Briefing

International briefing for February

Speed read

The main BEPS developments this month have been around peer reviews to assess the implementation of the actions considered to be minimum standards. In India, the Union Budget was presented on 1 February including thin capitalisation proposals in line with OECD recommendations. Proposals restricting relief for royalties in Germany could impact UK companies benefiting from the 'old' patent box regime and Belgium has updated its own innovation regime. The public in Switzerland voted against the introduction of the Corporation Tax Reform III measures in a referendum on 12 February.

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Following a few busy months on the international tax front, we are not seeing any let up in the pace of change. Increasingly people are focusing on potential US tax reform as this seems likely to be the next big thing in international tax, but for now we discuss this month's developments. On the topic of Brexit, the government has now published its white paper, which, as expected contained little new substantial detail and followed the prime minister's Lancaster House speech in which she set out 12 principles for Brexit. The white paper adds mainly background information to the public debate rather than revealing how different principles and business sectors will be weighted during negotiations.

BEPS/OECD update

At the beginning of this month the OECD released further documentation to enable peer reviews of the four BEPS actions that have been agreed as minimum standards. The documents include the evaluation criteria that will be used for assessing implementation of those minimum standards (the 'terms of reference') and the assessment methodology for the peer review process.

The peer review for the Action 14 standard on dispute resolution was launched in December 2016 with the first peer reviews of Belgium, Canada, the Netherlands, Switzerland, the UK and the United States now well underway. The OECD then invited taxpayer input this month to start the peer reviews for Austria, France, Germany, Italy, Liechtenstein, Luxembourg and Sweden. In addition, the documentation for the peer reviews for Action 5 (compulsory spontaneous exchange of information on tax rulings) and Action 13 (country by country reporting) was released this month.

These are three of the four BEPS minimum standards which require a peer review in order to ensure the recommendations are implemented in a timely manner and consistently across the OECD member states. The fourth is Action 6 (preventing the granting of treaty benefits in inappropriate circumstances) where documents are expected at a later date. The outcome of these peer reviews may lead to additional guidance on the implementation of these standards or possibly further changes to the recommendations.

In other BEPS news, at the end of January the OECD announced that seven further jurisdictions (Gabon, Hungary, Indonesia, Lithuania, Malta, Mauritius, and Russia) have signed up to the Multilateral Competent Authority Agreement for Country by Country Reporting, bringing the total number of signatories to 57.

India: Union Budget 2017

On 1 February, the Union Budget was presented. The tagline of this Budget is to 'transform, energise and clean India' with a clear aim to boost foreign direct investment (FDI) in India whilst encouraging greater compliance. The Foreign Investment Promotion Board is proposed to be abolished in 2017/18 and a new, more liberal FDI policy is expected to be announced shortly.

The demonetisation of late 2016 has created increased uncertainty and a decline in consumption in the short term, but the government is confident that this, coupled with the proposals in this Budget, will generate long-term benefits in terms of reduced corruption, greater digitalisation of the economy, increased flows of financial savings, and greater formalisation of the economy, all of which could eventually lead to higher GDP growth, better tax compliance and greater tax revenues.

Most notably, in line with the recommendations of the OECD BEPS project, thin capitalisation provisions have been introduced. Deductibility of interest payments made to a non-resident associated enterprise or any lender to whom a non-resident associated enterprise has provided a guarantee is restricted to 30% of EBITDA, and disallowed interest may be carried forward for up to eight years. This follows the recommendations of the OECD concerning interest deductions in the BEPS Action 4 final report and is consistent with rules being introduced elsewhere. However, such provisions are applicable only to interest payments that exceed INR 10m.

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Other tax highlights in the Budget include:

- eligible start-up companies being entitled to claim a full tax holiday for any three out of seven years from incorporation;
- the sunset clause which provided for a concessional rate of tax of 5% on interest payable on investments made in government securities or rupee denominated bonds is extended to 30 June 2020;
- purely domestic transfer pricing rules are now restricted to situations where any one of the entities involved in a related party transaction enjoys a specified profit-linked deduction (i.e. benefiting from a tax holiday); and

- the headline tax rate is reduced to 25% for companies with annual turnover or less than INR 500m.

On the indirect tax front, the finance minister reaffirmed his commitment to implement a goods and services tax (GST) and stated that implementation should be on schedule such that GST will be applicable from 2 July 2017.

