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In this issue:

CJEU decision may allow for tax refund claims by non-EU/EEA investment funds

The Court of Justice of the European Union (CJEU) ruled on 10 April 2014 that denying a non-EU/EEA investment fund an exemption from tax on Polish-source dividends when an exemption is available to comparable Polish funds violates the free movement of capital principle in the Treaty on the Functioning of the European Union (TFEU) if sufficient mechanisms for the exchange of information exist between Poland and the country in which the investment fund is resident, in this case, the US (*Emerging Markets Series of DFA Investment Trust Company v. Dyrektor Izby Skarbowej w Bydgoszczy* (*EMS* Case C190/12)). The CJEU remanded the case to the Polish court to determine whether such a mechanism is available under the Poland-US tax treaty or other agreement.

Background and facts of the case

Before 2011, the Polish Corporate Income Tax Act granted a general tax exemption (applicable to all types of income, including dividends and interest received) to Polish-registered investment funds and Polish pension funds. The European Commission took the position that the different tax treatment of Polish funds and funds established in other EU/EEA member states could be discriminatory and, in 2009, the Commission sent a “reasoned opinion” to Poland requesting that Poland amend the relevant law. To avoid having the case referred to the CJEU, Poland amended its domestic law as from 1 January 2011 to extend the tax exemption to also cover qualifying funds from EU/EEA member states. Investment funds established in non-EU/EEA member states, however, are not covered by the exemption; such funds are subject to Poland’s withholding tax at a rate of 19% (e.g. on dividends) or 20% (e.g. on interest), unless the rate is reduced under an applicable tax treaty.

In 2010, EMS, a US-based fund that invests in Polish companies, applied for a refund of tax withheld on dividends it received from Polish companies in 2005 and 2006. EMS argued that under the free movement of capital principle in the

TFEU, it should benefit from the same tax exemption for Polish dividend income that, at the time, applied only to investment funds established in Poland (and subsequently was extended to certain funds with a registered office in another EU/EEA member state).

After the Polish tax authorities rejected the refund application, EMS appealed the decision to the District Administrative Court in Bydgoszcz, which, in turn, referred the case to the CJEU for a preliminary ruling on whether Polish domestic legislation that provides for a tax exemption for Polish dividend income received by an investment fund established in an EU/EEA member state, but does not provide such an exemption for an investment fund that is tax resident in a non-EU/EEA member state, is contrary to EU law.

CJEU decision

The CJEU concluded that the Polish legislation constituted an unjustified restriction on the free movement of capital, but referred the case back to the Polish administrative court to analyze whether there are sufficient mechanisms under the agreements between Poland and the US for the exchange of information to allow the Polish tax authorities to verify if US investment funds operate under conditions equivalent to those applicable to investment funds established in the EU/EEA (comparability test). In making this determination, the Polish court will need to consider the relevant legal and regulatory framework under which the funds are established, to determine whether the US funds satisfy the conditions for the Polish tax exemption. If so, the exemption for Polish dividend income provided to funds in EU/EEA member states also must be granted to US investment funds.

Comments

Non-EU/EEA funds – refund claims – The Polish court's decision in the case likely will depend on (i) whether the investment fund provides sufficient evidence to the Polish authorities to support the comparability of its legal and regulatory framework with the framework in the EU/EEA, and (ii) whether the authorities have the ability to verify the facts and evidence provided with the US tax authorities. The CJEU held that it was up to the Polish courts to examine whether the exchange of information provisions in the Poland-US tax treaty are capable of allowing the necessary verifications to take place, based on the evidence provided.

Based on the CJEU's decision, the Polish tax administration will be obligated to treat Polish, EU, EEA and other foreign investment funds (including US funds) equally, and the Polish legislature will need to introduce nondiscriminatory legislation at the domestic level (e.g. an extension of the exemption to qualifying non-EU/EEA investment funds).

