Briefing

International briefing for April

Speed read

The UK Finance Bill contains legislation on the patent box, hybrids and royalty payments. In Europe, the EC published a proposal for public country by country reporting and the advocate general of the CJEU published an opinion on Portuguese withholding tax rules. The Italian Supreme Court concluded that the Italian CFC regime is compliant with EU principles but a group of tax professionals in Italy have submitted a complaint to the EC arguing that it is not. Outside the EU, the Swiss Corporate Tax Reform III proposals continued their progress through parliament, and the Canadian Federal Budget included several announcements focused on implementation of the OECD's BEPS recommendations.

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It has been a relatively quiet month for the OECD base erosion and profit shifting (BEPS) project, with the most notable output being a consultation document on the tax treaty entitlement of non-CIV (collective investment vehicle) funds on 24 March.

This month also saw the publication, just before the Easter weekend, of the UK Finance Bill which contained some international tax legislation. As anticipated, the Bill includes updated legislation to amend the UK patent box rules to comply with the OECD BEPS proposals. There are a number of changes since the draft legislation was issued in December, including transitional rules dealing with 'grandfathered' products that include both existing and new intellectual property (IP) and that increase the 'nexus' or 'R&D fraction' in exceptional circumstances. Changes have also been made to the 'safeguarding' rules that apply to grandfathering, meaning that more companies could continue to benefit from the current regime until 2021.

The legislation for hybrid mismatches in the Finance Bill has also been expanded since the provisions published in December to eliminate the tax advantage arising from the use of mismatches involving permanent establishments (PEs). The Finance Bill also includes an anti-avoidance provision to counteract arrangements which seek to circumvent the anti-hybrid rules.

As announced at the Budget on 16 March, the Finance Bill includes provisions affecting withholding tax on royalty payments. Most of this legislation was published on Budget Day and HMRC has stated that the parts still outstanding 'will be introduced later in the passage of the Finance Bill'.

EU update

Public country by country reporting

On 12 April, the European Commission published a proposal for public country by country reporting. The proposal will affect large multinational companies, defined as those with turnover of more than €750m which are EU-parented or have EU branches or subsidiaries. Specifically there are to be seven areas of mandatory disclosure: the nature of activities undertaken, the number of employees, net turnover, profit before tax, income tax accrued, tax paid and accumulated earnings. These details will be shown separately for each member state where the group is active and for all other countries the data will be aggregated, with the exception of tax jurisdictions 'which pose particular challenges'. A list of these jurisdictions will be produced, based on an assessment of all third countries' tax systems from a good governance perspective, and the first scoreboard results will be presented to member states in autumn 2016.

Where there are material discrepancies between the amounts of tax accrued and tax paid, groups will be required to explain this difference. This is a requirement which goes further than the OECD BEPS recommendations and places more onus on multinational groups to reconcile and contextualise their data.

Reports must be made available to the public on the company's website for at least five years and will need to be audited. Companies will also need to file their report with a business register in the EU.

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The proposals must now be considered by the European Parliament and Council and, because the proposals will be brought in via an amendment to the 'Accounting' Directive, they will only need to be adopted by a qualified majority as opposed to the unanimous approval that is usually required for tax related legislation. Once this has been completed, EU member states will have one year to transpose into national legislation.

Portugal: *Brisal* (Case C-18/15)

This case considers the Portuguese rules which impose a 20% withholding tax on interest paid to non-resident financial institutions and this tax is withheld from the gross amount without any deduction for the costs of financing the underlying loans. However, domestic financial institutions pay tax on net income and therefore may suffer less tax. On 17 March, the advocate general (AG) of the CJEU concluded that these rules violate EU law as they constitute a restriction to the freedom to provide services. What is interesting about this case is that the European Commission had previously challenged this treatment on similar grounds but the CJEU rejected the case without addressing the issues (*Commission v Portugal* (C-105/08)). We will have to wait and see whether the AG's opinion will be followed this time.

