerated based on a cost-plus basis. In all other cases, a profit-split method must be used to determine the profit to be allocated to the PE.

Documentation requirements

The draft decree introduces an obligation to prepare an annual “auxiliary calculation” for a PE for tax years that start after 31 December 2012. This calculation must show the allocated assets, chances and risks, capital and dealings between the PE and the other parts of the enterprise and will be used for calculating the taxable income of the PE. If the taxpayer is using one of the exemption clauses and applies a method that is different from the method described in the draft decree, additional information must be provided as part of the auxiliary calculation. The auxiliary calculation must be made no later than the date the tax return for the PE is filed because it is the basis for the determination of the taxable income as shown in the tax return that may be subject to a future tax audit.

Comments

The draft decree provides valuable guidance on how the German tax authorities will apply the AOA in practice. The goal of the authorities is to achieve a clear asset allocation, but it remains to be seen whether such an allocation is possible in all instances. The different approaches for the allocation of capital to German PEs of foreign companies and foreign PEs of German enterprises have been subject to intense criticism, although it is unlikely that the Ministry of Finance will modify this approach. Further, the use of rebuttable presumptions (e.g. that construction/assembly sites only provide services) is not found in the 2010 OECD report on the attribution of profits to a PE. Specific guidance on the profit allocation to agency PEs would be useful, but is not included in the draft decree.

If this version of the decree becomes final, affected taxpayers will be subject to significant additional documentation requirements. Auxiliary calculations will need to be provided for each PE based on the above principles and finalized at the time the tax return is filed.

Further, the retroactive application of the principles described in the draft decree without any grandfathering rule could create additional difficulties for taxpayers.

Affected taxpayers should start taking action now, even though the decree still is in draft form. The main principles outlined in the draft likely will remain intact and the final decree likely will enter into force at the end of 2013 or early 2014 (with retroactive effect). Taxpayers will need to prepare the required documentation as soon as possible and analyze whether allocation methods used in the past are in line with the principles in the decree, or whether sufficient reasons exist for adopting a different approach under one of the exemption clauses. Documentation will need to be prepared in such cases.

Comments on the draft decree must be submitted by 11 October 2013.

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Changes to Mexico's maquiladora regime on the horizon

The proposed tax reform unveiled by Mexico's president on 8 September 2013 includes some important changes to the maquiladora regime. (For other proposals, see Mexico tax alert in this issue.)
URL: http://newsletters.usdbriefs.com/2013/Tax/WTA/130913_alerts.html

Maquiladoras are Mexican companies that process, transform, assemble or repair imported materials, parts and components into finished goods that subsequently will be exported out of the country. Under the maquiladora regime, which is designed to encourage foreign investment, maquiladoras are allowed to import materials, machinery and equipment free of duties and value added tax (VAT), provided the finished products are exported outside Mexico. In addition to the indirect tax benefits available to maquiladoras, there are income tax benefits that protect the foreign parent or related party company from a permanent establishment (PE) determination and the corresponding exposure to Mexican tax as a result of its relationship with the maquiladora to the extent the maquiladora can apply certain special transfer pricing methodologies. There are currently three ways for a maquiladora to avoid creating a Mexican PE: (1) adopt the safe harbor rules; (2) prepare compliant transfer pricing documentation (following specified procedures); or (3) elect to obtain an advance pricing agreement (APA) from the tax authorities via a private letter ruling. Under the safe harbor, a maquiladora must report taxable income corresponding to the higher of the following:

- 6.9% of the value of its assets (taking into account the value of all assets employed in the maquiladora operations, including foreign-owned assets (both fixed assets and raw materials/inventory)); or
- 6.5% of its costs and expenses (taking into account operating costs and expenses, as computed under Mexican GAAP).

