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In this issue:

China enhances super deduction for R&D expenses

On 3 November 2015, China's Ministry of Finance, the State Administration of Taxation (SAT) and the Ministry of Science and Technology jointly issued new guidance (Circular 119) that expands the scope of the super deduction for research and development (R&D) expenses incurred by domestic enterprises and streamlines the administrative procedures relating to the super deduction. Circular 119, which is designed to encourage more businesses to invest in R&D, will enter into effect on 1 January 2016 and will replace the current rules (i.e. Circulars 116 and 70).

Background

The Enterprise Income Tax (EIT) Law grants a generous super deduction for qualifying R&D expenses incurred by enterprises for the development of new technology, new products and new techniques. Qualifying companies are allowed to deduct 150% of R&D expenses actually incurred (i.e. an additional 50% deduction on top of the normal expense deduction) if the expenses do not result in the production of an intangible asset. If intangible assets are produced, companies may amortize 150% of the actual costs incurred.

Although the super deduction rules aim to encourage R&D activities in general, the intended benefits have not been fully realized because the super deduction has been available only for select industries and expenses. Accordingly, in the State Council executive meeting on 21 October 2015, a decision was made to expand the scope of the applicability of the super deduction as from 1 January 2016, to encourage more businesses to invest in R&D. Circular 119 clarifies the details for the implementation of this decision.

Major changes made by Circular 119

Expansion of scope of eligible industries and activities: Under the current rules, only R&D activities listed in the Categories of High and New Technology Sectors Specifically Supported by the State and the Guidelines on Priority Areas for High Technology Industrialization are eligible for the super deduction. Circular 119 introduces a "negative list," so that any activities or industries that are not included on the list will be eligible for the super deduction, which will substantially broaden its applicability.

Circular 119 includes the following industries and activities on the negative list (so they will not be eligible for the super deduction):

- Tobacco industry;
- Hospitality and catering industry;
- Wholesale and retail industry;
- Real estate industry;
- Rental and commercial services industry;
- Entertainment industry;
- Normal upgrades of products (services);
- Direct application of research findings;
- Support activities following commercialization of a product;
- Duplication or simple alteration of existing products, services, technology, materials or processes;
- Market research, efficiency studies or management research;
- Quality control, testing and analysis or repair and maintenance activities that are related to industrial (service) processes or are routine in nature; and
- Research in the social sciences, the arts or the humanities.

Circular 119 specifically provides that expenses incurred during innovative, creative and "break-through" product design activities will be eligible for the super deduction. Such activities may include the development of multimedia and animation game software; digital animation and game design; architectural and landscape design; industrial design; multimedia design; animation and derivative product design, model design, etc.

Expansion of scope of eligible expenses: Circular 119 will expand the scope of expenses eligible for the super deduction to include the following types of expense:

- Labor costs of external R&D personnel;
- Testing expenses for trial products; and
- Other expenses directly related to R&D activities (such as expert consultation, "high and new technology" R&D insurance, intellectual property application costs, travel and meeting costs), up to 10% of the total R&D expenses that are eligible for the super deduction.

The current rules may be interpreted as providing that only depreciation expense related to equipment and instruments that are used solely for R&D activities is eligible for the super deduction. In practice, the wording in the current rules has given rise to disputes, and depreciation of equipment and instruments that have been used for both R&D and non-R&D purposes (even if primarily used for R&D purposes) may be disqualified from the super deduction. Circular 119 will revise the wording to “depreciation related to equipment and instruments that are utilized for research and development,” which should reduce the possibilities for disputes and should facilitate companies claiming the super deduction for their actual R&D expenses.

Amendments to rules on contract R&D: The current rules provide that, in contract R&D arrangements, the contractor must provide the principal with a detailed list of its R&D expenses; otherwise, the principal may not claim the super deduction. This requirement is not always commercially practicable when the contracting parties are not related, and there have been differing opinions with regard to whether the profits the contractor earns from its services provided to the principal may be included within the scope of the super deduction.

Circular 119 clarifies that, where the principal and the contractor are related parties, the contractor must provide the principal with a detailed list of R&D expenses; in other words, it appears that where such an arrangement is not between related parties, a detailed expense list no longer will be required. The circular also specifies that the principal may recognize up to 80% of the total actual R&D expenses that are on arm’s length terms (which means that the profits earned by the contractor may be considered part of the principal’s total R&D expenses) for purposes of claiming the super deduction. This new approach may, to some extent, help simplify the super deduction calculation and reduce the number of tax disputes.

Circular 119 specifically provides that expenses related to R&D activities carried out by foreign organizations or individuals are not eligible for the super deduction.

Streamlined approval and administrative procedures and other relevant provisions: Circular 119 provides guidance on a number of additional issues, including the following:

- Based on Circular 119 and recent State Council decisions, taxpayers must follow the applicable filing procedures to claim the super deduction; it is not necessary to obtain advance approval from the relevant tax authorities.
- Companies undertaking R&D projects at the provincial or ministerial level or above, or projects that span multiple years and that already have been verified, no longer will require annual verification by the competent science and technology authorities.
- For expenses incurred on or after 1 January 2016, a company is allowed to apply for the super deduction retroactively, within three years after the expenses are incurred.

