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International Tax Update

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01 BEPS: Recent Developments

The recent international developments relating to the OECD/G20 Base Erosion and Profit Shifting (BEPS) project are summarised below.

Ireland and Malta enter into competent-authority agreement

Per an eBrief issued on 27 November 2018, Revenue has signed a competent-authority agreement with the Maltese competent authority. The competent authorities have agreed that the deeming by the countries' double taxation agreement (DTA) of a company incorporated in Ireland but managed and controlled in Malta to be resident in Malta only does not serve the purposes of the DTA and is not "for those purposes".

This will be a key development for groups with Irish-incorporated, Maltese-tax-resident entities, which can in certain instances hold valuable intellectual property (IP) and earn royalties from the licensing of same or earn interest from loans. The competent-authority agreement seeks to target such a structure where the payments are received from an Irish-resident company as being contrary to the aims of the DTA between the two countries. Accordingly, an Irish-incorporated company will be resident in Ireland and the relevant payments to it that are deductible in Ireland will come within the charge to Irish corporation tax.

This competent-authority agreement will have effect for taxable periods beginning on or after the expiration of a period of six months from the later of the dates on which the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting enters into force for Ireland and Malta ("the MLI").

A key focus for taxpayers and practitioners will therefore be a review of structuring and financing arrangements where a Malta Company is the structured group.

In addition to the competent-authority agreement with Ireland, Malta has taken further steps to bring its domestic law in line with the BEPS agenda. In particular, Malta deposited its instrument of ratification for the MLI with the OECD on 18 December 2018. It is expected that the MLI will enter into force in Malta on 1 April 2019.

Digital taxation continues to dominate agenda

Against a backdrop of dissent and disagreement on the area of digital tax, although we have seen an increased volume of discussion on the matter, it is clear that we are no closer to consensus at EU level. At a meeting of the Economic and Financial Affairs Council on 4 December 2018, some Finance Ministers expressed readiness to move forward with proposals to tax advertising sales revenue. French and German Ministers came out strongly in support of adopting the Digital Services Tax Directive no later than March 2019, with the tax to enter into force from January 2021. The Franco-German proposals would impose a 3% levy on advertising revenues but would not cover data sales and online platforms.

A number of Member States have moved ahead with their own digital tax proposals, as follows.

UK

The UK Government recently proposed a 2% tax on revenues from certain digital services that derive significant value from UK users. This new tax will apply from 1 April 2020.

France

The digital services tax was proposed in France in 2018 and was originally intended to apply from 1 January 2019. However, as the law was not enacted by that date, it is now believed that a draft law will be presented to the Government in February and will apply retrospectively to revenues arising on or after 1 January 2019. The tax is proposed to apply to companies with annual global turnover exceeding €750m and French turnover exceeding €25m. The proposed rate of tax will range from 0% to 5%, depending on turnover.

Spain

The new Spanish tax on digital services proposed in the draft Bill is designed similarly to the European Commission's proposed Digital Services Tax Directive issued on 21 March 2018.

Austria

According to a press release issued by the Ministry of Finance on 11 January 2019, the Austrian Government intends to introduce a digital tax in 2019. The key element of the regime is a tax on revenue derived from online advertising, which will apply to companies with annual worldwide turnover of €750m or more and Austrian turnover of €10m or more.

The concerns raised at EU level also arise against the backdrop of comments made on 7 December 2018 by Pascal Saint-Amans. Speaking on the matter at the International Taxation Conference 2018 in Mumbai, Mr Saint-Amans said that he expects an update on the OECD's work on the taxation of the digital economy to be released at the end of January 2019. Given recent OECD meetings in Paris on the matter, it would appear that the OECD remains committed to considering proposals on the taxation of the digital economy. The work going on at OECD level may lend support to EU Member States who would prefer a global approach rather than unilateral action at EU level.

MLI enters into force for several countries

On 1 January 2019 the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) entered into force in respect of:

- Australia,
- France,
- Israel,
- Japan,
- Lithuania and
- Slovakia.

(See also the article by David Fennell in this issue "Ireland's Implementation of the Multilateral Instrument".)