The main tax reform proposals affecting maquiladoras are as follows:

Income tax

- The maquiladora "shelter" regime would be considered a transitional phase for foreign investors to determine whether to maintain their investments in Mexico in a more permanent operational form. To this end, it is proposed that a shelter maquiladora would be able to be used for only a period of three years.
- A 90% export requirement would have to be met for a company's activities to be regarded as those of a maquiladora qualifying for full benefits under the regime (i.e. statutory exemption from PE, special income tax treatment, etc.).
- The requirement that at least 30% of the value of machinery and equipment used in the maquiladora operation be owned by the nonresident would be eliminated.
- The rules under which maquiladora operations do not create a PE in Mexico for the foreign parent company and are deemed to be in compliance with Mexico's transfer pricing rules would be amended so that only the 6.9% of assets or 6.5% of costs methods, whichever is greater, would be applicable, giving companies less flexibility as regards their ability to recognize a lower taxable base corresponding to the maquiladora operation. It would, however, be possible to submit transfer pricing documentation to obtain an APA for this purpose if the maquiladora did not consider that the results of the application of the safe harbor were not consistent with its economic circumstances (e.g. in the case of asset-intensive operations). In effect, the proposed regime would be the same as the regime that applied during the period 2000-2002. The proposed rules would eliminate the option to self-comply with the transfer pricing and PE requirements by maintaining supporting transfer documentation.

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- Dividends distributed to domestic or foreign shareholders would be taxed at the level of the maquiladora at a rate of 10%.

Value added tax

- All temporary imports (including virtual imports) would be subject to VAT at the standard 16% rate. Currently, the importation of goods under the customs temporary regime benefits from a VAT exemption (unless the goods are destined for the local market). Charging VAT at the standard rate would mean that maquiladoras would generate substantial VAT balances that ultimately could be recovered through the refund process. (It should be noted, however, that the refund process in Mexico can take up to six months because the tax authorities frequently request information to verify the validity of the balance being requested.)
- The VAT exemption on the transfer of goods located in Mexico between maquiladoras and non-Mexican entities and between non-Mexican entities would be abolished. This would mean that VAT paid by non-Mexican entities would become a cost unless the VAT is creditable. The rationale for this proposal is that the government believes that domestic suppliers are at a competitive disadvantage as compared to non-Mexican entities that enjoy a VAT exemption available on goods imported on a temporary basis.
- The tax bill does not make any reference to the two presidential decrees that grant additional benefits with respect to the calculation of income tax and business flat tax liabilities. Since the business flat tax would be eliminated under the reform, it is expected that the decree relating to that tax would no longer be applicable. It is unclear whether the decree providing a partial exemption from income tax would continue to apply.

The general policy behind the proposed changes to the maquiladora regime is in line with the government's goal to eliminate all tax exemption regimes except those applying to the underprivileged. This includes the abolition of tax consolidation and several VAT exemptions currently available to taxpayers. With respect to the maquiladora regime, the government also has indicated that the VAT benefits and some of the income tax benefits granted under the regime have been the subject of abuse and no longer serve their original purpose. The stated objective of the new regime is for the tax authorities to be able to more closely supervise and control maquiladora operations.

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Argentina:
New tax on dividends and capital gains introduced

Argentina's House of Representatives passed a bill on 4 September 2013 that introduces a tax on the payment of dividends and profit distributions by Argentine entities and on gains derived from the sale of shares, bonds and securities under certain circumstances. These measures would affect both foreign investors and Argentine resident individuals.

Dividends and profit distributions   A 10% income tax would apply to dividend and other profit distributions made by Argentine companies, trusts and certain mutual funds organized in Argentina and on profit remittances made by permanent establishments and branches of nonresidents to resident individuals and individual and corporate nonresidents. Dividend and profit distributions made to resident companies would continue to not be subject to tax. There is an exception for

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distributions in kind in the form of shares or membership interests. Where a distribution is made to a nonresident, the Argentine payer would be required to act as the withholding agent.