Taxpayer obligations and post-event inspections: Companies no longer will be required to set up special accounts for R&D expenses; however, Circular 119 emphasizes that, in addition to complying with the standard accounting treatment under the prevailing financial accounting rules, companies must prepare supplementary financial records to accurately track the actual expenses that are eligible for the super deduction in the current year.

Circular 119 requires the tax authorities to intensify their administration of super deduction claims filed by taxpayers, through regular inspections and monitoring, with audits to cover no less than 20% of all cases annually.

Comments

With the substantial expansion of the scope of the application of the super deduction, more businesses likely will be able to benefit from the incentive. Companies should begin to examine their R&D activities to determine whether any adjustments are needed; enhance their expense tracking and monitoring for compliance and external inspection purposes; and monitor regulatory developments regarding the super deduction to position themselves to fully capture the potential tax benefits.

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VAT considerations for US companies providing e-services

As a result of the exponential growth of the digital economy, the VAT obligations on US businesses providing electronic services ("e-services") to foreign customers are expected to increase. This article looks at some areas that US businesses should consider in preparing for the potential impact of changes to the global indirect tax landscape.

Setting a level playing field between domestic and foreign suppliers

The digital economy has made it easier for businesses to sell e-services across borders. For VAT purposes, the definition of "e-services" can vary by country, but the term generally refers to services supplied electronically, often via the internet, with little or no direct human involvement. For example, this may include supplies of software, web hosting, access to platforms and databases, music, films, games, videos and images.

The digitalization of the economy may have resulted in tax authorities losing potential VAT and goods and services tax (GST) (collectively "VAT") revenue, since, from a global perspective, there generally have been few requirements for nonresident suppliers to charge and collect tax. This also has led to a distortion of competition between domestic and foreign suppliers.

Although the tax authorities in some jurisdictions already have taken steps to level the playing field between domestic and foreign suppliers, the OECD has launched an initiative to develop international VAT guidelines that could help to mitigate unfair competitive advantages and facilitate international trade.

At the third meeting of the OECD Global VAT Forum, held in Paris on 5-6 November 2015, representatives from more than 100 countries and jurisdictions resolved to endorse the guidelines as the preferred international standards for the coherent and efficient application of VAT to international trade in services (for prior coverage, see *World Tax Advisor*, 13 November 2015).
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/151113_ib.html

The guidelines represent an important step toward ensuring that VAT on cross-border services is effectively accounted for in the jurisdiction in which the services ultimately are consumed, particularly where services are provided by nonresident suppliers to private individual consumers (i.e. B2C supplies). This approach also finds support in the final report under action 1 (addressing the tax challenges of the digital economy) of the OECD's base erosion and profit shifting (BEPS) project.

As a result of these developments, more countries are expected to introduce new indirect tax rules that will impose VAT obligations on nonresident suppliers of e-services in the near future. Over the coming months and years, US businesses providing such services to foreign customers are expected to see an increase in their foreign VAT obligations. This article looks at some issues that such US businesses will need to consider, and how they can prepare to address the potential impact of changed compliance obligations.

Background

The EU member states first imposed VAT compliance obligations on non-EU resident suppliers of digital services to EU-based private individual customers (B2C supplies) in 2003, and many businesses with no establishment or nexus in the EU became liable to register, charge and collect VAT on their B2C supplies. Similar obligations were introduced in Iceland, Norway and Switzerland in 2010 and 2011.

Countries outside the EU also have introduced legislation to tax supplies of e-services to customers in the country in which the customer is established; these include Japan (October 2015), Kenya (September 2013), Korea (July 2015) and South Africa (June 2014).

Generally speaking, and consistent with the EU model, only B2C supplies of e-services by nonresidents may create VAT obligations for the supplier, since most business-to-business (B2B) supplies are taxed under a "reverse-charge" or "self-assessment" mechanism, under which the recipient is liable to account for any VAT due on behalf of the supplier. However, some countries do not have a reverse charge or self-assessment mechanism; their domestic legislation, therefore, has been revised so that nonresident suppliers of B2B e-services are liable to register for VAT (e.g. South Africa). This means that even businesses supplying e-services only to business customers should monitor relevant developments, since they also may be liable to register for and charge VAT in certain jurisdictions.

Challenges faced by suppliers of e-services

The result of the fast-changing global indirect tax landscape is that suppliers of e-services to private individuals are facing a significant increase in administrative obligations relating to VAT, which may include the following:

- The need to monitor developments in multiple jurisdictions, despite a lack of clear guidance issued by certain domestic tax authorities;
- Additional in-country VAT registration and compliance obligations (including obligations in jurisdictions that may not provide for simplification mechanisms, such as the EU "mini one-stop shop" scheme);
- Requirements to appoint a local tax representative in certain jurisdictions;

- Potential language barriers where the tax authorities correspond only in the local language;
- Specific nuances with respect to key domestic rules (e.g. the definition of e-services, whether B2B supplies are included in the scope, foreign exchange conversions, etc.);
- Customer pricing and contractual terms (i.e. VAT-inclusive or exclusive pricing) that can have a direct impact on profit margins and the overall business model;
- Internal reporting system requirements, including the need to be able to accurately identify the location of customers and whether a transaction should qualify as a B2B or B2C supply, and to report the corresponding VAT liability as appropriate;
- Potential VAT invoicing requirements; and
- The interaction between electronic platforms selling content, payment processors and producers of content to determine which party is liable to collect and remit any taxes due.