02 Luxembourg Transposes ATAD 1 into Domestic Law

The law transposing the EU Anti-Tax-Avoidance Directive (ATAD 1) into Luxembourg law was published on 21 December 2018, following Parliament's approval on 18 December. The ATAD 1 provisions will be applicable in Luxembourg for fiscal years starting on or after 1 January 2019, except for the exit tax provisions, which will apply from 2020. The following changes are introduced into domestic tax law.

Hybrid mismatch rules

The ATAD 1 measures counteracting hybrid mismatches will apply where there are differences in the legal characterisation of payments or entities in different EU Member States that result in (1) a deduction for the same expense in two Member States (double deduction) or (2) a deduction in one Member State without a corresponding income inclusion in another Member State (deduction without inclusion). Under these rules:

- in the case of a double deduction, the deduction will be allowed only in the Member State where the payment is sourced; and
- in the case of a deduction without inclusion, the deduction will not be allowed by the Member State of the payer.

Controlled foreign companies

The new rules, which are closely in line with Articles 7 and 8 of the ATAD 1, define a controlled foreign company (CFC) as a foreign collective undertaking or a foreign permanent establishment (PE) the income of which is not taxable or is exempt in Luxembourg if the following criteria are fulfilled:

- in the case of a foreign collective undertaking, the Luxembourg taxpayer, alone or together with associated enterprises, directly or indirectly (1) holds more than 50% of the voting rights, (2) holds more than 50% of the capital or (3) is entitled to receive more than 50% of the profits; and
- the actual corporate income tax paid by the foreign collective undertaking or the foreign PE on its income is lower than the difference between the tax that would have been paid on the same profits in Luxembourg and the actual tax paid in the CFC state.

In line with other jurisdictions, exemptions apply where the profits of the CFC do not exceed certain limits.

As Ireland has, Luxembourg has adopted Option B for implementing the new CFC rules into domestic law. Under the new rules, the income of the CFC at play is the undistributed income arising from non-genuine arrangements that are put in place for the purpose of obtaining a tax advantage. A key component of whether the structure or CFC is in place for the purpose of a tax advantage is whether the Luxembourg entity exercises "significant people functions" in managing the assets and risks of the CFC.

The introduction of CFC rules in Luxembourg, although not unexpected in light of the changing tax landscape globally, will require taxpayers to review their structures where people functions are exercised abroad. The concept of significant people functions and risks/assets borne/managed will be largely guided by OECD transfer pricing principles. The introduction of CFC rules in Luxembourg will undoubtedly serve as a push for taxpayers and practitioners to examine structures in this jurisdiction and to document effectively and defend arrangements that are likely to be at risk of exposure to the new rules.

Interest limitation rules

As a result of changes in the tax law, interest deduction limitation rules have been introduced. Under previous law, a taxpayer's borrowing costs (broadly defined as interest expenses on all forms of debt, other costs economically equivalent to interest, and expenses incurred in connection with the raising of finance) were fully deductible to the extent of the company's taxable interest revenue and other economically equivalent taxable revenue. Under the new rules, the deduction of any excess of borrowing costs over interest income, defined as "excess borrowing costs", is restricted to 30% of the taxpayer's tax-based EBITDA (earnings before interest, tax, depreciation and amortisation), with some carry-forward provisions and exemptions for *de minimus* amounts or group thresholds.

This change implements the 30% EBITDA restriction outlined in ATAD 1 and therefore is to be expected. However, given the wider tax reform agenda and the increased focus on BEPS-related measures both in Luxembourg and globally, future and current financing and IP structures will require further review by tax professionals.

03 European Commission Expands on Plans for Qualified Majority Voting on Tax Issues

Speaking to the media on 9 January 2019, the European Commissioner for Economic and Financial Affairs, Taxation and Customs, Pierre Moscovici, expanded on plans for qualified majority voting (QMV) on tax issues. Elaborating on his comments of 19 September 2018, Mr Moscovici referred to issues such as the digital services tax and the Common Consolidated Corporate Tax Base (CCCTB) proposals, which in his view were being stalled by the need for unanimity on tax matters. However, he qualified his comments by stating that not all taxation issues will move to QMV.