Capital gains on shares, bonds and securities   The current exemption for gains derived from the sale of shares, bonds and other securities by nonresidents would be abolished. Such gains would be taxed at a rate of 15%. At the option of the seller, the 15% rate would be applied either to 90% of the gross proceeds or to the entire gross profit less expenses incurred in deriving the gains. The current exemption for gains from the sale of government bonds, corporate bonds with a public offering and trust securities and mutual funds would remain intact. Where the acquirer of shares, membership interests, equity interests and other securities also is a nonresident, the acquirer would be responsible for paying the tax.

Gains derived by Argentine resident individuals from the sale of shares, bonds and other securities not listed on a stock exchange or authorized for public offering would be subject to a tax at a 15% rate.

The bill will now be debated by the Senate and is expected to be signed into law sometime in September. The new rules will become effective once published in the Official Bulletin and will apply to taxable events taking place after the date of entry into effect.

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China:
Qianhai clarifies conditions to quality for IIT subsidies

The Shenzhen Qianhai Administration Bureau (QHAB) has issued trial implementation rules that provide additional information on how individuals can qualify as "highly skilled employees" and "employees in short supply" for purposes of the Individual Income Tax (IIT) subsidy in Qianhai. The implementation rules became effective on 16 August 2013 and will apply for two years.

The QHAB first released provisional measures that grant IIT incentives to qualified expatriates working in Qianhai in December 2012. Under the incentives, accredited highly skilled employees and those with skills that are in short supply who work in Qianhai can qualify to have the IIT payable on their employment income capped at a rate of 15%. To qualify for the incentives, an individual must meet the following requirements:

- He/she must be a foreigner, a resident of Hong Kong, Macau or Taiwan, an overseas Chinese with a foreign residence or a returning student/qualified individual;
- He/she must be employed at a company that is registered in and operating in Qianhai in a key industry encouraged by Qianhai; and
- He/she must pay IIT in Qianhai.

The newly issued trial implementation rules supplement the provisional measures and set out more specific conditions for individuals to qualify as highly skilled or as having a skill that is in short supply in China. In addition to the basic conditions outlined above, the implementation rules require that the individual work consecutively for a full year with his/her company and spend at least six months working in Qianhai within the assessment year. The individual also must fall into one of the following categories:

- He/she must be an overseas "high-caliber talent" accredited by the national, provincial or municipal government;
- He/she must hold a managerial or technical role with a company registered and headquartered in Qianhai or a branch of a Fortune 500 company;

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- He/she must hold a middle-to-senior management role or an equivalent technical role at a company registered in Qianhai; or
- He/she must possess international professional qualifications or be an owner of patents that are needed in China.

Foreign individuals who fall outside any of the above categories, but who possess skills considered necessary for the development of Qianhai may apply for accreditation if they can demonstrate that they have the equivalent technical qualifications, professional abilities or job achievements.

In addition to setting out more specific requirements for individuals to qualify for the IIT subsidy in Qianhai, the QHAB also has made it possible for individuals who possess certain skills, but who do not specifically meet the prescribed criteria, to qualify for the subsidy. This flexibility demonstrates the QHAB's determination to attract highly skilled individuals to the area.

The implementation rules require that an individual actually work in Qianhai for at least six months, a requirement designed to prevent individuals from benefiting from the IIT incentive solely for tax savings purposes.

Individuals who wish to apply for accreditation and IIT subsidies in 2014 (for IIT paid in 2013) should review their travel records for 2013, as well as the other qualification criteria, to ensure they meet all the requirements.

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France:
List of noncooperative states/territories updated

France has updated its list of noncooperative states and territories (NCSTs) by adding Bermuda, British Virgin Islands and Jersey, and removing the Philippines. This list, updated annually, now classifies the following countries as NCSTs: Bermuda, Botswana, British Virgin Islands, Brunei, Guatemala, Jersey, Marshall Islands, Montserrat, Nauru and Niue.