Comments

Given the recent endorsement of the international VAT guidelines at the meeting of the OECD Global VAT Forum, suppliers of B2C e-services can expect more countries to implement new legislation to impose VAT obligations on nonresident suppliers. A significant number of countries already are considering such changes (including Australia, Canada, Israel, New Zealand and Turkey), and it is likely that more will follow in the near future.

Any business that may be affected by these changes should monitor developments closely, and consider the potential implications as quickly as possible. Taking early action may help to mitigate the risk of lengthy and costly changes that may be required to existing ERP systems, as well as reduce the potential risks and penalties associated with noncompliance with the rapidly increasing VAT obligations.

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Australia:
Parliament passes multinational anti-avoidance law

The Australian parliament passed the Tax Laws Amendment (Combatting Multinational Tax Avoidance) Bill 2015 (MAAL bill) on 3 December 2015. The MAAL bill will become effective following royal assent, which is expected before 31 December 2015 (for prior coverage, see *World Tax Advisor*, 25 September 2015). The government and the Australian tax authorities have made it clear that the purpose of the MAAL is to effect behavioral change by taxpayers.
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/150925_1.html

The key measures in the MAAL bill, which will apply as from 1 January 2016, target multinational tax avoidance where groups have global turnover of AUD 1 billion (approximately USD 750,000) or more. Once enacted, the measures will:

- Amend Australia's general anti-avoidance provisions (Part IVA of the Income Tax Assessment Act 1936) to prevent multinational entities from using certain arrangements to artificially avoid attributing business profits to a permanent establishment (PE) in Australia;
- Implement the OECD country-by-country (CbC) reporting obligations under the base erosion and profit shifting (BEPS) project in Australia;
- Increase the penalties that would apply to affected global entities; and
- Require Australian resident companies (and possibly some nonresidents) to file general purpose financial reports with the Australian Tax Office (ATO) for periods commencing on or after 1 July 2016 (in many cases, such companies currently may be preparing limited-scope special purpose accounts). This measure will result in further disclosures of financial information, including likely increases to tax-related and related-party transaction disclosures.

The MAAL bill is intended to ensure that multinational entities cannot use "complex, contrived and artificial" schemes to avoid paying Australian tax, and targets multinational entities that do not have a PE in Australia in the following circumstances:

- Where a non-Australian principal makes supplies to Australian customers and an Australian affiliate (e.g. an Australian marketing support services company) undertakes activities in Australia directly connected to those supplies; and
- Where there is a principal purpose of avoiding tax in Australia, or avoiding Australian tax and reducing foreign tax liabilities.

The ATO may deem the nonresident principal to have a PE in Australia, exposing the group to Australian income tax in respect of profits attributed to the notional PE; Australian withholding tax where the nonresident principal makes interest or royalty payments that are attributed to the notional PE; and potential penalties.

In addition, it is expected that related party transactions will come under increased scrutiny as a result of the additional transparency measures and the ATO's focus on transfer pricing.

The ATO has publicly stated that it will proactively approach businesses in enforcing the MAAL bill provisions; ATO guidance on the approach to proactively enforcing the MAAL bill on a real-time basis already has been issued, and further guidance is expected in the near future. The ATO has indicated that this measure could apply to as many as 300 companies, but it is expected that the ATO initially will target approximately 30-80 companies, some of which already are subject to risk reviews and other audit activities under existing law.

Comments

Potentially affected companies should undertake a risk assessment as to whether the MAAL bill could apply to any of their Australian connected businesses. As a result of that initial MAAL risk assessment, companies may need to consider the financial impact if the ATO were to apply the MAAL bill provisions, how the MAAL provisions will affect Q1 2016 financial reporting, possible strategies regarding engagement with the ATO and alternative business models or tax models that should be considered.

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China:
SAT clarifies new rules on tax treaty benefit claims

China's State Administration of Taxation (SAT) issued new guidance (Circular 128) in October 2015 that clarifies the responsibilities of the tax authorities at all levels of the government when they assess whether a nonresident is entitled to benefits under China's tax treaties. Circular 128 supplements guidance released in August 2015 (Bulletin 60) that eliminated the advance approval and registration requirement for nonresidents to obtain treaty benefits and introduced a new self-assessment procedure (for prior coverage, see *World Tax Advisor*, 25 September 2015). Both sets of guidance apply as from 1 November 2015.
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/150925_2.html

Highlights of Circular 128

Bulletin 60 relaxes the procedures for nonresident enterprises and individuals to obtain benefits under China's tax treaties by allowing benefits to be enjoyed based on assessments made by the nonresident recipient of China-source income or the Chinese withholding agent, and certain documentation submitted to the tax authorities. The tax authorities can review the documentation and request additional information from the nonresident or the withholding agent, and if the authorities conclude that a nonresident improperly obtained benefits under a treaty, they may require the nonresident to pay the relevant tax.

Circular 128 requires the local tax authorities to carry out periodic assessments of a certain percentage of nonresidents claiming treaty benefits. These examinations will target nonresidents located in jurisdictions that have low effective tax rates, those claiming significant tax benefits and those with poor tax compliance ratings.