Italy: EU law and CFC regime

A recent decision by the Italian Supreme Court (Judgement No. 25281) concluded that the Italian controlled foreign company (CFC) regime, which uses a 'black list' approach, is compliant with EU principles. The Supreme Court case considered an Italian company with a subsidiary based in Cyprus which sought clearance that the Cypriot company should not be brought into the CFC rules under the safe

harbour conditions, despite being on the Italian black list at the time. However, the Italian first and second instant courts held that the company was a holding company which did not actually carry out any activity, and as such the safe harbour conditions were not fulfilled and the CFC rules would apply.

The taxpayer argued that as the ruling it had requested also included years after Cyprus joined the EU (1 May 2004), the refusal to grant it was an infringement of the EU freedom of establishment (as interpreted in the *Cadbury Schweppes* judgment (Case C-196/04)). It went on to argue that the Italian CFC regime, even where it is justified to prevent artificial arrangements, exceeds what is necessary to combat tax avoidance and therefore infringes the EU principle of proportionality. Its final argument was that the Italian CFC regime seems to contradict the Italy-Cyprus double tax treaty.

The Supreme Court concluded that a domestic CFC regime would be compliant with the EU freedom of establishment principle if it contained either of the following conditions:

- the CFC is an artificial arrangement aimed at avoiding taxes; or
- the CFC is not actually established in its country or does not have a real business purpose.

It went onto conclude that the Italian CFC regime is compliant on this basis because it does not apply when the CFC satisfies either a 'business' test or a 'subject to tax' test. The court also decided that the Italian CFC rules do not contradict the Italy/Cyprus double tax treaty.

Separately, last month various tax professionals in Italy submitted a complaint to the European Commission arguing that the Italian CFC rules, particularly the provisions in respect of CFCs not located in 'black list' countries, do not comply with EU Treaty standards. We have yet to find out whether the European Commission agrees with the tax professionals or the Italian courts.

Global update

Switzerland: Corporate Tax Reform III

I have mentioned the fundamental tax reform process that is currently underway in Switzerland a number of times, most recently in January when I reported on the debate in the Swiss Council of States (the small chamber of the Swiss parliament). On 16 and 17 March, the debate on the draft legislation, which was published on 5 June 2015 and is known as Corporate Tax Reform III, moved to the Swiss National Council (the large chamber). The National Council confirmed its commitment to measures which favour the economy and reduce tax burdens and respond to international developments, such as the OECD's BEPS project.

The National Council approved various proposals, in particular the abolition of the privileged tax regimes – such as the holding, domiciliary and mixed company at cantonal/municipal level, and the principal company status at federal level. It also approved the introduction of a patent box regime and an R&D super deduction, however in contrast to the Council of States, the National Council would like to leave the decision on the amounts to the Cantons.

The National Council took a different view to the Council of States on the notional interest deduction, arguing for its reintroduction and stating that this, combined with the patent box regime and R&D super deduction, should result in a maximum overall reduction of 80% of the tax burden at the cantonal/municipal level. It also rejected the proposal to make qualified dividends fully taxable at an individual level and the abolition of stamp duty on equity, although the latter may be included in the scope of a separate proposal at a later date.

The proposals will now return to the Council of States for further joint discussion.

Canada: Federal Budget

As is the case in many countries at the moment, Canada's Budget on 22 March included several announcements focused on implementation of the OECD's BEPS recommendations. For Action 6, which looks at treaty abuse, going forward Canada will consider including either the principal purpose test or the limitation on benefits approach in treaties, depending on the particular circumstances and discussions with Canada's tax treaty partners. This will be achieved through bilateral negotiations, the multilateral instrument that will be developed in 2016 under the OECD's BEPS Action 15, or a combination of the two.

Country by country reporting will be introduced by Canada for tax years beginning after 2015, applying only to multinational enterprises with a total annual consolidated group turnover of €750m or more in the preceding financial year, in line with the OECD recommendations. Also in support of the BEPS project, Canada has announced that it will implement the OECD's minimum standard for the spontaneous exchange of certain tax rulings beginning in 2016, and it will implement the common reporting standard starting on 1 July 2017, allowing for the first exchanges of information with other countries in 2018. The Canadian government issued draft legislation on the Canadian common reporting standard on 15 April 2016.

Also of potential interest, the Budget proposes new rules to limit cross-border paid-up capital (PUC) increases and extends the 'back-to-back' loans rules that were introduced in 2014 to include royalties and shareholder loans. ■

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