Non-EU/EEA investment funds, especially US investment funds, should take the CJEU decision into account when requesting a refund of tax withheld on dividends in Poland or in another EU/EEA member state. The CJEU decision could make it easier for non-EU investment funds to recover significant amounts of withholding taxes from EU member states, but affected funds will need to consider the volume and type of evidence required to demonstrate comparability to funds based in the source state.

EU/EEA funds – refund claims – Although the CJEU decision in *EMS* is not directly relevant to EU/EEA funds because it focuses on the application of the tax exemption to third countries, EU/EEA funds also may be able to claim a refund of tax levied before Poland amended its domestic law in 2011.

In 2010, Poland's Minister of Finance issued a letter to one of the Polish tax chambers, confirming that the exemption could be applied to an EU/EEA pension fund, provided the fund earned income in Poland after 1 May 2004 (the date Poland became an EU member state) and the fund had features equivalent to those of a Polish pension fund. Although the letter was directed at pension funds, the same approach logically should apply to EU/EEA investment funds, meaning that both EU/EEA investment and pension funds could claim that they should have been entitled to an exemption in Poland as from 1 May 2004, and that any income/withholding tax paid in Poland should be refunded (provided the statute of limitations has not expired, and subject to any timing restrictions on overpayments).

This interpretation is supported by the fact that the European Commission sent a reasoned opinion to Poland indicating that taxation of non-Polish funds was discriminatory, and Polish courts have issued decisions confirming that qualifying EU/EEA-based investment funds should have been covered by the exemption. Accordingly, a qualifying EU/EEA investment or pension fund that paid income tax in Poland in the past, or suffered withholding tax, may be eligible for a refund.

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Brazil:
Guidance issued on tax treatment of bitcoins

Brazil's tax authorities recently issued informal guidance to taxpayers, in which they indicate that bitcoins (digital currency that can be used to make online purchases) will be considered financial assets for tax purposes, with the result that a 15% capital gains tax will be levied on a sale. Individuals that hold more than BRL 1,000 (roughly USD 450) in bitcoins as of 31 December 2013 should disclose the information in their personal income tax returns. Additionally, individuals selling bitcoins whose value exceeds the equivalent of BRL 35,000 (roughly USD 15,600) at any time will be required to calculate the capital gains and collect the 15% income tax.

In a recent media announcement, a Brazilian official indicated that the tax authorities are studying the issues relating to the tax treatment of bitcoins, but that there have been no proposals for new legislation that would specifically address the digital currency. According to the official, the existing legislation is broad enough to qualify bitcoins as financial assets, at least for income tax purposes. However, the Brazilian central bank published a note in February 2014 that alerted customers about the risks of digital currencies, since they are not issued or guaranteed by official financial institutions. Because of the growing importance of virtual and electronic transactions, the Brazilian authorities have stated that they are monitoring this market carefully to determine whether specific measures or legislation will need to be introduced.

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Brazil:
Court rules tax treaty provisions prevail over application of domestic CFC rules

Brazil's Superior Court of Justice issued a taxpayer-favorable decision on 24 April 2014 on the application of the controlled foreign company (CFC) rules in cases in which a CFC is resident in a country that has concluded a tax treaty with Brazil. Although the decision was not unanimous, the first panel of the court concluded that the business profits article in an applicable tax treaty should prevail over the application of Brazil's CFC rules. According to the court, the domestic CFC rules apply only in cases where the CFC is resident in a country that has not concluded a tax treaty with Brazil.

Under Brazil's CFC rules, profits earned by CFCs of Brazilian entities are subject to corporate income tax and social contribution tax on profits at the level of the Brazilian controlling company or parent company. Profits earned by CFCs of Brazilian companies are considered available to the controlling/parent company in Brazil on 31 December of each calendar year.

The Superior Court of Justice's decision applies only to the taxpayer in the case (Vale), a mining company. Vale had argued that the measure in Brazil's CFC rules described above is incompatible with some of Brazil's tax treaties (specifically, the treaties with Belgium, Denmark and Luxembourg). The court held that, with respect to these treaties, taxation would be required on dividends, but only at the time the dividends are effectively distributed.