In 2009, France strengthened the anti-avoidance rules that apply to transactions concluded with entities located in a NCST. French law restricts tax benefits for income flowing to or from a NCST and reinforces the controlled foreign company rules with the following measures:

- Disallowance of the 95% domestic participation exemption for dividends paid by an entity located in a NCST to a French resident company;
- Disallowance of the participation exemption for capital gains on the sale of a participation held in an entity located in a NCST;
- Imposition of a 75% withholding tax on dividends, interest and royalties paid to beneficiaries located in a NCST; and
- Imposition of a 75% withholding tax on real estate capital gains, i.e. gains derived from the sale of French real estate or shares in a French property-rich company (as defined by French domestic law) by a resident in a NCST.

The amended list entered into force on 21 August, the date it was published in the official journal; however, it will apply to the Philippines retroactively as from 1 January 2013 and to the newly added countries in respect of transactions concluded on or after 1 January 2014. Because the amended list removes the Philippines retroactively, in accordance with French administrative guidelines, any taxpayer that had a transaction with an entity in that country can file a claim for an adjustment of tax levied between 1 January and 21 August 2013.

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Italy:
Final implementation rules issued on optional exit tax deferral regime

Italy's Ministry of Finance has issued the final implementation rules for the optional deferral regime for the exit tax on deemed gains when an Italian company migrates to another EU/EEA jurisdiction (Decree of 2 August 2013, published in the Official Gazette No. 188 on 12 August 2013). The decree addresses the computation and scope of the exit tax liability, exit tax payment elections, termination of the regime and recapture of the deferral election amounts.

The optional exit tax deferral regime was introduced on 24 January 2012, in response to the 2010 decision of the Court of Justice of the European Union in the *National Grid Indus* case, to provide for an alternative to the immediate taxation of built-in gains on the assets of the migrating company, which the court held violates the freedom of establishment principle in the Treaty on the Functioning of the European Union.

Under the optional exit tax deferral regime, available for migrations implemented after 24 January 2012, a taxpayer that transfers its tax residence to another EU/EEA state may opt for deferral of the Italian exit tax on the built-in gains in the assets transferred abroad until the actual realization or disposal of the assets. The option to defer, however, is conditioned on the Italian company migrating to another EU member state or an EEA country that has signed a bilateral agreement with Italy for the recovery of tax claims that is comparable to the provisions of the EU mutual assistance directive (i.e. Iceland and Norway).

Implementation rules

The decree contains the following rules:

- The overall gain must be determined with reference to the fair market value of all assets not attributed to an eventual Italian permanent establishment (PE) of the migrating company, including a value for goodwill and taking into account the functions and risks that would have been remunerated in a transfer between independent parties.
- The tax deferral regime is not applicable to: (i) trade goods and inventory; (ii) net equity reserves with tax suspension status, to the extent not booked in the accounts of an eventual Italian PE of the migrating company; and (iii) income from activities carried out in the final year of tax residence in Italy, including tax-deferred items not related to the transferred assets.
- The computation of the gain is final as of the migration date and further gains or losses accrued abroad will not affect the Italian tax liability.
- Existing net operating losses should first be offset against the taxable income of the final year of tax residence in Italy, with any excess used to offset the gain determined as of the migration date. Any further net operating losses may be attributed to the eventual Italian PE of the migrating company under the ordinary limitations provided in Italy's Income Tax Code.
- The tax deferral may be applied to all assets or to only specified transferred assets; in the latter case, the overall gain will be attributed to the assets with respect to which deferral is elected by reference to the ratio of the respective higher values of those assets and the total higher value of all the assets transferred.
- Where deferral is elected, the deferred Italian tax liability must be paid in the year during which the assets would be considered to be disposed of under ordinary Italian tax principles (e.g. on a sale, on a distribution to shareholders, on the contribution of assets in exchange for shares, etc.). In the case of nonportfolio participations, a dividend distribution from subsidiaries also would be considered a disposal.
- The migrating company can elect to pay the exit tax in 10 equal annual installments starting from the year of the migration, but in this case, interest will be charged and the company will be required to provide a guarantee for the deferred amount.

