Briefing

International briefing for May

Speed read

Three dates for forthcoming BEPS discussion drafts were announced by the OECD and the second consultation on Action 4 (interest deductions) was published in the UK. In the Netherlands, details were published of how requests by non-resident shareholders for a refund of dividend WHT should be dealt with and a court case suggests a fiscal unity is possible where the parent company is established in a non-EU/EEA country. A new diverted profits tax was announced in the Australian Budget; US regulations which could have a significant impact on the debt financing of US subsidiaries were published; and there has been an important update to the India/Mauritius treaty.

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After a relatively quiet month for the OECD base erosion and profit shifting (BEPS) project last month, things seem to be picking up again now. The OECD has announced the dates for three new BEPS related consultations. Two of the planned discussion drafts relate to Action 4 (interest deductions), the first considering the design and operation of the group ratio rule (to be issued 6 July, with the consultation period running until 3 August), and the second covering approaches to BEPS involving interest in the banking and insurance sectors (to be issued 18 July, with the consultation period running until 29 August). A third consultation will consider hybrid mismatch arrangements for branches and this discussion draft will be issued on 15 July with the consultation period running until 29 August.

Here in the UK a second consultation document on implementation of the OECD's recommendations under BEPS Action 4 was published on 12 May. We have known for some time now that new rules on interest deductibility will be introduced in the UK from April 2017 in line with the recommendations set out in the OECD report. An initial consultation document was published in October 2015 and then the key policy design features were included in the *Business Tax Roadmap* published alongside Budget 2016. This latest consultation sets out further detail on the proposed design of the new rules together with 46 specific questions on which the government is seeking the views of stakeholders to inform the drafting of the legislation for Finance Bill 2017. It will be open for comment until 4 August.

EU update

Netherlands: changes to dividend withholding tax

The Dutch minister of finance has released a policy statement on the judgment made earlier in the year by the Dutch Supreme Court, which ruled that the Dutch withholding tax applied to dividends paid to non-residents on their portfolio holdings may result in a restriction of the free movement of capital (*Miljoen, X* and *Société Générale* cases, ECLI:NL:HR:2016:363).This restriction exists if and to the extent that the dividend withholding tax burden of foreign shareholders is higher than the personal or corporate income tax burden of resident shareholders that own the same shares in Dutch companies.

The policy statement, published on 29 April, sets out how the Dutch tax authorities should deal with requests by non-resident shareholders for a refund of Dutch dividend withholding tax. It explains that a refund should be granted following a comparative analysis between the Dutch tax burden of the non-resident shareholder on the dividends received from their Dutch portfolio shares and the tax burden of a hypothetical resident shareholder whose assets would only consist of the shares held by the non-resident taxpayer in Dutch companies over a period of one year.

This refund can be claimed upon request for the past five years (for non-resident individual taxpayers) or three years (for non-resident non-individual taxpayers).

Netherlands: fiscal unity where no EU/EEA parent

A Court of Appeal judgment in the Netherlands (ECLI:NL:RBGEL:2015:240) has concluded that, under certain tax treaties, a request to form a fiscal unity between Dutch sister companies must be granted, even if the joint parent company is established in a third country (i.e. a country outside the EU/EEA). Although it is well established now that the EU freedom of establishment principle allows a fiscal unity when the parent company is established in the EU/EEA, it is generally accepted that it is not possible to use EU law to support the position where the parent company is in a third country.

This current case, however, is based upon the Netherlands/Israel tax treaty and invokes the non-discrimination clause. This particular treaty has wording that is almost identical to article 24(5) of the OECD Model Tax Convention and so this principle could potentially apply in all cases where the Netherlands has concluded a tax treaty with a particular country which includes a non-discrimination clause that is based on the OECD wording. However, the argument is stronger if the treaty – like the one with Israel – was concluded before a significant change of the OECD Commentary in 2008.

The Dutch government is expected to appeal this decision to the Supreme Court but if it is upheld the implications could be far-reaching.

Global update

Australia: Budget 2016

The Australian Budget was announced on 3 May, with the introduction of a new diverted profits tax (DPT) being the most important announcement from an international tax perspective.

The DPT is modelled on those aspects of the UK's own diverted profits tax which were not included in Australia's multinational anti-avoidance law (MAAL) which was introduced in the 2015 Budget. The DPT is aimed at arrangements involving transactions with overseas related parties which are subject to a tax rate which is at less than 80% of the tax rate applied in Australia (currently 30%), where the arrangement lacks economic substance. The DPT will be levied on the 'diverted' profits at the punitive rate of 40%, and is payable upfront where the tax authorities deem there to be underpaid tax.

The DPT is only aimed at the largest multinational groups; there is a *de minimis* test such that the DPT will only apply to Australian entities or Australian permanent

establishments (PEs) of foreign entities which are members of a multinational group that has an annual income of 1bn Australian dollars or more (approximately £510m). This is the same *de minimis* threshold currently applicable for the MAAL. In addition, the tax will not apply if the Australian resident entity or PE individually has turnover of less than 25m Australian dollars (subject to some exceptions).

