Briefing

International briefing for July

Speed read

The EU referendum result was the big news from the last month but it is important to remember that until the negotiations are finalised the UK remains in the EU. There have been a number of amendments to international provisions in the Finance Bill. In France, questions have been referred on the 3% surcharge on dividend payments. There have been developments on the BEPS project, most notably a discussion draft on Action 4. In Germany, a draft Bill introducing BEPS related and other provisions has been published and the Corporate Tax Reform III process in Switzerland has finally been agreed by Parliament.

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It goes without saying that the big news over the last month was the EU referendum on 23 June and it has been widely reported that the next step will be for the UK to notify the EU under 'article 50' that we are leaving and then the negotiations will commence. I have written a great deal over the years on the impact of EU law on the UK corporate tax regime, particularly decisions from the Court of Justice of the European Union (CJEU) and it is important to remember that until the negotiations are finalised, the UK remains in the EU so to that extent nothing changes – despite the great amount of uncertainty about the future. The final outcome will depend entirely on what form the relationship between the UK and the EU takes. If the UK joins the European Economic Area (EEA) or enters a similar type of agreement that retains the EU freedoms then the UK's domestic tax legislation is likely to be unaffected by an exit. A different arrangement which does not retain the EU freedoms could result in more fundamental changes if the government then chooses to repeal domestic legislation which was only introduced to comply with EU law, such as the cross-border group relief provisions that were introduced by FA 2006. A potentially greater concern would be the loss of EU directive reliefs, in particular withholding tax on dividend flows, although it is important to remember that a number of member states do not levy dividend withholding tax and for many others there are double tax agreements in place which will eliminate it. However, there will remain a small number of countries where withholding tax will need to be considered including Germany, Italy and Portugal. Rather than taking a 'wait and see' approach, groups may wish to proactively identify the potential issues for their own structures and consider what steps would be advisable should these issues materialise.

Whilst the news has been focused around the EU, the UK Finance Bill has quietly progressed through a very brief Committee stage in the last few weeks with a number of amendments made to the international tax provisions in it. The Finance Bill includes changes to the patent box regime to ensure it complies with the new international rules set out by the OECD in BEPS Action 5. There have been a number of amendments made to these provisions and one in particular is a welcome change where there is a transfer of a trade, or part of a trade, including intellectual property (IP) between two companies: the transferee company will now stand in the shoes of the transferor so that the benefits of grandfathering will not be lost. There have been a number of other generally beneficial amendments including a reduction in the compliance burden for companies with small claims. An anti-avoidance measure has also been introduced to ensure the R&D fractions used in calculating the patent box benefits are not manipulated.

The Finance Bill also includes three changes to the withholding tax regime for royalty payments. The introduction of anti-treaty shopping provisions which came into effect for payments made on or after 17 March 2016 was included in the Bill as first published. Legislation for the other two changes has now been introduced into the Bill via amendments and will apply to payments made on or after 28 June 2016. These changes:

- expand the definition of payments connected with IP which will be subject to withholding tax; and
- expand the rules on when royalties are regarded as having a UK source to include situations where these are connected with the activities of a UK permanent establishment (PE) of an overseas company and resultant amendments to the diverted profits tax (DPT) legislation in respect of avoided PEs.

Further legislation on the proposed rules to ensure that offshore developers of UK land will pay the same amount of tax on their profits as UK developers has also been added to the Bill.

Before moving onto the usual round-up of key developments around the world, I should like to take the opportunity to inform readers that this will be my last 'International briefing'. After eight enjoyable years it is time to hand over the reins, and from September my colleague Tim Sarson will provide the monthly update on international tax developments.

EU update

France: 3% surcharge on dividend payments

On 27 June, the French High Court referred a number of questions for judgment to the French Constitutional Court and to the CJEU regarding the 3% surtax which is currently imposed on dividends paid by French companies to foreign parent companies. Specifically, the CJEU has been asked to determine whether the 3% surtax is compatible with articles 4 and 5 of the EU Parent-Subsidiary Directive, but surprisingly has not been asked whether the surtax is compatible with the principal of freedom of establishment which it arguably is not. It has been reported that French companies have been postponing making dividend distributions as a direct result of this surtax so the CJEU's decision (as well as the Constitutional Court's view on compatibility with domestic law) could have wide implications.