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- The tax deferral regime will terminate and the Italian tax liability must be paid immediately if the company subsequently migrates to a jurisdiction outside the EU/EEA; if the company is liquidated; or in the case of a merger, demerger or business contribution that results in the company's assets being transferred to an entity that is resident outside the EU/EEA.
- The Italian tax authorities will issue further guidance on the actual procedure to exercise the tax deferral option, the payment of installments, the type of guarantees to be provided (which will depend on the amount of the tax-deferred gain and the risk level associated with the specific type of taxpayer) and the annual reporting requirements in the tax return or other specific filing.

Although a few important items still are unclear (e.g. the type of guarantees to be provided to the Italian Treasury) and will be addressed by the Italian tax authorities in future guidance, the final implementation rules issued by the Ministry of Finance provide a base for discussion for multinational groups interested in restructuring their Italian operations.

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Mexico:
Energy and resources reform proposed

Mexico's President presented a bill to the Senate on 12 August 2013 proposing a reform of the energy and resources sectors by amending articles 27 and 28 of the Constitution. These articles currently prohibit private sector participation in the energy sector. The proposals aim to modernize the energy and resources sectors, increase the supply of energy and reduce energy costs.

The proposed reform does not contemplate any change with respect to the granting of concessions for radioactive minerals, for oil and hydrocarbons (solid, liquid or gaseous) or for the national electrical system or the public transmission and distribution of electricity.

Notable features of the proposal affecting the oil and hydrocarbon industry include the following:

- The government would be able to enter into Production Sharing Agreements (PSAs) with the private sector when this is in the national interest, which may allow it to generate less expensive energy. Under a PSA, the state would remain the owner of all oil reserves and oil income, together with the state-owned oil company, Petróleos Mexicanos (PEMEX).
- Although no specifics are provided in the energy proposals, a new tax regime would apply to PEMEX. The general policy is for the government to retain ownership of the country's oil assets with a view to their long-term economic benefits rather than their capacity to generate tax revenue in response to short-term needs. Mexico's president submitted a broad tax reform package to the congress on 8 September 2013 that includes, among other proposed laws, the "Income Law on Hydrocarbons" that aims to modify the current tax regime applicable to PEMEX. The proposal, if enacted, would enter into force from 1 January 2015.
- PEMEX's subsidiaries would be restructured into two divisions: exploration and production and industrial transformation.
- PEMEX would be subject to greater transparency and accountability requirements with respect to operations, acquisitions and PSAs with private individuals and entities, and there would be increased public access to information on the government's administration of energy resources.
- Rules would be established for PEMEX's national purchases and infrastructure projects that would aim to leverage the purchasing power of the energy sector to benefit Mexico's new industrial development policy.

The following provisions would allow for the modernization of the electricity sector and would likely increase the supply of energy and reduce costs for individuals and small businesses:

- Article 27 of the Constitution would be amended to allow the participation of private entities and individuals in the generation of electricity, which could potentially increase the supply and reduce the cost of electrical energy.

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- The government would maintain exclusive control of the National Electric System, as well as the transmission and distribution of electricity. Under this model, electricity would be acquired in blocks at a lower cost from each producer.
- The Federal Electricity Commission would be strengthened through increased operating and organizational flexibility, in an effort to reduce costs.
- The planning and direction powers of the Energy Ministry and the Regulating Energy Commission would be reinforced.
- The energy reform would be a green reform, which would favor a higher level of investment in technological research and development and the adoption of cleaner energy resources (such as solar, wind or gas energy) at a low cost.

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Netherlands:
Government announces plans to reinforce current international tax policy

In a 30 August 2013 letter presented to parliament, the Dutch government clarified its position on the international debate on the taxation of multinationals. The government acknowledges that international tax avoidance and fraud are issues that demand a global response and solutions, and that it fully endorses the OECD action plan on base erosion and profit shifting (dated 19 July 2013) and cooperation with the G20. According to the Dutch government, the OECD plan offers a promising framework for the reinforcement of international tax rules.

