Briefing

International briefing for June

Speed read

The general election result and its repercussions alongside the commencement of Brexit negotiations have dominated the news this month. Elsewhere, the signing of the OECD multilateral instrument represents a huge milestone for the BEPS project. Large companies may be about to lose relief under the voluntary disclosures program in Canada and a replacement for 'corporate tax reform III' is making progress in Switzerland. The tax authorities in India have issued revised 'safe harbour rules' and at the EU ATAD II has been adopted and some progress has been made towards the introduction of public CBC reporting.

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It has been a very eventful month in the UK with the surprise outcome of the general election on 8 June resulting in a hung Parliament and, at the time of writing, the prime minister is still in talks with the Democratic Unionist Party (DUP) for them to provide support to the government on a 'confidence and supply' basis although media reports suggest these negotiations are not going smoothly. The DUP's manifesto was light on tax policy but it is safe to assume they will be pushing for devolution of corporation tax varying powers to take place in April 2018 despite the current impasse with other parties in Northern Ireland (NI). Any decrease in tax or increase in spending in NI will have a knock-on impact on the Barnett formula across the UK and it will be a difficult balancing act for the government to ensure that any beneficial deal for NI does not unduly upset the Scottish and Welsh devolved administrations.

This uncertainty resulted in both the chancellor's Mansion House speech and the Queen's speech being delayed. The latter took place on 21 June and provided no information on the next steps for the provisions dropped from the Finance Bill prior to the election, notably the corporate interest restriction and loss reform proposals. There was confirmation that there will be a Summer Finance Bill 2017 but only that this 'will include a range of tax measures including those to tackle avoidance', so while it seems likely it will pick up the previously dropped measures, this point is still uncertain.

Brexit negotiations also kicked off on 19 June amidst fierce media speculation over what the implications of the general election result might be for Brexit. Some are suggesting a hung Parliament paves the way for a 'softer' or more 'open' Brexit with cross-party support in the House of Commons while others believe the prime minister, now without a majority, will need to maintain her approach of leaving both the single market and the customs union as well as prioritising a reduction in immigration in the talks to appeal to the Eurosceptic wing of her party. It may take some time for clarity on the direction of travel to emerge.

I've included updates on developments in the US in all my recent introduction sections and, although there are few relevant developments over the past month, there is still enough to merit a brief mention. At the end of May, the Trump administration released its fiscal year budget for 2018, entitled *A new foundation for American greatness*, containing its recommendations to Congress for spending and taxation (the 'budget'). Although the budget does not include a specific US tax reform proposal, it reaffirms the tax reform principles set forth by the President's administration in April and indicates that a reform package should be deficit-neutral and that business tax reform must accomplish the following objectives: reduce the corporate tax rate; eliminate most 'special interest' tax breaks; move to a territorial tax regime, with repatriation of newly earned overseas profits without incurring additional taxes; and provide a one-time repatriation tax on already accumulated overseas earnings. As is the case with any administration's budget proposals, there is no expectation that Congress will enact (or even vote on) the President's budget as a whole. Instead, the budget represents the administration's view of the optimum direction of spending and revenue policy.

BEPS/OECD update

The major news from the OECD this month was that, on 7 June, representatives from 68 jurisdictions signed the multilateral instrument (MLI), introduced as part of the BEPS project; a further eight countries have formally expressed an intention to sign. MLI signatories included China, Australia, Japan and the majority of the EU member states including France, Germany, Spain and the UK, but not the US. The MLI will implement a number of tax treaty measures which will update, based on the current signatories, an existing network of around 1,100 bilateral tax treaties to implement the treaty-based recommendations of the BEPS process. This includes measures to prevent treaty abuse, changes to the definition of permanent establishment (PE), changes to the residence tie-breaker for companies, mutual agreement procedures, and mandatory binding arbitration.

As part of the signing procedure, the OECD has provided countries with templates to allow them to file a list of their agreements that are covered by the MLI. A document containing this information, with links to the official statement for each jurisdiction (in terms of covered tax agreements, and provisional options and reservations) has now been published by the OECD on its website. The OECD does not plan to prepare consolidated texts of treaties (i.e. a document that combines the MLI and DTA components), as it is expecting local governments to handle this on a domestic basis (if they choose to do so at all).

The MLI will only enter into force three months after five jurisdictions have deposited their instrument of ratification, acceptance or approval, a threshold the OECD currently believes could be reached by 30 September 2017. The MLI provisions will generally take effect with respect to withholding taxes on the first day of the calendar year following the last date on which the MLI enters into force for each of the two contracting jurisdictions and six months from this date with respect to all other covered taxes.

Also, over the course of the last month, the OECD has published a discussion draft on hard to value intangibles (HTVI) as a follow up to the BEPS Actions 8–10 final recommendations published in 2015. This paper sets out the principles that should underline the implementation of

that approach, provides illustrative examples and addresses the interaction between the approach to HTVI and the mutual agreement procedure under an applicable treaty. Comments have been requested by 30 June.

