Briefing

International briefing for June

Speed read

Discussions on the challenges of taxing the digital economy continue on the international stage. We also see further evidence of individual countries taking unilateral action, with Italy and Uruguay taking their turn this month. Italy's changes come in the form of a revised definition of permanent establishment (PE), reflecting the developments that have resurfaced this month with further activity at the EU level and in the Czech Republic in relation to PEs. Finally, we provide updates on the ongoing tax reform in the Netherlands and Australia.

Tim Sarson
KPMG
Tim Sarson is a tax partner at KPMG in the UK. He has worked in the international tax and transfer pricing field since 1998, in both practice and industry. Email: tim.sarson@kpmg.co.uk; tel: 020 7694 4831.

This month the leaders of the G7 met in Canada, with the digital economy being one of the many items on the agenda. Whilst the published declaration made reference to the taxation of the digital economy, its wording suggests that no significant progress has yet been made on this topic. As widely reported, after leaving the meeting, President Trump subsequently declared that the published declaration was no longer endorsed by the USA, further limiting the influence of the output of the meeting.

Furthermore, the OECD has clarified their proposed timetable for reporting on the taxation of the digital economy. Pascal Saint-Amans, speaking at the OECD International tax conference on 4 and 5 June, said that comments on the revised timing had been incorrectly reported and confirmed a 2020 timetable but noted that the OECD intends to publish an interim report in 2019.

Whilst the OECD has pushed back its timetable on the taxation of the digital economy individual jurisdictions continue to consider the challenges at a domestic level. For example, this month sees Italy issuing guidance on a revised PE definition (see below), and Uruguay issuing a decree outlining measures that will affect multinational corporations operating in the digital economy space or providing digital economy services in Uruguay.

Updates from the EU

The CJEU gave its decision in *Bevola and Jens W. Trock* (Case C-650/16), concerning the compatibility with EU law of the Danish rules on the deductibility of losses from foreign permanent establishments in certain cases.

In 2009, A/S Bevola, a Danish company, sought to deduct the losses incurred by its PE in Finland from its taxable base in Denmark, arguing that the PE had ceased to exist during the same year and therefore loss relief could not be claimed in Finland. The Danish tax authorities denied the deduction on the grounds that revenue or expenses attributable to a foreign PE cannot be taken into account in a taxpayer's taxable base, unless the latter has opted for the Danish international joint taxation scheme. Under this scheme, a Danish company has to integrate the benefits and losses of all its group companies, real properties and PEs for a period of at least ten years, regardless of their residence. However, it is possible to deduct losses incurred by domestic branches, with or without the scheme.

Bevola appealed the tax authorities' decision before the Danish Eastern Regional Court, which decided to refer the case to the CJEU. In particular, the CJEU was asked whether, in circumstances equivalent to those in the CJEU decision in *Marks & Spencer* (Case C-446/03), i.e. the losses are considered final, Danish rules on cross-border loss relief are compatible with the freedom of establishment.

The CJEU has now concluded that the Danish legislation is contrary to the freedom of establishment, as it prevents Danish companies from offsetting losses of foreign PEs, even when those losses are final.

The CJEU also clarified the applicability of the 'Marks & Spencer exception', ruling that the losses attributable to a foreign PE become definitive when firstly, all possibilities of deducting those losses that are available under the law of the PE's residence state have been exhausted and, secondly, the company has ceased to receive any income from that PE.

The Advocate General (AG) Paolo Mengozzi of the CJEU also published his opinion in *X-GmbH* (Case C-135/17). The case concerns the derogation from the prohibition on restrictions to the free movement of capital with non-EU countries (also referred to as the 'standstill clause') and its application to the German CFC rules. The AG considered that the German rules are in line with EU law, as they fall within the scope of the standstill clause and that the restriction to the free movement of capital may be justified by the need to guarantee the balanced allocation of powers to tax and the effectiveness of fiscal supervision.

The Netherlands

This month has seen the proposed future tax plans of the Dutch minister of finance progress through the Dutch legislative process. These proposals consider the implementation of an anti-tax avoidance directive (ATAD I) and emergency remedial measures for the fiscal unity for corporate income tax purposes.

It is intended that the bill to implement the first European directive to combat tax avoidance (ATAD I, as of 2019) will be presented to the Lower House before the summer recess. It is proposed that the earnings stripping rules (forming part of this bill) will:

- not include a group exemption;
- be unlikely to allow for the 'grandfathering' of loans already in place in June 2016, but it was acknowledged that there may be opportunities for further discussions of this. It has been suggested that any such transitional arrangements could be financed by a (temporary) more modest reduction of the corporate income tax rate; and
- provide a €1m de minimis threshold.

The bill with the emergency remedial measures for the fiscal unity system was published on 6 June 2018. Based on the proposed measures, some corporate income tax and dividend withholding tax rules will have to be applied as if there is *no* fiscal unity. The measures have been taken to comply with CJEU case law.

The above measures will drastically change the Corporate Income Tax Act as virtually all important elements (including the interest deduction, the participation exemption and the fiscal unity) will be affected.

