FEBRUARY 2015 ISSUE 37
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INTERNATIONAL

COUNTRY-BY-COUNTRY REPORTING – OECD GUIDANCE

On 6 February 2015, the OECD issued guidance on the implementation aspects of Country-by-Country (CbC) Reporting for tax, following up from its report in September describing a three-tiered (master file, local file and CbC Report) approach to transfer pricing documentation. This represents one of the most significant milestones in the OECD's Base Erosion and Profit Shifting (BEPS) initiative; the OECD/G20 and tax administrations see it as the single most important achievement of the international tax transparency agenda.

The key highlights are:

– **Timing**
The first CbC Reports are required for fiscal years beginning on or after 1 January 2016.

– **Exemption for Smaller international groups**
There is to be an exemption for groups with total revenues of less than EUR 750 million (but the appropriateness of this will be reviewed in 2020).

– **Other exemptions**
There will be none. All industries will be included, as will investment funds and all 'non-corporate' entities.

– **Consistency of data disclosed**
The OECD emphasized the importance of utilizing the standard CbC Reporting template.

– **Confidentiality**
Information provided in the CbC Reports will not be available to the public and will only be exchanged between tax authorities through existing mechanisms under double tax conventions (or as enabled through the OECD's proposed multinational instrument).

– **Appropriate use**
Jurisdictions are directed to use the CbC Report to assess high-level transfer pricing risk but may also use it to assess other BEPS-related risks.

– **Filing mechanisms**
CbC Reports will be filed with the jurisdiction of the ultimate parent entity of a group within one year from the close of the fiscal year concerned. A requirement to file locally or to the next tier parent entity may be required if the ultimate parent jurisdiction does not require CbC Reporting or there is no adequate mechanism for the timely exchange of CbC Reports (or there is a failure to do so in practice).

– **Government-to-government exchange of information**
There is to be an 'implementation package' to facilitate effective exchange of information, including by way of automatic exchange.

The primary purpose of CbC reporting is as a risk assessment tool for tax administrations. The OECD specifically recognise in their release of 6 February that the need for countries "for more effective dispute resolution may increase as a result of the enhanced risk assessment capability following the adoption of a CbC Reporting requirement".

Businesses need to prepare themselves for the nature and level of tax authority scrutiny that will inevitably arise from CbC Reporting. Our approach and proprietorial CbC tools will enable you to efficiently and effectively identify, measure and manage your risk. Please contact your BDO advisor to discuss how we can help you manage that risk.

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EDITOR'S LETTER

Welcome to this issue of *BDO World Wide Tax News*. This newsletter summarises recent tax developments of international interest across the world. If you would like more information on any of the items featured, or would like to discuss their implications for you or your business, please contact the person named under the item(s). The material discussed in this newsletter is meant to provide general information only and should not be acted upon without first obtaining professional advice tailored to your particular needs. *BDO World Wide Tax News* is published quarterly by Brussels Worldwide Services BVBA in Brussels. If you have any comments or suggestions concerning *BDO World Wide Tax News*, please contact the Editor via the BDO International Executive Office by e-mail at mderouane@bwsbrussels.com or by telephone on +32 (0)2 778 0130.