The decision of the Superior Court will be final if the Brazilian tax authorities do not file an appeal with the Federal Supreme Court; it is currently unclear whether the authorities will appeal the decision.

The tax treaty override issue has been litigated for more than 10 years, with various Brazilian courts issuing conflicting decisions. The tax authorities consistently have taken the position that domestic legislation, including the CFC rules, should prevail over the application of tax treaties. For this reason, some taxpayers have initiated lawsuits against the federal authorities in the hopes of a court decision that would put the issue to rest.

It should be noted that Provisional Measure No. 627/2013, issued on 13 November 2013 and still awaiting conversion into federal law, would amend the CFC rules, but it does not address the treaty override issue.

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Chile:
Carbon tax to be introduced

Chile's new president presented a comprehensive tax reform bill to the national congress on 1 April 2014, which is expected to be enacted in 2014. Among other provisions, the bill proposes to establish an annual tax on the emission of particulate matter, nitrogen oxide, sulfur dioxide and carbon dioxide produced by boilers or turbines with a thermal generation capacity of at least 50 megawatts. The emissions would be measured at each emitting source, which could include one or more production units.

In the case of emissions of particulate matter, nitrogen oxide and sulfur dioxide, the tax would be USD 0.1 per ton issued, increased by an amount resulting from a formula based on the concentration of pollutants in the municipality and their social cost. The emission concentration factors for each pollutant and the social costs of pollution (considering the costs to the population's health) would be defined by the Ministry for the Environment, in accordance with a regulation to be issued by the Ministry that would be cosigned by the Secretaries of Health and Treasury. In the case of carbon dioxide, the tax would be USD 5 for each ton of pollutant emitted.

The tax would be payable in April of the year following the year of emissions, in local currency, based on the exchange rate at the payment date.

The Ministry for the Environment would determine which boilers or turbines would be subject to the tax, and each March the Superintendency for the Environment would certify the emissions generated by the taxpayer in the previous year.

For these purposes, taxpayers generating emissions would be required to install a continuous monitoring system and have it certified. The Ministry for the Environment would issue regulations providing the requirements for an emission monitoring system and its certification. The certifications would be issued by the Superintendency for the Environment, which also would be in charge of supervising compliance with the rules. Taxpayers would be required to submit quarterly emission monitoring reports to the Superintendency.

Taxpayers that do not comply with the monitoring and reporting obligations would incur a fine ranging from 20 to 50 monthly tax units (approximately USD 1,500 – USD 3,750), and closure of the facility or pertinent unit for up to 20 days.

The Superintendency would provide the Chilean tax authorities with the data required to calculate the tax for each emitting source.

If the tax affects power generators that feed power into the pooled power system, the cost of the tax would be distributed among all power companies that withdraw power from this system, in proportion to the power withdrawn.

Pursuant to the bill, the new carbon tax would be due for the first time in 2018, in respect of emissions generated in 2017.

The governing coalition holds a sufficient majority in congress to push the reform through, including the new carbon tax, and it hopes to be able to enact the reform within the near future.

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European Union:
Changes proposed to parent-subsidiary directive to tackle tax avoidance

The European Council has released a proposed change to one of the suggested changes in the European Commission's draft amended parent-subsidiary directive (PSD) that was published on 25 November 2013, to tackle corporate tax avoidance in the EU.

The proposal to amend the directive closely follows the OECD's base erosion and profit shifting (BEPS) initiative. However, the European Commission has stated that there also is a need to address mismatches and anti-abuse at the EU level, taking into account existing EU legislation, and that the revision of the PSD can be an important contribution to the OECD BEPS project.

The directive originally was designed to prevent the double taxation of same-group companies based in different EU member states. It provides a tax exemption for dividends and other profit distributions paid by qualifying subsidiary companies to their parent companies, thus eliminating the risk of double taxation, i.e. the same income being taxed in both the member state of the subsidiary and the member state of the parent company. However, some companies have exploited loopholes in the PSD to avoid paying tax in either member state. The European Commission, therefore, proposed an amendment to tackle hybrid financial mismatches (due to the interaction of different national tax systems) within the scope of the directive. It also proposed a general anti-abuse rule (GAAR) to protect the functioning of the PSD.