The tax authorities are directed to carry out "sample" examinations of nonresidents that claim tax benefits under the dividends, interest, royalties and capital gains articles of treaties within three months after the end of each quarter. The authorities must examine at least 30% of the total number of nonresidents claiming benefits under each of these four articles during the relevant quarter. For other treaty articles, the authorities must examine, within six months of the end of each quarter, at least 10% of the total number of nonresidents claiming benefits under the same article during the relevant quarter.

The examinations will focus on the following issues:

- Whether the nonresident's tax residence certificate meets the requirements under Chinese law and whether the nonresident was a dual resident for tax purposes;
- Whether the income concerned was correctly categorized for purposes of obtaining the relevant treaty benefits, whether the correct treaty provision was applied and whether the nonresident was eligible to obtain the benefits;
- Whether the tax payable was calculated correctly; and
- Whether any tax treaty abuse was present.

If the local tax authorities discover that a nonresident recipient of China-source income does not qualify for benefits under a relevant treaty and the authorities require the taxpayer to repay at least RMB 5 million in taxes, the local tax authorities must prepare a *Tax Adjustment Case Summary of Ineligibility for Tax Treaty Benefits* and submit the summary to the next level of the tax authorities. The summary ultimately will be submitted to the SAT, which will circulate consolidated summaries to the tax authorities throughout the country. For cases that expose high tax risks and/or inconsistencies in practice, the SAT will set up expert panel reviews.

The provincial level tax authorities must maintain a record of poor tax compliance, which will contain information on nonresidents that have inappropriately claimed treaty benefits. The local level tax authorities must complete a *List of Nonresidents Having Poor Tax Compliance Ratings for Inappropriately Claiming Tax Treaty Benefits*, which ultimately will be submitted to the SAT and circulated to other tax authorities on a regular basis. Nonresidents with poor tax compliance ratings will be targeted for further examinations by the tax authorities at all levels.

Comments

Bulletin 60 relaxes the procedure for nonresidents to obtain benefits under China's tax treaties and shifts from an advance approval/registration system to a system based on follow-up administration by the tax authorities. Circular 128 provides guidance to the local tax authorities on how they should conduct and strengthen the subsequent administration.

It should be noted that Bulletin 60 does not make changes to the substantive requirements (such as beneficial ownership, satisfying the purpose test, etc.) that must be met for a nonresident to be entitled to treaty benefits. Further, the frequency and proportion of sample examinations by the tax authorities required under Circular 128 are not low. Therefore, when making self-assessments for tax treaty benefit purposes, both the nonresident recipient of income and the Chinese withholding agent should ensure that the claims are valid and accurate.

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Germany:
Exemption to change-in-ownership rules expanded

The German tax reform 2015, published in the federal gazette on 5 November 2015, includes a new exemption from the strict change-in-ownership rules that result in the forfeiture of tax loss carryforwards.

According to the change-in-ownership rules introduced in the 2008 business tax reform, a direct or indirect transfer of more than 25% of the shares of an entity to an acquirer will result in a pro rata forfeiture of tax loss carryforwards, and a transfer of more than 50% of the shares will result in a complete forfeiture of tax loss carryforwards.

For transfers taking place after 31 December 2009, an exemption for intragroup reorganizations applied where the “same person” held directly or indirectly a 100% participation in both the transferring and the purchasing entity. However, the exemption did not apply to a share transfer from or to the ultimate parent entity where the ultimate parent entity was not held by the “same person,” which would be the case, for example, for any stock exchange-listed company.

The tax reform 2015 extends the intragroup exemption rule to apply to changes of shareholders within a 100% controlled group, including the situation where an ultimate parent is the transferring or the purchasing entity and is held by more than one person. Additionally, the ultimate shareholder may be a partnership or an individual; this had been an area of uncertainty, and the Federal Ministry of Finance had issued a draft decree that would not allow a partnership or individual to be the ultimate shareholder.

The new rules apply retroactively to share transfers taking place after 31 December 2009, thus allowing taxpayers to benefit in cases where tax losses already were forfeited under the previous wording of the law.

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Netherlands:
State aid decision to be appealed

In a letter dated 27 November 2015, the Dutch government announced that it will formally appeal the recent decision of the European Commission that the Netherlands granted illegal state aid to Starbucks (for prior coverage, see *World Tax Advisor*, 13 November 2015). The commission ruled on 21 October that based on an advance pricing agreement (APA) concluded between the Dutch tax administration and Starbucks, selective tax advantages were granted that are not permitted under EU state aid rules. (The European Commission issued a decision against Luxembourg on the same day on the grounds that Luxembourg granted illegal

state aid to Fiat Finance and Trade. The Luxembourg government issued a press release on 4 December 2015, announcing it, too, will appeal.)
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/151113_4.html

The letter issued by the Dutch Ministry of Finance sets out the government's reasons for appealing the European Commission decision, its views on combating tax avoidance (as well as initiatives the Netherlands has taken to address tax avoidance) and its desire to preserve a favorable business climate.

Appeal of state aid finding

The Dutch government would like to use the appeal process to obtain clarity from the EU on the application of advance certainty through rulings granted to multinational corporations. The government values the advance ruling process and has taken the position that the European Commission did not convincingly demonstrate that the Dutch tax administration deviated from statutory rules and that there is an issue of state aid. According to the Dutch government, the commission applied new criteria for the calculation of profits for transfer pricing purposes that deviate from national legislation and the OECD transfer pricing guidelines.