In the letter, the government rejects any notion that unilateral Dutch measures should be introduced to combat tax avoidance/evasion because such measures likely would not be effective and actually could be detrimental to the Netherlands' investment climate. The government does emphasize that any global measures should be binding on all countries to ensure a level playing field for countries and multinationals alike. The government also confirms that the existing Dutch fiscal infrastructure (including the participation exemption, the broad tax treaty network and the advance tax ruling (ATR) practice) is an essential component of the Dutch investment climate, but that it will broaden the existing policies relating to the ruling practice.

There is a growing international consensus that countries have a responsibility for ensuring transparency and the exchange of information as and when needed. The Dutch government acknowledges its own responsibility in this regard and emphasizes that it will focus on these areas, and that the transparency policy of the ruling practice will be expanded:

- The minimum substance requirements (i.e. at least 50% of directors of a company must be Dutch resident and there must be a Dutch address, local administration, etc.) will be expanded to apply in more situations. These requirements currently apply to companies carrying out (intragroup) financing and/or licensing activities that request an advance pricing agreement (APA) – the requirements also will apply even when an APA is not requested by such companies. The Dutch tax authorities can spontaneously exchange information with a tax treaty partner country if the minimum substance requirements are not met (as is currently the case).
- An exchange of information on the content of an APA (relating to (intragroup) financing and/or licensing activities) will be able to take place if the multinational group to which a Dutch entity belongs does not carry out any activities in the Netherlands other than meeting the minimum substance requirements. This is a new ruling policy measure that likely will apply in only a limited number of cases, since most multinationals carry out some level of activities in the Netherlands through operating companies.
- To reduce the workload of the tax authorities' ruling team in respect of ATR requests for holding companies, a sufficient "nexus" will have to exist with the Netherlands for a company to obtain a ruling. A sufficient nexus will exist, for example, if the minimum substance requirements described above are met. The government also seems to suggest that a sufficient nexus will be present if adequate Dutch (operating) activities are carried out by group companies or the entity itself (even if the minimum substance requirements are not met).This measure generally is in line with current ruling practice. It should be noted, however, that holding companies without an ATR can continue their activities regardless of whether or not they comply with the minimum substance requirements.

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Finally, to prevent the unintended use of Dutch tax treaties, the government will make an effort to contact developing countries that already have concluded a tax treaty with the Netherlands to offer to update the tax treaty and add anti-avoidance measures. This policy is in line with many recent Dutch tax treaties.

More details on the policy broadening are expected to be published in the near future as part of the 2014 budget proposals, and at that time affected companies should review their Dutch structures. Nevertheless, the policy expansion likely will have no impact or only a minimal impact on most foreign multinationals that are active in (or through) the Netherlands, since (intragroup) finance and licensing companies generally comply with the substance requirements described above, even in non-APA/ATR situations, and other activities often are carried out in the Netherlands within the multinational group.

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Netherlands:
MOF proposes change to "compartmentalization" rule

The Dutch Ministry of Finance submitted a legislative proposal to parliament on 3 September 2013 to counter a decision of the Supreme Court regarding "compartmentalization" with respect to the participation exemption. In a decision issued 14 June 2013, the court ruled that the application of the participation exemption should not be compartmentalized when the regime has been amended and no transition rules have been provided for the new measures. Immediately after the decision was issued, the State Secretary of Finance announced that the Corporate Income Tax Act would be amended to specifically require compartmentalization whenever any changes are made to the participation exemption regime.

The participation exemption provides for an exemption from corporate income tax for dividends and capital gains arising from a qualifying participation. The issue of "compartmentalization" arises where a taxpayer receives dividends/capital gains attributable to a period in which it qualified for the participation exemption, but it does not qualify at the time at which it receives the dividends/capital gains. It also arises in the opposite situation, i.e. where a taxpayer receives dividends/capital gains attributable to a period in which it did not qualify for the participation exemption, but it does qualify at the time at which it receives the dividends/capital gains.