In respect of hybrid financial mismatches, the Commission proposed changes to the tax treatment of hybrid loan arrangements (such as profit participating loans). Specifically, a cross-border group of parent and subsidiary companies using hybrid loan arrangements would be denied a tax exemption for payments received in the member state in which the parent company is resident if the payments are deductible in the member state in which the subsidiary is resident. In other words, if a hybrid loan payment is deductible in the subsidiary's state of residence, it would have to be taxed by the parent company's state of residence.

To clarify this provision, the European Council has requested that the Commission change the wording of the proposed amendment to explicitly add, not only that an exemption should not apply if the payment is deductible in the source state, but also that a payment that is deductible in the source state should be taxed at level of the recipient.

The Commission's draft of the amended directive also proposed introducing a GAAR to protect the functioning of the PSD. The proposal would require EU member states to adopt a common, more comprehensive anti-abuse rule that would allow them to ignore artificial arrangements used for tax avoidance purposes, and to tax these arrangements on the basis of their real economic substance. The proposal was targeted at groups that interpose an intermediate holding company in the EU in their arrangements to act as a "letterbox" company, to take advantage of lower withholding tax rates. However, because the Council of Finance Ministers (ECOFIN) could not reach agreement on proposed changes to the wording of the GAAR, the plan now is to proceed with the anti-hybrid rule and postpone the GAAR. At the 6 May ECOFIN Council, the ministers of the EU member states implicitly approved postponing the GAAR discussion until the second half of 2014. The Commission now expects that all other amendments to the PSD will be accepted at the June ECOFIN Council.

If the European Council adopts the amended directive, it should be implemented by the member states by 31 December 2015.

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Germany: BFH questions constitutionality of interest deduction limitation rule

In a decision dated 18 December 2013, Germany's Federal Tax Court (BFH) expressed doubts that the interest deduction limitation rule is in line with the principles of the German constitution. The BFH provided its opinion in an order suspending the taxpayer's obligation to pay the appealed tax assessment notice.

Under the general German interest deduction limitation rule, which covers interest payments to related and unrelated parties, the tax deductibility of net interest expense is limited to 30% of the tax EBITDA of a business. Exceptions to this rule apply where (i) the annual net interest expense does not exceed EUR 3 million (EUR 1 million for the period covered by the assessment in this case); (ii) the relevant business is not part of a "group"; or (iii) the conditions of the "escape clause" are satisfied, i.e. where the German borrower's equity ratio does not fall short by more than 2% (1% for the period covered by the assessment) of its worldwide equity ratio.

The taxpayer in the case appealed a tax assessment notice in which the tax authorities partially denied an interest deduction based on the rules described above. In addition, the taxpayer asked for a suspension of the obligation to make the tax payment due under the assessment until a final decision about the assessment is reached on appeal; the request was denied by the tax authorities and by the lower tax court.

The BFH has now suspended the taxpayer's obligation to make the payment until a decision is reached on its appeal against the tax assessment notice, which currently is pending in a separate proceeding at the BFH (reference number I R 2/13). The fact that the Constitutional Court (which has the exclusive right to ultimately declare a law/provision unconstitutional) could declare the interest deduction limitation invalid prospectively (and not retroactively) should not affect the taxpayer's ability to obtain such a suspension based on the opinion of the BFH.

In its decision, the BFH refers to the governing principle of German tax law, according to which each taxpayer must be taxed based on its financial performance and ability. The BFH stated that the interest deduction limitation rule violates this principle, and that it is questionable whether such a violation can be justified. The court looked at various reasons that could justify a violation (abuse of law, fiscal stability) but it concluded that it is doubtful whether such a justification exists.

The BFH's decision is the first decision in which a tax court has opined on the constitutionality of the interest deduction limitation rule, although the question whether the rule is in line with constitutional principles has been controversial.