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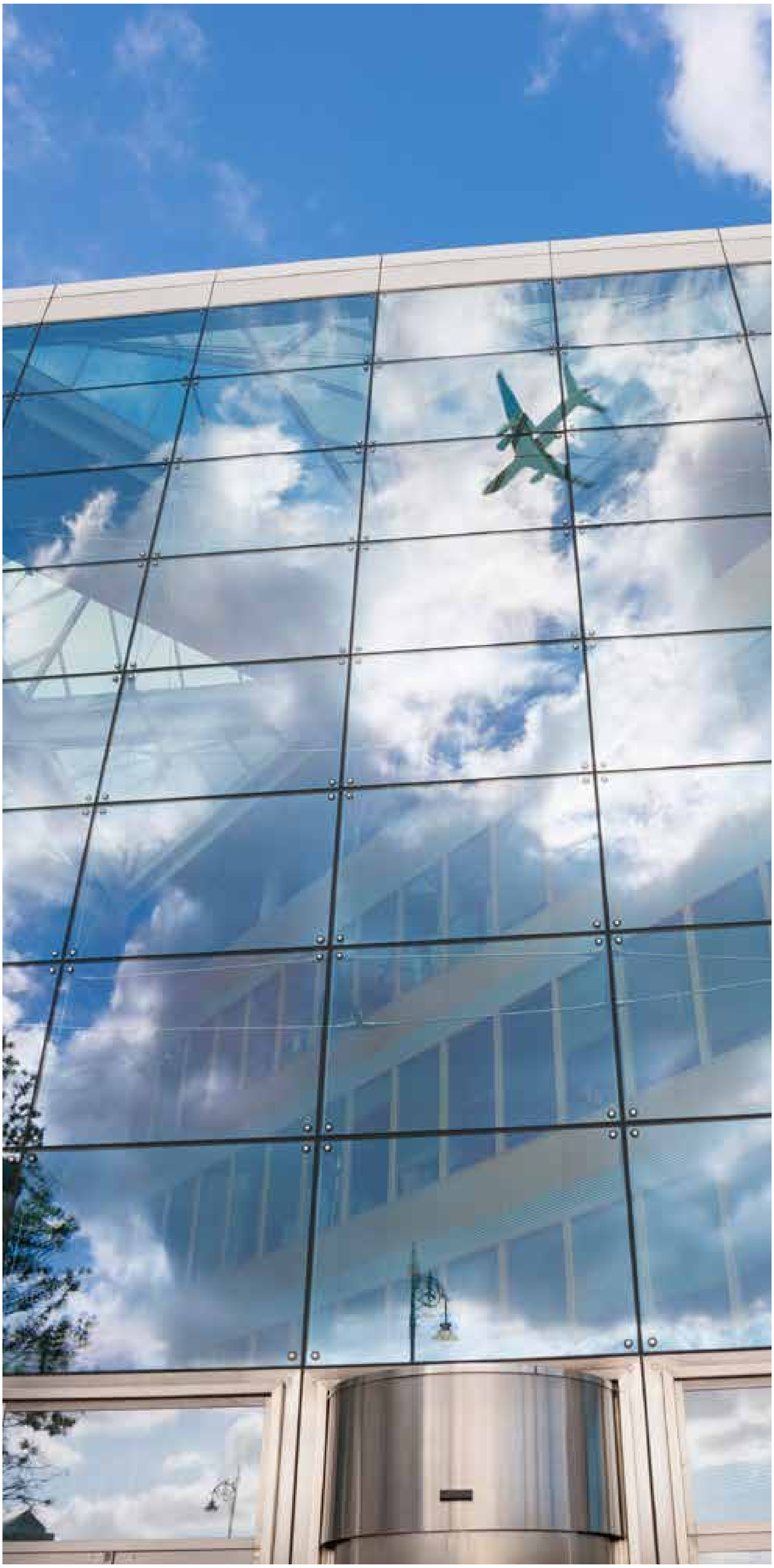

INTERNATIONAL – continuation

BEPS: THE WORK CONTINUES

The work of the Organisation for Economic Co-operation and Development (OECD) on its Base Erosion and Profit Shifting (BEPS) project shaping international measures to counter tax avoidance continues with its rapid progress. Over the course of November and December the OECD have issued 6 papers related to BEPS. BDO have been actively engaged in the consultation – our submissions are available on request.

In this edition, we will focus on the discussion drafts recently published relating to Actions 8, 9 and 10 (Risk, Recharacterisation, and Special Measures), Action 10 (Low Value Adding Intra-Group Services, and Action 14 (Dispute Resolution).