Combating tax avoidance/preserving the Dutch business climate

The letter reiterates the government's commitment to full support of the OECD base erosion and profit shifting (BEPS) project and the three-pronged strategy that is to be applied in the context of the Netherlands' collaborations at the OECD and EU levels:

- Proactively adapting Dutch legislation and tax treaties (e.g. adopting the transfer pricing measures recommended under the OECD BEPS project to the extent necessary);
- Aiming at "hard law" by ensuring an internationally coordinated approach in areas such as limitations on interest deductions, the tax treatment of hybrid entities and controlled foreign company rules; and
- Promoting Dutch policy, such as a broad tax treaty network, the availability of the participation exemption and the accessibility of the tax administration in providing certainty up front through APAs and advance tax rulings.

The government states that domestic transfer pricing legislation and policy are based on the OECD transfer pricing guidelines and that the arm's length principle, as articulated in the guidelines, has been implemented into Dutch law. The government also notes that the commission itself has stated in the past that the Netherlands has a robust ruling process that requires taxpayers to produce extensive information to obtain a ruling.

The letter specifically mentions the Dutch government's commitment to preserving an attractive business climate for tax purposes, and that this will be further clarified during 2016.

Finally, the letter includes a summary of initiatives taken at the domestic level to proactively tackle tax avoidance; these include reinforcing the substance requirements to enjoy tax treaty benefits, increasing supervision of financial services entities and increasing transparency under the EU Code of Conduct.

The government also announced it will undertake an examination of the differing domestic dividend withholding tax treatment of NVs/BVs and cooperatives (coops); in principle, NVs/BVs are subject to dividend withholding tax, but coops generally are not. This review, which could have been prompted by the fact that the Court of Justice of the European Union has ruled on the compatibility of the tax with EU law in specific cases (for prior coverage, see the EU tax alert dated 18 September 2015), ultimately may lead to a full or partial abolition of the dividend withholding tax.
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-europeanunion-18-september-2015.pdf

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Netherlands:
European Commission challenges LOB in treaty with Japan

The European Commission issued a press release on 29 November 2015 announcing that it has issued a “reasoned opinion” asking the Netherlands to amend the limitation on benefits (LOB) article in the 2012 Netherlands-Japan tax treaty because the Commission considers the provision to be incompatible with EU law. The Netherlands must respond to the Commission’s request within two months; otherwise, it may be referred to the Court of Justice of the European Union.

LOB clauses in tax treaties typically are used to ensure that treaty benefits accrue only to the intended parties, i.e. to prevent treaty shopping. An LOB provision, which usually relates to benefits available under the dividends, interest and royalties articles, will contain tests to determine whether recipients of income qualify for treaty benefits and will include safe harbors for certain persons.

Netherlands-Japan tax treaty

The LOB provision in the Netherlands-Japan requires a beneficiary of certain items of income to be a “qualified person” to obtain treaty benefits. The tax treaty contains several possibilities to be a qualified person. According to the European Commission, two items are incompatible with EU law:

- The requirement that a shareholder be a resident of the Netherlands or Japan; and
- The requirement that the beneficiary be a company whose shares are traded regularly on a recognized stock exchange.

If the recipient of income is not a qualified person, it cannot apply the treaty benefits, meaning that a higher rate of withholding tax will be levied on dividends, interest and royalties from Japan than would apply to companies with Dutch resident shareholders or to those whose shares are quoted and traded on recognized stock exchanges (which include EU and third-country stock exchanges).

Commission challenge

The European Commission believes that, on the basis of previous cases, such as the Open Skies case, an EU member state concluding a treaty with a third country cannot agree to better treatment for companies held by shareholders resident in its own territory than applies to comparable companies held by shareholders that are resident elsewhere in the EU/European Economic Area (EEA). The European Commission also is of the opinion that, since not all EU stock exchanges are deemed to be recognized, this condition is incompatible with EU law. Hence, a member state cannot agree to better conditions for companies traded on its own stock exchange than for companies traded on stock exchanges elsewhere in the EU/EEA.

Additionally, the Commission considers the requirement that excludes beneficiaries from other EU member states from treaty benefits to be incompatible with EU law. This position of the Commission is not fully clear, since residents of other EU member states do not fall within the scope of the Netherlands-Japan treaty. If the European Commission means that residents of other member states should be entitled to the exception to the LOB provision for purposes of the tax treaty between that member state and the Netherlands, the Commission's position also is not fully clear; the applicable treaty with the other EU member state may not even contain an LOB provision.

It is difficult to understand why the Commission focused only on the LOB provision in the Netherlands-Japan tax treaty, since a number of Dutch treaties with other non-EU countries contain an LOB provision (including the treaty with the US), as do certain treaties of other EU member states with third countries.

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Saudi Arabia: New company law adopted

On 5 November 2015, Saudi Arabia's Ministry of Commerce (MOC) announced that a new company law has been approved that will make significant changes to the regulatory framework for doing business in the country.

Highlights of the new law include the following:

- The minimum two-shareholder requirement to set up a limited liability company (LLC) will be eliminated; thus, it will be possible to establish an LLC with a single shareholder;
- The minimum share capital requirement for a joint stock company (JSC) will be reduced from SAR 2 million to SAR 500,000, and the minimum number of shareholders in a JSC will be reduced from five to two;

- Shareholders in an LLC will not be personally liable for the company's debts if losses exceed 50% of the company's capital; rather, the LLC will be dissolved by operation of law, unless the shareholders resolve otherwise;
- The concept of a holding company will be introduced; and
- The MOC will be responsible for supervising and regulating matters relating to all types of companies, except for "listed companies," which will be supervised by the Capital Market Authority.