Affected taxpayers with nondeductible interest expense due to the 30% limitation should consider filing an appeal against their tax assessment notice (where possible) that refers to the pending court case, and requesting a suspension of the payment obligation based on the BFH's decision. It should be noted that interest may arise on a suspended tax payment if the appeal is unsuccessful.

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Japan: Consumption tax rate increased

The Japanese government increased the consumption tax (JCT) rate from 5% to 8% on 1 April 2014, the first JCT increase in 17 years. The rate is scheduled to be further increased to 10% in October 2015.

Since taking office in December 2012, Prime Minister Shinzo Abe has promoted economic policies referred to as "Abenomics" that have brought Japan steady GDP growth. The JCT increase is expected to negatively affect consumer spending, which currently accounts for 60% of Japan's GDP, and slow down the economy. It is estimated that the extra financial burden placed on households due to the increase will amount to approximately JPY 8 trillion a year.

To mitigate the impact of the tax increase, the government plans to introduce reduced JCT rates for daily necessities when the standard JCT rate is further raised to 10%. The Tax Commission announced that it would develop plans by May 2014 and compile a specific regime to incorporate into the 2015 tax reform by December 2014. Issues to be considered include the determination of which items are considered daily necessities eligible for the reduced rates, and the implementation of new JCT accounting requirements to separately record items that are taxable at different rates. Future changes may affect the entire JCT regime, including the requirements for claiming input JCT credits.

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Mexico:
Supreme Court rules on expense sharing agreements with nonresidents

The second chamber of Mexico's Supreme Court issued a decision on 19 March 2014, ruling that expenses incurred on a pro rata basis with nonresidents may be deductible if certain requirements are met, despite a provision in the Income Tax Law (ITL) that specifically disallows the deductibility of such expenses.

The case involved a payment made by a Mexican subsidiary to its parent company for the reimbursement of its share of fees paid to international advisors for the acquisition of various international businesses, including a Mexican business.

The relevant provision of the ITL was introduced in 1958, at a time when cross-border transactions were uncommon in Mexico and were difficult to verify and control. In issuing its decision, the Supreme Court looked at the historical and legislative background of the provision, but concluded that, in the current environment, the provision should not be read in isolation. According to the Court, the tax authorities now have many methods at their disposal to validate international transactions, such as tax treaties, exchange of information agreements and the transfer pricing rules and documentation requirements.

The Court ruled that pro rata expenses incurred with nonresidents will be deductible if the following requirements are met:

- The expenses must be necessary for the company to carry out its activities.
- There must be a justifiable connection between the expenses incurred and the benefit received, or expected to be received, by the company.
- If the expenses were incurred between related parties, the taxpayer must demonstrate that the allocation was agreed on at arm's length terms.
- The taxpayer must provide the Mexican tax authorities with detailed information on the foreign transaction, including (i) tax information on the related parties; (ii) the activities carried out by each party, as well as its assets and any risks assumed; and (iii) the method used to determine the transfer price.
- The taxpayer must maintain supporting documentation on the types of transactions carried out, the contractual terms, the transfer pricing method selected and comparable transactions or entities for each type of transaction. In essence, these items will be documented by the regular transfer pricing study required under the ITL.
- The taxpayer must maintain documentation that demonstrates that the sharing of expenses was based on objective tax and accounting methods, and was not determined in an arbitrary manner by the company. There must be a valid business purpose for all pro rata expense transactions.

This is an important case in Mexico, and a welcome interpretation by the Supreme Court that is consistent with current international practice. However, the Mexican tax authorities will not necessarily automatically apply the decision, so controversies are likely to arise; affected taxpayers, therefore, should maintain appropriate documentation to support claims for the deductibility of expenses shared with nonresidents.

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Mexico:
Deadlines approaching for maquiladoras and companies operating under customs regimes

Companies operating in Mexico under a maquiladora structure or under the automotive bonded warehouse, bonded warehouse or strategic bonded warehouse customs regimes should be aware that they may need to take action very soon to meet compliance, election and application deadlines.