BEPS ACTIONS 8, 9 & 10: REVISIONS TO CHAPTER I OF THE TRANSFER PRICING GUIDELINES (INCLUDING RISK, RECHARACTERISATION, AND SPECIAL MEASURES)

On 19 December 2014 the OECD published a discussion draft on the above Actions, which are concerned with assuring that transfer pricing outcomes are in line with value creation.

The paper is in two parts:

1. Proposed revisions to Section D of Chapter I of the Transfer Pricing Guidelines dealing with the application of the arm's length principle to related party transactions.

   This contains revised proposals and guidance in relation to:

   – The delineation of transactions, including the relevance and allocation of risk

   – Establishing the 'economically relevant' characteristics or comparability factors of transactions

   – The delineation of the comparability factors of controlled transactions with uncontrolled transactions

   – The recharacterisation or non-recognition of transactions.

2. Options for special measures 'either within or beyond the arm's length principle', to meet the objectives of the BEPS project.

   Options are put forward in relation to:

   – Hard-to-value intangibles – A potential measure that would permit a tax administration to presume that a price adjustment mechanism would have been adopted between parties with, as a result, a rebasing of a previously established price for a transfer of intangibles based on subsequent events/outcomes.

   – Over-capitalisation – Potential measures seeking to address issues arising from the freedom MNE groups often have to 'control their structures, including the creation and capitalisation of companies'.

The OECD acknowledges that significant design work will need to be undertaken as the proposed measures are further considered.

BEPS ACTION 10: PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDING INTRA-GROUP SERVICES

On 4 November 2014 the OECD released a discussion draft in relation to the above Action.

Action 10 directs the OECD to 'develop transfer pricing rules to provide protection against common types of base eroding payments, such as management fees and head office expenses'.

Under this mandate, the OECD has developed a simplified transfer pricing approach for low value-adding intra-group services. The resulting guidance seeks to achieve a balance between appropriate charges for low value added services and the need to protect the tax base of payor countries.

The main aspects of this additional guidance include:

– A standard definition of low value-adding intra-group services

– Clarifications of the meaning of shareholder activities and duplicative costs, specifically in the context of low value-adding intra-group services

– Guidance on appropriate mark-ups for low value-adding intra-group services

– Guidance on appropriate cost allocation methodologies to be applied in the context of low value-adding intra-group services

– Guidance on the satisfaction of a simplified benefit test with regard to low value-adding services

– Guidance on documentation that taxpayers should prepare and submit in order to qualify for the simplified approach.

BEPS ACTION 14: MAKE DISPUTE RESOLUTION MECHANISMS MORE EFFECTIVE

Action 14 aims to 'Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under the mutual agreement procedure (MAP), including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.'

The OECD published a discussion draft on 18 December 2014 which sets out its proposals on this subject for analysis and comment.

The discussion paper lays down four guiding principles, and presents options for achieving the aims:

Principle	Options
Ensuring that tax treaty obligations related to the 'mutual agreement procedure' are fully implemented in good faith.	Potential changes to OECD guidance to emphasise that the mutual agreement procedure is an integral part of the obligations that follow from concluding a tax treaty. Participating countries could commit to include in all their tax treaties terms which clarify their obligation to grant access to the MAP using the multilateral instrument envisaged by BEPS Action 15 where appropriate.
Ensuring that administrative processes promote the prevention and resolution of treaty related disputes.	Participating countries could commit to adopt the best practices currently included in the OECD Manual on Effective Mutual Agreement Procedures (MEMAP) in order to ensure: – The independence of a competent authority; – The provision of sufficient resources to their competent authorities; and – The use of appropriate performance indicators for their competent authority functions and staffs; Participating countries could commit to: – Using paragraph 3 of Article 25 more effectively in order to reinforce the consistent bilateral application of tax treaties; – Ensuring that audit settlements do not block access to the mutual agreement procedure; – Implementing bilateral Advance Pricing Arrangement (APA) programmes; and – Implementing administrative procedures to permit taxpayer requests for MAP assistance with respect to recurring (multi-year) issues and the roll-back of APAs.
Ensuring that taxpayers can access the mutual agreement procedure when eligible.	Participating countries could commit to adopt the best practices currently included in MEMAP in order to: – Improve the transparency and simplicity of the procedures to access and use the MAP; – Provide additional guidance on the minimum contents of a request for MAP assistance; Participating countries could commit to: – Clarifying the availability of MAP access where an anti-abuse provision is applied; – Ensuring that taxpayer objections are evaluated by both competent authorities; – Clarifying the meaning of "if the taxpayer's objection appears to it to be justified"; – Amend Article 25(1) to permit a request for MAP assistance to be made to the competent authority of either Contracting State; – Clarifying the relationship between the MAP and domestic law remedies; – Clarifying issues connected with the collection of taxes and the MAP; – Clarifying issues connected with time limits to access the MAP; and – Clarifying issues related to self-initiated foreign adjustments and the MAP.
Ensuring that cases are resolved once they are in the mutual agreement procedure.	Participating countries could commit to: – Ensuring a principled approach to the resolution of MAP cases; – Improving competent authority co-operation, transparency and working relationships; – Increasing transparency and tailoring the scope of MAP arbitration; – Facilitating the adoption of MAP arbitration following a change in treaty policy; – Clarifying the co-ordination of MAP arbitration and domestic legal remedies; – Amending Article 25(5) to permit the deferral of MAP arbitration in – Appropriate circumstances; – Appointing arbitrators; – Improving confidentiality and communications; – Developing additional guidance on the use of different decision-making mechanisms as default approaches in MAP arbitration; – Developing guidance to address particular evidentiary issues; – Establishing mutually-agreed guidance for arbitrators on how to deal with multiple, contingent and integrated issues. Participating countries could consider ways to reduce the costs of MAP arbitration procedures, address issues related to multilateral MAPs and APAs, and provide guidance on consideration of interest and penalties in the MAP.

BDO's view is that the need to overcome obstacles to the effectiveness of MAP is paramount, and that is it an essential component of the work on BEPS issues.

Our principal observations in response to the discussion draft are:

- A step change in improving the efficiency and effectiveness of MAP is absolutely critical to the success of the BEPS project as a whole.
- We recognise the need for, and completely support the introduction of, complementary solutions for dispute resolution, including the development of best practice guidance.
- We welcome the prospect of a 'forum of competent authorities' being responsible for monitoring the overall functioning of the MAP and the measures to which countries will have committed.
- It is important that competent authorities develop a more collaborative mindset and relationship, both between them and with taxpayers and their advisors, to seeking 'the right answer' in the context of a dispute based the application of a principled and objective approach.
- BEPS will trigger a significant increase in MAP cases, and new ways of managing and resourcing cases will be required.
- To enable the proper and consistent application of treaties, a dramatic change in mindset and culture is required to curtail the common practice of tax administrators to influence taxpayers not to initiate MAPs.
- Collection procedures should be suspended pending resolution of a MAP in all cases.
- Some resource issues might be solved if more work is done by the taxpayer, and taxpayer involvement could motivate all parties to reach a conclusion in good faith.

OTHER RECENT BEPS MATERIAL

In December 2014 the OECD also published discussion drafts on:

BEPS Action 4: Interest Deductions and Other Financial Payments

BEPS Action 10: Use of Profit Splits in the Context of Global Value Chains

BEPS Action 10: Transfer Pricing Aspects of Cross Border Commodity Transactions

NEXT STEPS

Further public consultation on recent discussion drafts and other topics will be held on 17 February and 19-20 March 2015 in Paris, France.