In the case before the Supreme Court, a taxpayer realized a profit in 2007 on the disposal of a participation in an active subsidiary that was not subject to tax; in that year (i.e. 2007), the participation exemption applied due to a change of rules on 1 January 2007. However, the increase in the value of the participation was allocable to years before 2007 when the participation exemption did not apply with respect to subsidiaries that were not subject to tax. The court decided that the entire gain was exempt because it was realized at a time when the participation exemption did apply and that compartmentalization should not apply where there is a change in the application of the participation exemption due to legislative amendments. The State Secretary for Finance disagreed with the Supreme Court decision and has taken the position that benefits under the participation exemption should apply only to dividends/capital gains attributable to a period in which a taxpayer held a qualifying participation.

The bill would require compartmentalization in all circumstances in which there is a change in the applicability of the participation exemption to a particular taxpayer. Under current rules, a distinction is made between a change due to a change of the taxpayer's circumstances (compartmentalization applies) and a change due to an amendment of the law (compartmentalization does not apply). Under the proposal, the reason for the change in the applicability of the participation exemption is irrelevant. If a taxpayer receives dividends/capital gains at a time at which it qualifies for the participation exemption, but the dividends/gains are attributable to a period in which it did *not* qualify, the dividends/gains would not be exempt under the participation exemption. In the opposite situation, i.e. where the taxpayer receives dividends/capital gains at a time at which it *does not* qualify for the participation exemption, but the dividends/gains are attributable to a period in which it did qualify, the dividends/gains would be exempt under the participation exemption.

Under the bill, compartmentalization would be achieved by requiring taxpayers to establish a "compartmentalization reserve." This reserve would be equal to the difference between the fair market value of the participation immediately before the change in the applicability of the participation exemption and the book value of the participation. The reserve

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would be taxable if it relates to a change from a period during which the participation exemption did not apply to a period during which the participation exemption did apply. However, tax would be levied only if the participation is sold or if a benefit is realized that is allocable to the period during which the participation exemption did not apply. The reserve would be tax-free if it relates to a change from a period during which the participation exemption did apply to a period during which the regime did not apply. Future benefits from the participation that relate to the period during which the participation exemption applied would be exempt.

If approved, the proposed rule would apply retroactively as from 14 June 2013, the date of the Supreme Court decision. This should prevent taxpayers from attempting to benefit from the Supreme Court decision in anticipation of the bill entering into force.

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In brief

Bahamas – The government has announced that a VAT will be introduced as from 1 July 2014 at the rate of 15%. The VAT threshold will be set at BSD 50,000, and VAT returns and payment will be due on a monthly basis. The VAT will apply to a wide range of goods and services. A 10% rate will apply to hotels, replacing the current Hotel Occupancy Tax. Zero-rating will apply to exported goods and services and the international transport of goods and passengers. Certain goods and services will be exempt from VAT, including financial services, transfers of leases and residential buildings, agriculture and fisheries, health and education services and social and community services.

Colombia – A decree issued on 27 August 2013 makes changes to the rules governing the "fairness tax" (or CREE) that was introduced under the 2013 tax reform. The CREE is payable by resident companies and nonresident companies that earn income through a permanent establishment or branch in Colombia at rates of 0.3%, 0.6% or 1.5%, depending on the taxpayer's activities. CREE tax withholding must be reported monthly. As from 1 September 2013, each taxpayer must self-assess the CREE tax withholding and submit a special tax return to the Colombian tax authorities.

International – G20 leaders released a declaration on 6 September that reaffirms the group's support for automatic information exchange on tax matters and for the OECD's action plan on addressing base erosion and profit shifting. G20 leaders expect that the OECD will release a global standard for tax information exchange (included in a model competent authority agreement) at its February 2014 meeting and that G20 members will begin exchanging tax information automatically with other G20 members by the end of 2015. The G20 also plans to work with the OECD and other international organizations to help developing countries participate in automatic information exchange.

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Mexico

Tax reform presented to congress

Mexico's president submitted a broad tax reform package to the congress on 8 September 2013. The proposals – part of the 2014 budget – contain a number of measures that would affect companies doing business in the country and include elimination of the business flat tax. If enacted, the reform would apply as from 1 January 2014.

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