> This is a new threshold for Australian anti-avoidance provisions and represents a significant tightening of the point at which the anti-avoidance rules may apply

For the DPT to apply, it must be determined that there is insufficient substance in the arrangement. This will be based on whether it is reasonable to conclude, based on information available to the tax authorities, that the arrangements were 'designed to secure' a tax reduction, i.e. where the non-tax financial benefits are less than the tax benefits. This is a new threshold for Australian anti-avoidance provisions and represents a significant tightening of the point at which the anti-avoidance rules may apply.

The DPT takes effect for income years beginning from 1 July 2017, and there are no grandfathering rules for existing arrangements.

There were various other actions included in the Budget as part of a 'tax integrity package'. This included the introduction of anti-hybrid rules which aim to counteract the double taxation benefits of certain cross-border transactions, and establishing a new tax avoidance taskforce that will focus on compliance of large corporates and high wealth individuals.

US: anti-inversion and 'debt-equity' rules

Last month the US Treasury Department issued new temporary and proposed regulations intended to reduce the tax benefit of, and limit the number of, corporate tax inversions (which generally involve the relocation of a corporation's tax residence from a high tax territory – such as the US – to a lower tax territory – such as Ireland). Although the associated Treasury press release described the regulations as designed to 'reduce the benefits of and limit the number of corporate tax inversions, including by addressing earnings stripping', the proposed regulations would have their greatest impact outside the inverted company context.

In terms of scope, these have the potential to be the most significant international US regulations since the 'check-the-box' rules were introduced as they could have a very significant impact on the debt financing of US subsidiaries of overseas groups. Many US commentators believe the Obama administration is focused on getting this package finalised before its term ends and, if successful (and finalised in their present form), this will significantly impact US inbound structuring in the future.

In terms of content, the proposed changes to the debt and equity regulations would generally recharacterise an intercompany debt instrument as equity unless the intercompany debt is issued in exchange for cash or other assets that increase the non-equity gross assets of the issuer, taking into account related transactions (certain exceptions and safe harbours may apply). These 'recast' rules under the proposed regulations would apply with limited exceptions to debt instruments issued on or after 4 April 2016. Intercompany debt instruments subject to recharacterisation would continue to be treated as debt for 90 days after the issuance of final regulations and, at the end of that period, would be viewed as exchanged for equity. If intercompany debt is recharacterised as equity under the proposed regulations then, among other consequences:

- the issuer will not be entitled to a deduction for interest payments on the debt; and
- interest payments will be characterised as dividends for all US tax purposes.

There is also a 'bifurcation authority' proposal, which would give the IRS the authority to treat a debt instrument as part debt and part equity, and a proposal which would require contemporaneous documentation when issuing intra-group debt. If documentation is not in place contemporaneously (some aspects must be in place within 30 days of issuance) the debt may be considered to be equity for federal income tax purposes. Both the bifurcation and documentation rules would generally be prospective, applying to debt issued after the date the rules are finalised.

Updates to the India/Mauritius double tax treaty

It was announced on 10 May that India and Mauritius have signed a protocol amending, among other things, the capital gains and interest articles in their double tax treaty. These amendments are aimed at preventing treaty abuse and double non-taxation. This is a significant development for overseas investors as Mauritius has traditionally been a popular route for investing into India, being one of only a handful of territories offering certain tax efficiencies.

The key features of this protocol are:

- Source-based taxation of capital gains on shares: India will now have taxation rights on capital gains arising from alienation of shares acquired on or after 1 April 2017 in a company resident in India. Gains on shares acquired before 31 March 2017 have been grandfathered. There will be a transition period from 1 April 2017 to 31 March 2019 where the tax rate will be limited to 50% of the full domestic tax rate in India, rising to 100% thereafter.
- Limitation of benefits (LOB): The abovementioned transitional provision will not be available if the taxpayer fails a main purpose test and *bona fide* business test. This test is failed if the Mauritian company's total expenditure on operations in Mauritius is less than 2.7m Indian Rupees (approximately £28,000) in the immediately preceding 12 months, unless it is listed on the Mauritian stock exchange.
- Source-based taxation of interest income: Interest arising in India and payable to Mauritian residents will be subject to tax in India at the rate of 7.5%. Interest arising in India will be exempt from tax in India if it is derived and beneficially owned by any bank resident in Mauritius, but this only applies if the interest arises from debt claims existing on or before 31 March 2017.
- Source-based taxation of other income: As is the case for capital gains, India will now have taxation rights on other income of Mauritius residents sourced from India. This will have an impact on group restructurings such as a shareholding migration actioned by a gift or sale of Indian company shares at lower than fair market value to a Mauritius company. Prior to this amendment, such transactions/ income were not taxable in India. ■

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- News: New BEPS consultations (18.5.16)
- News: Australia follows UK's diverted profits tax lead (4.5.16)
- News: New US anti-inversion regs (6.4.16)