One option, as a first step toward QMV, would be to use the ordinary legislative procedure to make decisions on proposals that do not "have an impact on the right to tax, on tax bases, or on tax rates". That would cover, at a minimum, proposals strengthening administrative cooperation between Member States, such as the standardisation of VAT returns and the automatic exchange of information on tax rulings.

On 15 January 2019 the European Commission published a roadmap outlining a gradual, four-step progression towards decision making based on QMV. The steps envisaged are:

- Step 1: Member States would agree to move to QMV decision making for measures that improve cooperation and mutual assistance between Member States in fighting tax fraud and tax evasion, as well as for administrative initiatives for EU businesses, e.g. harmonised reporting obligations. These measures are usually welcomed by all Member States but are prone to being blocked for reasons unrelated to the issues at hand.
- Step 2: QMV would be used as a tool to progress measures in which taxation supports other policy goals, e.g. fighting climate change, protecting the environment, and improving public health.
- Step 3: QMV would be used to help modernise already harmonised EU rules such as VAT and excise duty rules.
- Step 4: QMV would be used for major tax projects, such as the CCCTB and a new system for the taxation of the digital economy.

The roadmap suggests that Member States should consider developing Steps 3 and 4 by the end of 2025.

According to diplomats, only Spain and Portugal expressed clear support for such an approach, whereas France seemed reluctant, unless the move is strictly limited to a few tax areas. Given the potential for such proposals to result in a loss of sovereignty by Member States, it is no surprise that the reaction to Mr Moscovici's comments has been mixed.

04 European Commission Publishes Report on Automatic Exchange of Tax Information

On 17 December 2018 the European Commission presented the first report on the review of the automatic exchange of information between Member States in the field of direct taxation. According to the report, EU transparency rules led to Member States compiling and sharing data from 8.7m financial accounts with a total value of €2,919bn in 2017. The report also shows that some countries have been able to use this data to increase their tax base due to a new awareness of potentially taxable foreign income and capital of their tax residents.

With regard to work that remains to be done, the report notes that Member States have to improve the way they collect and exploit the data that they exchange. Also, work should continue on assessing the full benefits of exchange of information.

05 Italian Budget for 2019 Approved

On 30 December 2018 the Budget Law for 2019 was approved by the Italian Parliament. The main tax measures include:

- the corporate income tax rate on profits reinvested in certain qualifying activities and assets, e.g. research and development activities and new hires, will be reduced to 15%;
- the 15% income tax rate available to qualifying self-employed individuals will be

extended by increasing the income threshold from €30,000 to €65,000;

- a 21% substitute tax will apply to new rental contracts, including those related to commercial property;
- certain incentives will be introduced for enterprises reducing pollution;
- various procedures will be available for the settlement of past tax liabilities;
- the current VAT rates will not be increased; and
- simplification measures for the issuance and registration of invoices and VAT payments will be adopted.

06 IRS Releases Proposed Regulations on Hybrid Arrangements and BEAT

The US Treasury Department and the Internal Revenue Service (IRS) released proposed Regulations to provide guidance on s59A of the Internal Revenue Code (IRC) – the base erosion and anti-abuse tax (BEAT) – on 13 December 2018. In addition, guidance relating to hybrid dividends and certain amounts paid or accrued in hybrid transactions or by/to a hybrid entity was published on 20 December 2018.

A related IRS release (IR-2018-250) on the BEAT states that the proposed Regulations provide detailed guidance regarding which taxpayers will be subject to s59A, the determination of what is a base erosion payment, the method for calculating the base erosion minimum tax amount and the required BEAT amount resulting from that calculation.

The proposed Regulations on hybrid situations contain rules under IRC ss1503(d) and 7701 to prevent the same deduction from being claimed under the tax laws of both the US and a foreign country. The proposed Regulations affect taxpayers that would otherwise claim a deduction related to such amounts and certain shareholders of foreign corporations that pay or receive hybrid dividends.