The deputy minister also shed more light on proposals for the future tax grouping regime (replacing the emergency remedial measures, which have been previously reported in this column). The deputy minister firstly reiterated that a cross-border fiscal unity is not a realistic option for the government and instead, the Dutch rules should look to align with comparable tax grouping rules in other countries. Replacing the current fiscal unity regime with a new group regime is complex, because a large number of corporate income tax rules are related to the fiscal unity, which means the process will take at least a few years. A final bill is expected to be presented to the Lower House before the end of this government's term of office.

Australia

Following on from the announcement on Australia's 2018/19 Federal Budget last month, the Australian government has introduced the Tax Laws Amendment (Tax Integrity and Other Measures No. 2) Bill 2018 and accompanying explanatory memorandum. These follow earlier drafts addressing hybrid mismatch arrangements and interposed entity financing transactions through low or no tax jurisdictions.

The bill clarified that the start date for the hybrid mismatch and financing integrity rule will be income years starting on or after 1 January 2019, but the start date of the direct and indirect imported mismatch rule (but not the structured arrangement rule) has been delayed to income years starting on or after 1 January 2020, to better align with the expected introduction of the EU rules.

The 'interposed entity financing integrity rule' can apply to deny a deduction for interest or derivative payments on financing arrangements made via an interposed related entity in a jurisdiction with a corporate tax rate of 10% rate or less, or with a territorial regime system of tax. Amongst other clarifications, the bill introduced a legislative instrument power to enable the minister to determine that specific types of schemes are caught by the integrity rule.

Despite the welcome delay for the imported mismatch rules, groups should be mindful that unconnected hybrid arrangements anywhere in the global group could have significant adverse consequences in Australia unless unwound in the next 18 months or so.

Czech Republic

Proposed changes to the income tax law of the Czech Republic have now completed the comment process. Most of these changes are proposed to be effective from 1 January 2019; however, the exit tax and hybrid mismatch rules are proposed to be effective from 1 January 2020. As proposed, the legislative amendments would cover a variety of matters including:

- new limitations on the deductibility of certain borrowing costs;
- the introduction of controlled foreign corporation rules and anti-hybrid mismatch arrangement rules;
- an exit tax on the relocation of assets without a change of ownership;
- formalised anti-abuse rules; and
- new reporting duties for certain withholding tax payments.

Separately in the Czech Republic, a regional court of České Budejovice has found that the activities of a Czech company (the agent) have created a PE of a German company. The German resident taxpayer claimed that all of its business activities were managed and carried out in Germany and the activities of the unrelated Czech company were solely of a preparatory or auxiliary nature. The Czech agent was not authorised to conclude contracts or place orders for the sale of goods in the taxpayer's name; it only provided administrative and call centre services for the taxpayer and it did not have a power of attorney from the taxpayer. The taxpayer thus claimed that it had no PE in the Czech Republic under either the Czech income tax law or the income tax between the Czech Republic and Germany.

The tax authority, however, contended that there was a PE because the agent's activities formed a separate essential part of the taxpayer's activities. In reaching this conclusion the court held that the activities of the agent do not necessarily have to be carried out under a power of attorney, and that it is irrelevant whether the agent conducts the activity for multiple entities. The taxpayer has appealed to the Supreme Administrative Court.

Italy

Guidance by the Italian tax authorities has been released to clarify the definition of a PE following amendments made by the 2018 Budget. This essentially brings Italy's PE definition in line with the post-BEPS updated OECD Model Tax Convention. The amendments are generally effective from 1 January 2018, absent clarifications. Among other things this guidance clarifies that:

- There is a new form of 'fixed place' PE, implementing certain recommendations made in the OECD's BEPS Action 1 (addressing the tax challenges of the digital economy) report. In effect, this addresses prior limitations under the definition of a PE that required a physical presence in the territory of the country or state, and is expected to allow taxation in Italy of activities conducted through intangibles.
- The occurrence of one activity on the 'negative list' (article 5(4) of the OECD Model Tax Convention) is no longer sufficient to exclude a PE. Instead, the taxpayer must now prove the preparatory or auxiliary nature of the activities.
- A new 'anti-fragmentation rule' means that each single activity of all group companies in Italy must be examined. Business processes and functions that are integrated with each other must be grouped together, and the preparatory or auxiliary nature of the combination of the activities must be evaluated.
- Under the term 'dependent agency PE', it will be necessary to look beyond the legal aspects and formalities of situations involving a resident commissionaire that does not formally conclude contracts in the name of the foreign enterprise, but plays a decisive role in the conclusion of the contracts, and evaluates what functions and authority the commissionaire actually has.
- Entities or persons who operate exclusively (or almost exclusively) on behalf of one or more enterprises to which they are closely related can no longer be considered independent. ■

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- Cases: A/S *Bevola and Jens W. Trock ApS v Skatteministeriet* (19.6.18)
- Examining the EC Anti-Tax Avoidance Directive (Tom Wesel & Zoe Wyatt, 7.7.16)
- Tax reform in the digital economy: recent OECD and EC activity (Murray Clayson, 4.4.18)