Finally, the Brazilian government has announced that it has submitted a formal request to the OECD for Brazil to become a member of the organisation. If the request receives a favourable initial response direct negotiations should then commence.

Global update

Canada: large companies to lose relief under VDP

The 'voluntary disclosures program' (VDP) in Canada allows taxpayers to correct prior years' compliance matters. The VDP currently allows taxpayers to make disclosures to correct inaccurate or incomplete information or to disclose information not previously reported. If accepted into the VDP any taxes owing still need to be paid but the CRA will waive penalties and may reduce interest charges.

The Canada Revenue Agency (CRA) released a draft information circular on 9 June proposing a number of changes to the VDP. Most significant is a proposal that corporations with gross revenue in excess of $250m in at least two of their last five taxation years will no longer be eligible for the VDP and, as a result, will not be protected from penalties or eligible for interest relief. There was also a proposal that the CRA will no longer consider applications relating to transfer pricing adjustments or to applications that depend on an agreement made at the discretion of the Canadian competent authority under a tax treaty provision.

The proposals are still under consultation so may be changed but, as currently drafted, they represent a significant curtailment of the benefits larger companies are currently able to access in Canada. As a result, large companies that are considering a VDP application in Canada should do so before these proposals are effective.

Switzerland: corporate tax reform

After the Swiss electorate rejected the 'corporate tax reform III' (CTR III) proposals in the February 2017 referendum, the Swiss Federation announced that it would soon be presenting a new tax reform plan. Federal Councillor Ueli Maurer, in early June, provided parameters of recommendations from a steering committee to the Federal Council regarding 'Tax proposal 17' which is largely based on CTR III, but with some new elements aimed at achieving a majority vote. The Federal Council communicated its view on these proposals on 9 June, mainly confirming them.

The proposals include:

- Introduction of a patent box regime and a research and development (R&D) 'super deduction'– both similar to the measures in CTR III. However, the taxed income definition would be narrowed under the patent box regime, and the additional 'super deduction' for R&D (50%) would focus more on personnel costs.
- Unlike CTR III, no notional interest deduction is foreseen.
- Higher dividend taxation for individuals on qualifying investments, so that 70% of an individual's dividend income would be taxable (portfolio dividends would continue to be 100% taxable).
- Overall tax relief for all tax measures would be limited to 70%, instead of 80%.
- The cantonal share of direct Federal tax income should be increased. The originally proposed increase to the cantonal share from 17% to 21.2% was adjusted by the Federal Council to 20.5%.

The timeline for the legislative process remains ambitious, demonstrating the importance that is being placed on this reform. The consultation process is expected to start in September and then the Swiss Federal Council will present its proposals to Parliament in spring 2018, with the potential for some aspects of the new law to be effective by 2019. If another referendum is scheduled this could impact the timeline.

India: transfer pricing safe harbour rules

The Central Board of Direct Taxes in India, in an effort to address the increasing number of transfer pricing audits and prolonged disputes, has issued revised 'safe harbour rules'. Rules were originally issued in September 2013 but have received a tepid response from taxpayers, due to perceived high margins and ambiguity in the classification of services. In an effort to address these issues, revised safe harbour rules were issued on 7 June.

The safe harbour rates for all contract services have been revised including:

- For information technology services, the rates are reduced to 17%–18% from a range of 20%–22%.
- The rates for 'knowledge process outsourcing' services are 18%, 21% or 24% depending on the percentage of employee cost to operating cost (reduced from 25%).
- The rate for contract R&D service providers is 24% (reduced from 29%–30%).

There are new provisions concerning the safe harbour for receipt of low value-adding intra-group services, and rates are introduced for loans advanced in a foreign currency. The new guidelines also clarify the definitions of operating costs and operating revenue.

EU: ATAD II, public CBCR and new reporting proposals

On 29 May, the Council of the EU unanimously adopted Anti-Tax Avoidance Directive II which extends the original proposals to address hybrid mismatches to non-EU countries. Then, on 12 June, the EU's Economics and Legal Affairs committee voted to approve a draft report containing the European Commission's proposals on mandatory country by country reporting, with possible exemptions in the case of commercially-sensitive information. However, the draft report did not receive enough votes to go to negotiations with the Council, and so it will now go to a plenary session of the EU Parliament, meaning any implementation of the report's proposals is likely to be some way off.

In another significant development, on 21 June the European Commission published proposals for mandatory automatic exchange of information in relation to 'potentially aggressive tax planning arrangements'. The reporting obligation is limited to cross-border situations and the proposals have the potential to widen the reach of the UK disclosure regime significantly but the practical impact remains to be seen, particularly the interaction with Brexit. The Directive is intended to apply from 1 January 2019 but with disclosure of reportable arrangements implemented between the date 'when political agreement is reached' and 31 December 2018 also required. ■

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- The multilateral instrument: anti-abuse provisions (Heather Self, 26.1.17)
- ATAD II: the revised EU rules on hybrid mismatches (Sandy Bhogal & Kitty Swanson, 5.4.17)
- MEPs vote for public CBCR (Tim Law, 15.6.17)