Restructure or segregation of direct marketing activities

The 2013 tax reform tightened the requirements for a maquiladora to qualify for tax benefits and protect its foreign principal from having a permanent establishment (PE) in Mexico. For example, the new income tax law that applies as from 1 January 2014 contains a stricter definition of maquila operations. For an operation to be considered a maquiladora and qualify for PE protection, the entity generally must derive all of its income from the export of maquila services (manufacturing services), although some exceptions may apply. Income will be deemed to be derived exclusively from the export of maquila services when it is derived from the provision of maquila services (or activities related to such services) to foreign related parties. The tax authorities have clarified in administrative rules that income will not be considered to be derived from maquiladora activities if it is derived from the sale and distribution of finished products, regardless of whether the products are manufactured by the maquiladora.

Maquiladoras that generate income from other activities, such as local market sales, distribution activities, etc., must segregate these activities from export activities or restructure their operations by 30 June 2014 to comply with the new rules. Failure to do so will result in the foreign resident losing PE protection for its maquiladora activities in Mexico, and any tax benefits granted to the maquiladora will be lost.

Selection of maquiladora transfer pricing option

As a result of the 2013 tax reform, the only available options for a maquiladora to avoid creating a PE for its nonresident related party and to comply with Mexico's transfer pricing rules are the following:

- Have taxable income of at least the higher of (a) 6.9% of the value of the maquiladora's assets, including fixed assets and inventory owned by the nonresident principal; or (b) 6.5% of the maquiladora's costs and expenses (safe harbor option); or
- Obtain a multi-year advance pricing agreement (APA) with the Mexican tax authorities (APA option).

Affected companies should evaluate which of these options would be more appropriate; maquiladoras with a significant asset base for the safe harbor calculation typically may benefit from the APA option. A maquiladora electing to obtain an APA in 2014 must notify the Mexican tax authorities no later than 30 June 2014.

Application for indirect taxes certification

The 2013 tax reform eliminated the 0% VAT rate on temporary imports and the excise tax (ET) exemption for maquiladoras and companies operating under one of the bonded warehouse regimes; such imports are now subject to a 16% VAT at the time the goods enter Mexico and may be subject to ET at various rates (depending on the type of goods). However, a maquiladora or bonded warehouse is allowed to apply a credit in the month the VAT or ET is due if the entity has been "certified" by the Mexican tax authorities. As from 1 January 2015, companies that do not obtain the special certification will be required to pay VAT and any applicable ET on their temporary imports under the customs regimes for maquiladoras (IMMEX companies) and the various types of bonded warehouse companies; the VAT and ET will be recoverable only after the goods are exported, which is likely to have an effect on the cash flow of these companies.

In January and February 2014, the tax authorities published guidelines and requirements to obtain certification, as well as its benefits; a three-tier rating system (A, AA and AAA) will be used to assess maquiladoras' controls and overall tax and customs compliance. Certification will be renewed automatically, provided the maquiladora/bonded warehouse files a notice before the term expires and it continues to be in compliance with the requirements.

The dates for filing a certification request during 2014 generally depend on the taxpayer's location, except for taxpayers operating under certain specified customs regimes. Companies operating under the automotive bonded warehouse regime and certain companies operating under a special customs certification (i.e. companies operating under the NEEC L modality) were required to file a certification request between 1 April and 30 April 2014; for other companies, a request may be filed between 15 April and 22 October 2014, depending on the taxpayer's location. The relevant dates are as follows:

Location	Dates
Pacific North (Baja California, Baja California Sur, Sonora)	15 April-15 May 2014
Northeast (Nuevo Leon, Tamaulipas)	3 June-3 July 2014
North Central (Chihuahua, Coahuila, Durango, Zacatecas)	7 July-7 August
Central (Hidalgo, Estado de Mexico, Morelos, Queretaro, Guanajuato, Michoacan, San Luis Potosi, Guerrero, Distrito Federal)	7 August-8 September 2014
West and South (Sinaloa, Jalisco, Aguascalientes, Nayarit, Colima, Veracruz, Tlaxcala, Puebla, Chiapas, Oaxaca, Tabasco, Yucatan, Quintana Roo, Campeche)	22 September-22 October 2014

Companies operating under the customs regimes for maquiladoras or bonded warehouse companies that are unable to obtain certification still may avoid paying VAT or ET by obtaining a bond (in an amount equal to the taxes due) from an authorized institution. Once the entity demonstrates that the relevant goods have been exported, the bond will be released. The tax authorities are expected to issue further guidance on the bond option.