The release of Regulations on hybrid arrangements and the BEAT may result in different interpretations of some of the provisions being taken compared to those applicable to the original legislation. Also, the fact that more Regulations are yet to be released serves to increase further the complexity around US tax reform.

07 Netherlands Enacts 2019 Tax Package

On 18 December 2018 the Dutch Senate approved the 2019 tax package, originally published by the Ministry of Finance on 18 September 2018 and amended on 15 October 2018. The tax package became effective on 1 January 2019 and includes the following amendments to Dutch corporate income tax:

- ATAD 1 is implemented, including the earnings stripping rule and CFC rules. Option A for implementation of the CFC rules has been chosen by the Netherlands.
- There will be a gradual reduction of the corporate income tax rate from 20% on the first €200,000 of income to 16% by 2020. Income over €200,000, currently taxed at 25%, will see a reduction in the tax rate to 22.25% by 2020.
- Changes are introduced to the rules on tax losses and the depreciation of buildings.

The initial proposals to abolish the current dividend withholding tax and introduce a withholding tax on inter-company dividend distributions to low-tax jurisdictions and in abusive situations were withdrawn.

08 HMRC Introduces Profit Diversion Compliance Facility

Based on guidance issued on 10 January 2019, HMRC has outlined its finding that some multinational enterprises (MNEs) appear to have adopted cross-border pricing arrangements that are not consistent with the OECD Transfer Pricing Guidelines. In the guidance, HMRC recognises that this inconsistency can arise from a variety of factors, including insufficient understanding of the nature of functions, assets and risks, and changes to the business over time such that the functional profile becomes different from the original structure.

To combat this deviation from the Transfer Pricing Guidelines, HMRC has introduced a Profit Diversion Compliance Facility for MNEs using arrangements targeted by diverted profits tax, to give them the opportunity to bring their UK tax affairs up to date. The facility is designed to encourage MNEs with arrangements that might fall within its scope to review both the design and the implementation of their transfer pricing policies, change them if appropriate, and use the facility to put forward a report with proposals to pay any additional tax, interest and, where applicable, penalties due.

Groups reviewing their structures will also be mindful of the proposed UK offshore receipts income tax on income from UK sales where the income arises in relation to intangible property held in a low-tax jurisdiction.

09 UK Reviews Corporate Intangible Fixed Asset Regime

Following on from announcements in Budget 2018, draft legislation is included in Finance (No. 3) Bill 2017–19 to reinstate partially relief for goodwill and other relevant assets acquired on or after 1 April 2019 where certain conditions are fulfilled. At Budget 2018, HMRC released a summary of responses to their earlier consultation on the intangible fixed assets regime in the UK.

Under previous rules, no amortisation relief was available for “relevant assets” being goodwill, customer related intangibles and unregistered trademarks. The review provides for a partial reinstatement of tax relief for acquired goodwill and other “relevant assets”. Relevant assets are defined as including the following:

- goodwill in a business or part of a business,
- information that relates to customers or potential customers of a business or part of a business,
- a customer relationship (whether contractual or not) between a person carrying on a business and one or more customers of that business or part of that business,
- an unregistered trademark or other sign used in the course of a business or part of a business and
- a licence or other right in respect of any of the above assets.

For the purposes of the quantifying the relief, the tax base cost of a relevant asset is subject to a cap equal to six times the expenditure incurred on “qualifying IP assets” acquired as part of a business acquisition. The term “qualifying IP asset” therefore can be somewhat confusing, as it does not refer to whether an IP asset qualifies for relief but is a specific term defined for the purposes of capping relief on “relevant assets”. Registered trademarks and know how are not treated as qualifying IP assets as they are not on the defined list. While this does not necessarily mean that a trade mark cannot qualify for relief, it means that the cost of the trademark cannot be used to increase the cap on the relief for relevant assets

10 Economic-Substance Requirements Introduced in Cayman Islands and Other Jurisdictions

noted above. The exclusion of trademarks from the calculation of the cap suggests that the relief is somewhat more limited in comparison to the Irish regime under Section 291A, which does not provide any such cap in calculating qualifying spend.