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INTERNATIONAL – continuation

BDO INTERNATIONAL TAX WEBINARS SERIES

TAP INTO WORLDWIDE TAX INSIGHTS

Throughout 2015 BDO will be hosting a series of webinars on international tax. The webinars will be presented by BDO tax specialists from around the world and will cover a range of topics of relevance to businesses operating internationally.

A full list of the scheduled webinars is shown opposite. The webinars are free to attend, but numbers are limited so please sign up early to ensure a place. You can register via the BDO international website on http://www.bdointernational.com/Services/Tax/tax-webinars/Pages/Tax-webinars---2015.aspx

UPCOMING WEBINARS

- **Tuesday 24 February**
  Value Chain Tax Planning – how has it been affected by recent developments – in particular the OECD's project on Base Erosion and Profit Shifting as well as the proposed changes to the Swiss and Irish tax regimes
- **Tuesday 2 June**
  Transfer Pricing update – looking at the OECD's work on intangibles and documentation as well as other transfer pricing news from around the world
- **Tuesday 25 August**
  Compliance Traps – common problems in tax compliance encountered by groups expanding into new territories
- **Tuesday 24 November**
  Base Erosion and Profit Shifting – an overview of the most recent releases from the OECD on their 15 point action plan

All the webinars will last one hour and will start at 16.00 GMT.

From time to time we will run additional webinars on new developments in the world of international tax. Please keep a look out for these on our website. We look forward to welcoming you to our international tax webinar series.

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AUSTRALIA

NEW TRANSFER PRICING LAW – DOCUMENTATION REQUIREMENTS LOOSENED

Australia's new Transfer Pricing Law applies for income years commencing on or after 29 June 2013.

TRANSFER PRICING ADJUSTMENTS

The main difference between the new and old transfer pricing rules is the change from looking at the arm's length pricing of an international transaction to now looking at the arm's length conditions of the international transactions. Where the actual conditions between the two parties to international dealings differ from arm's length conditions, adjustments are required where under arm's length conditions:

- The amount of an entity's taxable income for a year would be greater
- The amount of an entity's loss of a particular sort for an income year would be less
- The amount of an entity's tax offsets for a year would be less
- An amount of withholding tax payable in respect of interest or royalties by an entity would be greater.

Arm's length conditions

Arm's length conditions are the conditions that might be expected to operate between independent entities dealing wholly independently with one another in comparable circumstances. When identifying the arm's length conditions, one uses the method, or combination of methods, that is the most appropriate and reliable, having regard to all relevant factors. These methods must be consistent with the Organisation for Economic Cooperation and Development (OECD) Transfer Pricing Guidelines.

RE-CHARACTERISATION/ RECONSTRUCTION

In most cases, identification of arm's length conditions will be based on the commercial or financial relations in connection with the actual conditions that operated, and having regard to both the form and substance of those relations. However, a taxpayer may have to re-characterise an arrangement where:

- The form of an arrangement is inconsistent with its substance: the substance of the arrangement takes precedence over its form when identifying the arm's length conditions
- Parties dealing at arm's length would not have entered into the actual commercial or financial relations but rather would have entered into other commercial relations: the arm's length conditions must be based on those other commercial or financial relations
- Parties dealing at arm's length would not have entered into commercial or financial relations: the arm's length conditions must be based on the absence of commercial or financial relations.

Debt interest

In the context of identifying an arm's length interest rate on intergroup debts, the new rules also require a determination of the arm's length creditworthiness of the borrower. This requires not only a consideration of the arm's length interest rate but also the arm's length debt amount.

SELF-ASSESSMENT

Unlike the previous Transfer Pricing Law, which required a determination by the Commissioner, for upwards assessments of taxation liabilities, the new measures apply on a self-assessment basis. In other words, taxpayers must review their own transfer pricing arrangements, and where such a review indicates that transfer prices were such that taxable income is less than would be the case where dealings were at arm's length, adjust such taxable income upwards. Downward adjustments resulting in reduced taxable income cannot be self-assessed.