For information on VAT certification benefits, see the alert dated 4 January 2014.
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-mexico-040114.pdf

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Taiwan:
Ruling issued on tax treatment of bargain purchase gains under IFRS

Taiwan's tax authorities have issued a ruling dated 10 April 2014 (Tax Ruling No. 10200192840) that addresses the tax treatment of gains arising from a bargain purchase under International Financial Reporting Standards (IFRS).

IFRS 3, *Business Combinations*, sets out the principles that apply to the recognition and measurement of acquired assets and liabilities when an acquirer obtains control of a business, such as through a merger. A bargain purchase gain arises where the fair value of the identifiable net assets acquired exceeds the purchase price in a merger.

Publicly listed companies in Taiwan were required to adopt IFRS as from 1 January 2013; private companies can continue to follow the Taiwan local GAAP (ROC GAAP).

According to ROC GAAP, the difference arising from a bargain purchase (i.e. the amount by which the fair value of the acquired assets exceeds the purchase price) must be allocated to reduce the value of acquired noncurrent assets on a pro rata basis. Once the value of all acquired noncurrent assets has been reduced to zero, any remaining difference should be recognized as a gain from the purchase.

Under IFRS 3, however, gains arising from a bargain purchase must be recognized as profit or loss on the date of acquisition, when identification of assets and liabilities is completed for financial reporting purposes.

According to the ruling issued by the Taiwan tax authorities, when a surviving company adopting IFRS 3 acquires identifiable net assets from dissolved companies via a bargain purchase in the course of a merger, for tax reporting purposes, the surviving company can recognize the relevant gain as a bargain purchase gain equally over a five-year period starting from the year the merger takes place. To be consistent with the tax basis, assets acquired under the merger can be recognized at their fair market value.

The following points in the ruling are noteworthy:

- The recognition period is calculated on an annual, rather than a monthly, basis. For example, surviving Company A with a bargain purchase gain of NTD 100 under a merger completed on 1 October 2014 could recognize a NTD 20 gain each year during the period from FY 2014 to 2018;
- The ruling applies to mergers concluded after 1 January 2013, but it does not apply retroactively to mergers concluded before that date;
- Application of the ruling to companies that follow ROC GAAP will need to be addressed on a case-by-case basis; and
- Application of the ruling to bargain purchase gains from a share acquisition transaction under IFRS 3 (as opposed to a merger) also must be addressed on a case-by-case basis.

Comments

Before the adoption of IFRS 3, the tax treatment of gains arising from a bargain purchase was unclear. In practice, such gains rarely were recognized, since the gains first were allocated to reduce the value of acquired noncurrent assets. The issuance of the ruling clarifies that the gains arising from a bargain purchase under a merger are taxable for companies adopting IFRS 3.

However, since the ruling does not address the treatment of bargain purchase gains in a share acquisition transaction, affected parties should request a ruling from the authorities in this situation.

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In brief

Australia – The Australian Taxation Office (ATO) has issued its first tranche of guidance on the application of the transfer pricing rules. The guidance takes the form of draft taxation rulings and practice statements. The most controversial aspect of the new transfer pricing rules, and the one causing the most concern for multinationals, is the ATO's power to reconstruct transactions. TR 2014/D3 confirms the ATO's intention to disregard transactions entered into by entities when they are not "commercially realistic" or when, in the ATO's view, independent entities would not have entered into the transaction.