The new company law will become effective 150 days from the date it is published in the official gazette.

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South Africa:
CbC reporting to be implemented

The South Africa Revenue Service (SARS) has announced that it will implement country-by-country (CbC) reporting in line with the OECD base erosion and profit shifting (BEPS) initiative (action 13), effective as from 1 January 2016.

The objective of CbC reporting is to provide the tax authorities in the jurisdiction of the ultimate parent company with an overview of the aggregate tax position of a multinational enterprise (MNE), and the allocation of revenue across the jurisdictions in which the MNE operates. South African-headquartered MNEs will be required to submit the CbC report to the SARS, which will share the report (as well as the master file) with relevant tax authorities through the exchange of information process.

The CbC report is structured to provide insight into the group's places of economic activity through the number of people it employs and its functional activity so that the authorities can map economic activity and substance to reported revenue and tax payments. The CbC report must contain the following information on each entity within a group:

- Details of each entity and the jurisdiction in which that entity is tax resident;
- Profitability, taxes payable, tax accruals, stated capital, accumulated earnings, number of employees and details of noncash tangible assets, which will allow some broad economic ratios to be calculated and compared; and
- Details of the main functional nature of each entity (e.g. R&D, manufacturing, group finance, holding company), which will allow mapping of functionality to revenues, number of employees and tax contribution.

Fundamentally, the CbC report is intended to assist the tax authorities in carrying out a transfer pricing risk assessment. For example, a CbC report that shows an intellectual property holding company situated in a low tax jurisdiction with high revenue, low tax and a small number of employees likely would increase the level of transfer pricing risk. This does not necessarily mean that there would be a transfer pricing issue, but it does highlight the importance of ensuring that transfer pricing policies and documentation are robust and defensible.

The CbC report is the third tier of the recommended documentation proposals from the OECD, with the other two tiers being a group master file and local country files. The intent is that all of these documents work together to provide tax authorities with sufficient information to make an informed decision on the level of transfer pricing risk, as well as the basis for an audit and possible transfer pricing adjustments. The CbC report will function as the risk assessment tool, while the master file will function as the basis for a transfer pricing audit.

CbC reporting

South African MNEs with annual group consolidated turnover exceeding ZAR 11.5 billion in the 2015 financial year will be required to prepare the CbC report for financial years starting on or after 1 January 2016. The reporting deadline is 12 months from the end of the financial reporting year; therefore, the first reporting period for a South African MNE with a 31 December year-end will be 1 January-31 December 2016, with the report due to the SARS by 31 December 2017.

CbC reporting will not be applicable to South African intermediary holding companies.

Although SARS previously indicated that it likely would require more information in its CbC reporting template than what is provided in the OECD's action 13 report, SARS now has confirmed that the template issued by the OECD should be used.

Preparing for CbC reporting and practical considerations

A South African MNE that is likely to meet the threshold for CbC reporting should be considering whether its systems are adequate to provide the information that will be required and, if not, what system upgrades will be required. In addition, it will be important to ensure that an audit trail supporting the source of the data is maintained and that the group's transfer pricing documentation is current and aligned with the CbC report. Because CbC reporting will apply as from 1 January 2016, there is a limited window in which an MNC can review its existing transfer pricing policies and structures to ensure that what is disclosed in the CbC reporting is defensible.

CbC reporting will expand the compliance requirements for MNEs; they will need to assess their current systems and processes (tax, finance and information technology) to determine the most efficient and effective manner in which to extract the required financial information across the group.

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Sweden:
Foreign tax credit on incentive-based income denied due to statute of limitations

The Swedish Administrative Court of Appeal ruled on 14 September 2015 that a foreign tax credit on share-based incentive income may be granted only for the income year in which the income is subject to tax in Sweden.

In the case, a Swedish taxpayer performed work abroad, and both Sweden and the other country (Finland) taxed the same share-based incentive income. However, Sweden taxed the income at the time the relevant shares vested, while Finland taxed the income at the time the option was exercised, which occurred more than six years after the vesting. (Under Swedish domestic law, the statute of limitations for reassessing a tax return is six years from the end of the relevant accounting year (five years from the end of the assessment year)).

The Swedish taxpayer filed a reassessment with the Swedish Tax Agency for the year in which the income was taxed abroad, claiming that a foreign tax credit should be granted in Sweden for that year, rather than for the year in which the income actually was taxed in Sweden.

The Administrative Court of Appeal rejected this claim, ruling that a foreign tax credit must be applied for the same income year in which double-taxed income is subject to tax in Sweden, i.e. at the point of vesting in this case. Because the vesting took place more than six years before the income was taxed abroad, it was too late to reassess the tax return to claim a foreign tax credit for the relevant income year. The fact that tax on the capital gains from the sale of the relevant shares was due in Sweden in the same year as the exercise was irrelevant, since that tax related to a different type of income (capital or investment income), and not to employment income (arising from an incentive-based benefit).

Comments

Although this case has certain unusual and specific features, it serves as a reminder that it is important to consider timing issues for share-based incentive income, since different events may be subject to tax in different countries. The decision still may be appealed to the Supreme Administrative Court.