Whilst there is nothing particularly ground breaking announced in the Budget, it is encouraging that non-OECD member states such as India are beginning to adopt the recommendations of the OECD that have come out of the BEPS project, which should result in greater global tax consistency.

Royalties from Germany: interaction with patent box/ other IP regimes

The German government have this month released a draft Bill introducing new rules to limit the benefit received by companies taking advantage of preferential IP regimes which are seen as harmful. For this purpose, the draft Bill provides for a restriction of the tax deductibility of royalty expenses in certain cases.

The new rules are aligned with Action 5 of the OECD's BEPS project (countering harmful tax practices) which, amongst other areas, focussed on preferential regimes for intellectual property. The final BEPS reports recommended a 'nexus approach' for these regimes, which broadly means that taxpayers should be granted the benefits of a preferential IP regime in a country only to the extent that they incurred research and development (R&D) expenditure in that country for the creation of that IP.

This could have far reaching consequences, even in territories that have announced they will adopt the nexus approach

Not all countries are expected to alter their IP regimes to fit in with this 'nexus approach' and, although many countries have announced changes, some will not come into force immediately. Therefore the German government considers this restriction necessary to prevent tax avoidance. There is, however, an exception to the rule if the preferential regime requires substantial activity in the recipient state, following the OECD recommended 'nexus approach'. There is also an exception where the income is taxed in Germany through its controlled foreign company rules.

The rules apply to expenses accruing after 31 December 2017 and the scope of the restriction is limited to payments between related parties.

Where a restriction is required, the percentage of non-deductible royalty amount is calculated using the following ratio:

(25% – rate at which the royalty is taxed) / 25%

Therefore the higher the tax rate imposed on the royalty income, the higher the deductible share of the expense is available for the German company.

This could have far reaching consequences, even in territories that have announced they will adopt the nexus approach. For example, if a German company pays a royalty to the UK which falls under the 'old rules' for Patent Box (which do not follow the nexus approach), 60% of the royalty payment may be disallowed for German tax purposes (as the UK patent box taxes profits at 10%). Royalties benefiting from the 'new' patent box rules will not be caught.

The German proposals are still in draft so it is possible changes will be made as the legislation passes through Parliament.

Belgium: deduction for innovation income

Following the same theme, Belgium is one of those countries that has taken steps to align its tax regime with the OECD recommendations. The Belgian parliament has recently approved a draft law that introduces a deduction for innovation income. The new regime will replace the previous patent income deduction that was repealed as it was found to be not in line with the OECD 'modified nexus approach' (with a 'grandfathering period' until 30 June 2021). The new deduction for innovation income will be effective retroactively from 1 July 2016. The main features of the new regime are:

- The deduction equals 85% of net income from qualifying IP.
- The deduction applies to income from patents or supplementary protection certificates, breeders' rights, orphan drugs, data and market exclusivity and copyrighted software. Capital gains on such IP also qualify if reinvested.
- The net income is determined using the 'modified nexus approach'.
- A 'tracking system' is introduced, whereby taxpayers must closely monitor expenses, IP and income.
- The unused deduction can be carried forward.
- The taxpayer can claim the deduction through an exempt reserve while the patent application is pending.

Switzerland: referendum vote on corporate tax reform

As this article has mentioned several times in the past, Switzerland has been under increasing pressure from the international community to amend its tax regime, particularly from the OECD and EU, specifically in relation to the privileged taxation of holdings, mixed and domiciliary companies in Switzerland. In June last year the Swiss Parliament adopted a range of measures, 'Corporate Tax Reform III', which aimed to respond to this pressure.

The overall aim of Corporate Tax Reform III was to maintain and further develop Switzerland's position as one of the most attractive business locations worldwide, while increasing international acceptance of its corporate tax legislation and sustainably securing adequate tax revenues to finance public activities.

A referendum was held on 12 February for the Swiss people to decide whether this reform should go ahead. 59% of voters rejected the proposals. Those opposing the plans had argued that they were too generous for multinationals and that the reduced tax revenue would lead to cuts in public services or higher personal taxes.

The Swiss government will now define an adjusted tax reform package together with all interested political parties which will outline an alternative plan in order to bring their tax policy in line with global standards whilst maintaining their competitiveness. ■

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- 30 questions on BEPS (Jill Gatehouse & Susie Brain, 29.10.15)
- News: Swiss reject corporate tax reforms (15.2.17)