Relief will be available for expenditure on relevant assets over approximately 15 years on a straight line basis, in alignment with the Irish regime. However, unlike the Irish regime there is no option to follow the accounting rate of amortization for tax purposes.

The Cayman Islands' Legislative Assembly passed a law in December 2018 introducing increased economic-substance requirements for Cayman companies. The new law, effective as of 1 January 2019, requires every Cayman Islands entity engaging in a relevant activity to maintain a substantial economic presence in the Cayman Islands. A relevant entity (which will include most exempted companies, LLPs and LLCs) will be deemed to comply with the requirements if it:

- conducts core income-generating activities in relation to the relevant activity in the Cayman Islands,
- is directed and managed in the Cayman Islands,
- has adequate operational expenditures incurred in the Cayman Islands,
- has an adequate physical presence in the Cayman Islands and
- has an adequate number of full-time employees in the Cayman Islands.

Relevant activities include banking, financing, leasing and IP-type activities such as licensing. An annual reporting obligation will arise for all relevant entities engaged in such activities.

Similar rules have been introduced in the British Virgin Islands, Bermuda, the Isle of Man, Jersey and Guernsey.

The introduction of economic-substance rules in various countries will be of interest to groups with IP and financing structures operating through these countries where there may be currently limited substance. Although an element of grandfathering may be available for current structures, the new rules may encourage groups looking to move their IP or financing elsewhere to consider accelerating such restructures.

11 Belgium Submits Tax Bill to Parliament

On 20 December 2018 a Bill on fiscal, anti-abuse, financial and various other provisions was submitted to the Belgian Parliament. The most important details of the Bill are summarised below.

Interest barrier

On 31 January 2019, the Belgian Government approved the advancement of the implementation date of the new interest limitation rule (30% EBITDA rule).

Concretely, this means that the Belgian 30% EBITDA rule will enter into force retroactively as from assessment year 2020, i.e. financial years starting on or after 1 January 2019, which is in line with the targeted implementation date under ATAD I.

Stock options and benefits-in-kind received from a foreign company

If an employee receives stock options or other benefits-in-kind from a foreign related company, the Belgian employer is obliged to withhold wage tax and to notify the Belgian tax administration about the granting of the stock options or the benefits-in-kind.

Exchange of information with third countries

The exchange of information on the "ultimate beneficial owner" register will be extended to include jurisdictions outside the European Union with which a legal basis exists for the exchange of information with Belgium. The relevant data can be requested from Belgian entities and must be submitted within one month.

Legal constructions

With respect to taxpayers using legal constructions that involve low-tax countries with which no tax treaty providing for exchange of information has been concluded, the assessment and investigation periods are expected to be extended to 10 years.

Rulings

With respect to planned transactions involving a tax haven that is included in the OECD list of non-cooperative countries or a country that is included in the domestic list of states with low or no taxation, rulings will no longer be issued, except with regard to countries exchanging information with Belgium.

12 Sweden Adopts Proposal to Amend CFC Legislation

On 14 November 2018 the Swedish Parliament adopted a proposal to amend the current CFC legislation. Although the changes are driven by ATAD 1, they extend significantly further than required.

The rules entered into force on 1 January 2019 and apply to any financial year beginning after 31 December 2018. Under the rules, certain thresholds and definitions become wider, meaning that more situations fall within the scope of the CFC rules. In addition, changes were made to the "white list", which result in income from more countries being subject to the Swedish CFC charge.

- Malta, which is on the existing white list regarding all types of income, is completely removed from the list, which means that all types of income from Malta could fall within the scope of the Swedish CFC rules unless the "real economic activities test" is fulfilled.
- The white-list status of several jurisdictions is amended, meaning that they remain on the list but the types of income not considered to be subject to low taxation are further limited by the recently adopted rules. These changes will impact Ireland and Luxembourg, in particular. Under the new rules, income from royalties and other intangibles that is not subject to the general corporate tax rate will be excluded from the white list and thus within the scope of the CFC charge.

This will be an area of focus for large corporates with Irish subsidiaries, particularly where such companies earn a return from the use and exploitation of royalties.