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In brief

Australia: The government has passed new legislation that aims to tighten its foreign investment system audit, compliance and enforcement framework. On 11 November 2015, two bills, the Foreign Acquisitions and Takeovers Fees Imposition Bill 2015 and the Register of Foreign Ownership of Agricultural Land Bill 2015, were passed by both houses of parliament and a third bill, the Foreign Acquisitions and Takeovers Legislation Amendment Bill 2015, was passed by both houses of parliament on 24 November 2015. Several changes took effect as from 1 December 2015, including the introduction of civil penalties and stricter criminal penalties, the transfer of responsibility for regulating foreign investment in residential real estate to the Australian Taxation Office, a decrease in the screening thresholds for investments in Australian agriculture, the introduction of fees for all foreign investment applications and the establishment of a register of foreign ownership (including existing holdings and subsequent acquisitions and disposals) of Australian agricultural land.

Costa Rica: The tax authorities issued guidance on 14 October 2015 that modifies the rule requiring taxpayers classified as large taxpayers or large territorial enterprises to file audited financial statements within six months of the end of the fiscal period. Under the new rules, which apply as from the date of issuance, such taxpayers are required file audited financial statements only upon a request from the tax authorities. The taxpayer has three months to respond to a request (which may be extended an additional three months). Taxpayers may continue to file statements annually, rather than waiting for a request from the tax authorities.

New Zealand: As foreshadowed in the consultation document issued in August 2015, New Zealand has introduced a bill that, if passed, would apply Goods and Services Tax (GST) to cross-border business-to-consumer (B2C) supplies of both digital services (e.g. video, music and software downloads) and more traditional services (e.g. legal and accounting services received remotely). According to the commentary issued with the bill, the proposed amendments broadly follow the OECD guidelines on global standards for the application of VAT/GST to international trade. The bill indicates that offshore suppliers of “remote services” would be required to register and account for GST when the value of their supplies of remote services to New Zealand resident consumers exceeds NZD 60,000 in a 12-month period. It also provides for adjustments if GST is wrongly charged on business-to-business (B2B) supplies, and an option for offshore suppliers to zero-rate B2B supplies (and hence be able to recover related input GST).

Peru: The executive branch has published a decree that sets forth the conditions for submitting a private binding ruling request under the regime introduced by Law 30296 (enacted on 31 December 2014) and provides guidelines for the regime’s gradual implementation by the Peruvian tax authorities (SUNAT). A taxpayer with a direct and legitimate interest in a tax issue may request a private binding ruling from the SUNAT on the tax treatment applicable to specific facts and circumstances affecting that taxpayer, as long as a related tax obligation has not yet arisen or, in the case of customs procedures, the cargo manifest or the numbering of the goods declaration has not been initiated. At the initial stage, private binding rulings may be requested only on matters involving the application of the corporate income tax and/or value added tax and that affect certain taxpayers (with the relevant criteria based on the size and scale of the taxpayer and other relevant characteristics).

Romania: The withholding tax rate on dividends paid to resident or nonresident legal entities and individuals will be reduced from 16% to 5% as from 1 January 2016. The new rate will apply regardless of where the recipient is resident.

BEPS corner

In each issue that provides updates on developments in the OECD's base erosion and profit shifting (BEPS) initiative, *World Tax Advisor* includes a "BEPS corner" covering these developments.

Australia: The parliament has passed a tax bill, which will apply as from 1 January 2016, to implement the OECD country-by-country (CbC) reporting obligations under the BEPS project. See the article in this issue.
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/151211_3.html

South Africa: The South Africa Revenue Service has announced that it will implement CbC reporting in line with the OECD BEPS initiative, effective as from 1 January 2016. See the article in this issue.
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/151211_9.html

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Tax treaty round up

At the end of each month, *World Tax Advisor* provides an update on recent tax treaty developments, with a focus on items that directly affect the withholding tax rates of the key jurisdictions covered by the Deloitte International Tax Source (DITS). Additional coverage may include stated negotiating priorities and other important tax treaty trends.
URL: http://www.dits.deloitte.com?id=us:em:na:wta:eng:tax

Unless otherwise noted, the developments discussed below are not yet in force.

Argentina-Mexico: When in effect, the treaty signed on 4 November 2015 provides for a 10% withholding tax rate where dividends are paid to a company that holds at least 25% of the capital of the payer company; otherwise, the rate will be 15%. The protocol to the treaty states that the reduced withholding tax rates under the treaty are not applicable to the additional withholding tax that applies under Argentine domestic law where dividends exceed the payer company's accumulated taxable income, after certain adjustments. A 12% rate will apply to interest. A 10% rate will apply to royalties paid in respect of literary, dramatic, musical, artistic or scientific works (including news); patents, designs and models, plans, secret formulas or processes; computer programs (subject to certain conditions); industrial, commercial or scientific equipment; or for information concerning industrial, commercial or scientific experience, as well as for the rendering of technical assistance services; otherwise, the rate will be 15%.

Bulgaria-Norway: The 2014 treaty to replace the 1988 treaty entered into force on 30 July 2015 and will apply as from 1 January 2016. When in effect, the treaty provides for a 5% withholding tax rate where dividends are paid to a company (other than a partnership) that holds directly at least 10% of the capital of the payer company; otherwise, the rate will be 15%. The rate on interest will be 5%, with an exemption for interest paid in connection with the sale on credit of any industrial, commercial or scientific equipment and on all bank loans. The rate on royalties will be 5%.