Chile – The government has modified the proposed effective date of a measure to limit the deductibility of certain payments to foreign related parties, which was contained in the comprehensive tax reform bill presented to congress on 1 April 2014 (for prior coverage, see the alert dated 17 April 2014). This measure would apply as from the month following the enactment of the law (previously, it was proposed to apply as from 1 January 2017).
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-chile-170414.pdf

China – As from 1 June 2014, the VAT reform will be expanded to include telecommunications services (such services currently are subject to business tax (BT)). According to a circular issued by the Ministry of Finance and State Administration of Taxation on 30 April 2014, telecommunications service providers (both entities and individuals) in China will be subject to VAT at the following rates: 11% (basic services) and 6% (value added services); telecommunications services provided to foreign entities will be exempt. The 11%/6% VAT rates represent a significant increase for the telecom sector when compared with the 3% BT that currently applies. If telecom companies are unable to pass on the increased VAT cost to their customers through pricing adjustments, the challenge will be to ensure there are sufficient VAT inputs to mitigate the negative effect. However, providers of telecom equipment should see some improvement in their business, as the VAT they charge no longer will be a cost to their customers (i.e. telecom companies).

Mexico – The president sent a package of energy reform bills to congress on 29 April 2014 that would amend 12 existing laws and create nine new laws. The package of "secondary legislation" was anticipated following amendments to the Mexican constitution in December 2013 to allow a broad-based reform of the oil, gas and electricity sectors and to allow domestic and foreign private investment and participation in these sectors. In general terms, the intention is establish a comprehensive legal and tax framework for public and private investment in the hydrocarbon exploration and extraction sector, transportation and the storage and distribution of petroleum, natural gas and its derivatives. The proposed measures would establish a legal structure for exploration and production activity contracts, as well as for production and profit sharing. Mexico's state-owned companies, PEMEX (oil and gas) and the Federal Electricity Commission (power), would be converted to productive state companies and granted greater budgetary and administrative autonomy and financial flexibility.

OECD – The OECD has announced that the governments of 86 countries have taken a key step toward preventing VAT from burdening trade, while safeguarding state revenues, by endorsing the first internationally agreed framework for applying national VAT rules to cross-border transactions. More than 250 high-level representatives from approximately 100 countries, jurisdictions and international organizations attending the OECD Global Forum on VAT meeting on 17-18 April 2014 endorsed a new set of OECD guidelines for the application of VAT or GST (Goods and Services Tax) to international trade. These guidelines seek to address the problems that arise when national VAT systems are applied in an uncoordinated way in the context of international trade, and set standards aimed at ensuring neutrality in cross-border trade and a more coherent taxation of business-to-business trade in services.

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Canada
FCA limits scope of foreign affiliate anti-avoidance rule in *Lehigh*
Canada's Federal Court of Appeal issued a decision on 23 April 2014 on the anti-avoidance rule in paragraph 95(6)(b) of the Income Tax Act. In a taxpayer-favorable decision, the court confined the scope of the provision to the manipulation of foreign affiliate or controlled foreign affiliate status.
Issue date: 25 April 2014
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-canada-250414.pdf?id=us:em:na:wta:eng:tax:050914

Greece
Greece Provides Guidance on Transfer Pricing Rules
Greece's Finance Minister has issued a ministerial decision that provides guidance on the contents of the transfer pricing documentation file, the parties subject to the transfer pricing rules and exemptions therefrom, language requirements, transfer pricing documentation methods, and the content of the summary information table.
Issue date: 25 April 2014
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-tp-alert-greece-2014-009-250414.pdf?id=us:em:na:wta:eng:tax:050914

Norway
MOF issues exceptions to interest deduction limitation rules
Norway's Ministry of Finance issued regulations on 24 April 2014 that set out certain exceptions to the application of the interest deduction limitation rules.
Issue date: 25 April 2014
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-norway-250414.pdf?id=us:em:na:wta:eng:tax:050914

United States

Cross-Border Triangular Reorganizations Notice

On 25 April 2014, the IRS and Treasury Department issued Notice 2014-32 to notify taxpayers that they will issue regulations to modify Treas. Reg. §1.367(b)-10's treatment of cross-border triangular reorganizations.

Issue date: 25 April 2014

URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-united-states-250414.pdf?id=us:em:na:wta:eng:tax:050914

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