Global update

BEPS update

There have been a number of further developments this month on the OECD base erosion and profit shifting

(BEPS) project. Most notably, the OECD has published a discussion draft on Action 4 (deductibility of interest costs) which provides guidance on the design and operation of the group ratio rule. Action 4 recommends that countries consider introducing a fixed ratio rule, which restricts interest deductions to a fixed percentage of earnings before interest, tax, depreciation and amortisation (EBITDA). It goes on to recommend the introduction of a group ratio rule, which allows an entity in a highly leveraged group to deduct net interest expense in excess of the amount permitted under the fixed ratio rule, based on a relevant financial ratio of its worldwide group. The latest document discusses the approach to calculate a group's net third party interest expense, the definition of EBITDA and the approach to deal with the impact of losses on the operation of the group ratio rule. A number of approaches are included within the discussion document and comments are requested by 16 August. There are some differences between these proposals and HM Treasury's own interpretation of how the group ratio rule should be applied on which comments have been requested by 4 August, so it is important that taxpayers engage with both consultations.

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Further guidance has also been released this month by the OECD on country by country (CbC) reporting including its application to investment funds and partnerships and whether these are included in the definition of a multinational group. Guidance was also provided in respect of parent surrogate filings such that an 'ultimate parent entity' resident in a country that has implemented CbC reporting but does not require 2016 filings may be able to make a voluntary parent surrogate filing which should satisfy the reporting requirements in other jurisdictions which have introduced it for 2016. The US, Switzerland and Japan have confirmed they will have parent surrogate filing mechanisms in place for 2016 periods and further countries are expected to be added to this list in due course. One further clarification was given where the ultimate parent entity is in a country where the threshold is based on €750 or similar in local currency, such that lower thresholds for group companies in other countries should not trigger local filings.

The OECD also issued a discussion draft on 4 July on how the attributions of profits to PEs should take account of the changes in the final BEPS reports to both the PE definition and the Transfer Pricing Guidelines.

Germany: CbC reporting and other measures

On 13 July, the Federal government published a draft Bill implementing the CbC reporting recommendations from the OECD BEPS project. This will apply from fiscal years commencing on or after 1 January 2016. A German group parent company will be required to produce a CbC report if the group includes at least one foreign enterprise or foreign PE and consolidated turnover in the prior period is €750m or more. Other BEPS measures, such as CFC taxation and hybrid mismatch arrangements, are expected to be included in subsequent bills.

The draft Bill will also implement the amendment to the EU Administrative Assistance Act on 8 December 2015 which provided that advance cross-border tax rulings and advance transfer pricing arrangements between internationally related businesses should be exchanged automatically within the EU. This will apply for advance rulings and arrangements issued, made, amended or revised since 1 January 2012 and still valid on 1 January 2014 (or since 1 January 2014 irrespective of whether they are still valid or not).

A further measure included within the draft Bill is in respect of the trade tax treatment of non-portfolio dividends received by a controlled company in a tax group. 5% of the dividend payment will now be considered a non-deductible expense of the business for trade tax purposes provided the controlling entity is a corporation or a partnership with corporations as partners. This will apply to dividend payments received after 31 December 2016.

The draft Bill also includes measures for the imputed income under the German CFC rules to be subject to trade tax in Germany from 1 January 2017, as it will be considered to be income accrued in a PE in Germany. This will apply irrespective of whether the income was generated through either a foreign corporation or a PE.

Switzerland: Corporate Tax Reform III

Following on from my last mention in April of the fundamental tax reform process that is currently underway in Switzerland, on 17 June the National Council (the large chamber of the Swiss Parliament) passed further proposals on which they had previously taken a different view to the Council of States (the small chamber). The measures, which are now agreed, are expected to apply from 1 January 2019.

The final list of agreed measures includes an R&D super deduction, the introduction of a patent box regime, the introduction of a notional interest deduction (where a deduction of a deemed interest of excess equity shall be allowed), the abolition of the cantonal tax statuses for holding, domicile and mixed companies and the abolition of the principal company taxation and the finance branch regime. Furthermore a general reduction of overall corporate income tax will be financed by federal direct income tax. Canton Vaud, as the first canton, has decided to reduce the overall effective income tax rate (including direct federal income tax) from 22.3% to 13.8%, which should also be applicable from 2019. Other cantons will follow soon.

A number of the original proposals were rejected by both the National Council and the Council of States, including the abolition of stamp duty on equity and a proposal to fully tax dividends as well as a Switzerland-wide standardisation of a 70% taxation of dividends. The stamp duty on equity abolition as well as a tonnage tax scheme may be included in the scope of a separate proposal at a later date. ■

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