Chile-Czech Republic: When in effect, the treaty signed on 2 December 2015 provides for a 15% withholding tax rate on dividends. However, the reduced treaty rate does not apply to limit the withholding tax payable on dividends distributed by a Chilean payer company where full credit is available to the payer for the corporate tax paid. A 5% rate will apply to interest paid to banks or insurance companies; otherwise, the rate will be 15%. A 5% rate will apply to royalties in respect of industrial, commercial or scientific equipment; otherwise, the rate will be 10%.

China: See article in this issue.
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/151211_4.html

China-Zimbabwe: When in effect, the treaty signed on 1 December 2015 provides for a 2.5% withholding tax rate where dividends are paid to a company that controls directly or indirectly at least 25% of the payer company; otherwise, the rate will be 7.5%. The rate on interest and royalties will be 7.5%.

Estonia-Switzerland: The 2014 protocol to the 2002 treaty entered into force on 16 October 2015 and will apply as from 1 January 2016. When in effect, the protocol provides for a 0% withholding tax rate where dividends are paid to a company (other than a partnership) that holds directly at least 10% of the capital of the distributing company for at least one year prior to the dividend payment, or to a pension scheme; otherwise, the rate will be 10%. Interest and royalties will be taxable only in the state of residence of the recipient.

Hungary-Liechtenstein: The 2015 treaty will enter into force on 24 December 2015 and will apply as from 1 January 2016. When in effect, the treaty provides for a 0% withholding tax rate where dividends are paid to a company (other than a partnership that is not liable to tax) that holds directly at least 10% of the capital of the payer company; otherwise, the rate will be 10%. Interest and royalties will be taxable only in the state of residence of the recipient.

India-Thailand: The 2015 treaty to replace the 1985 treaty entered into force on 13 October 2015 and will apply as from 1 January 2016 for Thailand and as from 1 April 2016 for India. When in effect, the treaty provides for a 10% withholding tax rate on dividends, interest and royalties.

Iceland-Switzerland: The 2014 treaty to replace the 1988 treaty entered into force on 6 November 2015 and will apply as from 1 January 2016 for withholding tax purposes. When in effect, the treaty provides for a 0% withholding tax rate where dividends are paid to a pension scheme or to a company (other than a partnership) that holds directly at least 10% of the capital of the distributing company for at least one year prior to the dividend payment; otherwise, the rate will be 15%. Interest will be taxable only in the state of residence of the recipient. The rate on royalties for the use of, or the right to use, a patent, trademark, design or model, plan, secret formula or process will be 5%; otherwise, the rate will be 0%.

Israel: Israel has become the 91st signatory to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. The convention provides for all forms of administrative assistance in tax matters: exchange of information on request, spontaneous exchange, automatic exchange, tax examinations abroad, simultaneous tax examinations and assistance in tax collection.

Netherlands-Japan: See article in this issue.
URL: http://newsletters.usdbriefs.com/2015/Tax/WTA/151211_7.html

Saudi Arabia-Kyrgyzstan: The 2014 treaty entered into force on 1 October 2015 and will apply as from 1 January 2016. When in effect, the treaty provides that dividends and interest will be taxable only in the state of residence of the recipient. The withholding rate on royalties will be 7.5%.

Saudi Arabia-Sweden: When in effect, the treaty signed on 19 October 2015 provides for a 5% withholding tax rate where dividends are paid to a company (other than a partnership) that holds at least 10% of the capital of the payer company; otherwise, the rate will be 10%. Interest will be taxable only in the state of residence of the recipient. The rate on royalties for the use of, or the right to use, industrial, commercial, or scientific equipment will be 5%; otherwise, the rate will be 7%.

Spain-Andorra: The 2015 treaty will enter into force on 26 February 2016 and will apply as from that date for withholding tax purposes. When in effect, the treaty provides for a 5% withholding tax rate where dividends are paid to a company (other than a partnership) that holds directly at least 25% of the capital of the payer company; otherwise, the rate will be 15%. The 15% rate also will apply to dividends paid by a Spanish corporation listed on the Real Estate Investment Market (REIT) to an Andorra resident. The rate on interest and royalties will be 5%.

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Italy
Tax authorities clarify application of patent box regime

On 1 December 2015, the Italian tax authorities issued guidance that further clarifies the application of the patent box regime and its implementation rules and provides detailed instructions on how to elect into the regime, the procedure for obtaining a tax ruling, the

treatment of losses connected to the use of qualifying intellectual property (IP) and the consequences of extraordinary transactions.
Issue date: 10 December 2015
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-italy-10-december-2015.pdf

France

Measures proposed to bring tax consolidation rules in line with EU jurisprudence

France's amended finance bill for 2015 has been updated to include an amendment that would revise the tax group consolidation regime to comply with the decision issued by the Court of Justice of the European Union in the *Groupe Steria* case. The scope of the proposal is more limited than had been anticipated, since the benefit it would introduce would be available only with respect to dividends received by French companies that are members of a tax consolidated group from other French companies within the same tax group or from qualifying 95%-owned EU/European Economic Area subsidiaries.
Issue date: 2 December 2015
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-france-2-december-2015.pdf

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