PERIOD FOR AMENDED ASSESSMENTS

In the absence of fraud or evasion (where there is no time limit imposed on the Commissioner of taxation to amend assessments) there is a seven year time limit on the Commissioner's power to amend assessments involving transfer pricing. This is in contrast to the unlimited amendment period under the old transfer pricing rules.

DOCUMENTATION REQUIREMENTS

While there is no requirement to prepare contemporaneous documentation supporting the transfer pricing position of a taxpayer, a failure to prepare such documentation will preclude the taxpayer from relying on the reasonably arguable position (RAP) defence against taxation penalties resulting in, effectively, a minimum 25% of tax shortfall penalty.

To satisfy the new transfer pricing documentation requirements, documentation must:

- Be prepared by the time of the lodgement of the relevant income tax return
- Be held by, or freely accessible to, the Australian taxpayer. Documents held offshore that are available upon request will not be sufficient, and cannot later be relied on as evidence of documentation kept at the date of lodgement
- Consider the application of the Australian law, including the 'reconstruction' provisions
- Explain how the taxpayer's transfer pricing analysis best achieves consistency with OECD guidance.

Failure to maintain contemporaneous documentation will result in the inevitable imposition of penalties (up to 50% of an adjustment) if the Commissioner challenges the taxpayer's transfer pricing. The Australian Taxation Office (ATO) requires taxpayers to consider 'five key questions' in documenting their transfer pricing position (previously a 'four step' approach) as follows:

- What are the actual conditions that are relevant to the matter (or matters)?
- What are the comparable circumstances relevant to identifying the arm's length conditions?
- What are the particulars of the methods used to identify the arm's length conditions?
- What are the arm's length conditions, and is/was the transfer pricing treatment appropriate?
- Have any material changes and updates been identified and documented?

The five key questions are unique to Australia. In practice, this means a taxpayer will need to prepare specific Australian transfer pricing documentation or to 'localise' any group OECD documentation in order to achieve a RAP.

DE MINIMIS RECORD KEEPING CONCESSIONS

The ATO has introduced an online *Simplified Transfer Pricing Record Keeping* options guide, which provides relief from preparing full transfer pricing documentation for certain categories of (smaller) taxpayers and perceived lower risk transactions. This is in recognition that preparing documentation to meet all of the new documentation requirements may impose an administrative burden that may be disproportionate to an entity's risk of not complying with the rules in certain circumstances.

Where a taxpayer is eligible and opts to rely on a simplified option, it will not need to prepare documentation in accordance with the new rules. It will however need to maintain records to evidence its eligibility to apply the simplified option, and retain records in keeping with the general record keeping requirements under the Australian Tax Law.

Subject to additional limiting criteria, the Simplified Transfer Pricing Record Keeping options are available for:

- Small business taxpayers with Australian economic group turnover of up to AUD 25 million
- Distributors with Australian economic group turnover of up to AUD 50 million and with a profit before tax ratio of 3% or greater
- Intragroup service dealings (being non-specified (i.e. non-core) services) of AUD 1 million or less (*the de-minimis* rule), or if greater than AUD 1 million: no more than 15% of the total expenses of the Australian economic group for services received, with the mark-up on costs no greater than 7.5% (this mark-up on costs also applies to *de-minimis* services received)
- No more than 15% of the total revenue of the Australian economic group for services provided, with mark-up on costs no less than 7.5% (this mark-up on costs also applies to de-minimis services provided)
- Low level intragroup loans where the combined cross border balance is less than AUD 50 million for the Australian economic group (at all times throughout the year), and where the inbound loans interest rate is no more than the Reserve Bank of Australia (RBA) indicator lending rate for '*small business; variable; residential-secured; term*' loans.

In all of the above cases, certain additional criteria must also be met which limit the circumstances in which a taxpayer may opt to rely on the simplified record keeping options. Such criteria include, for example: not having three years of consecutive (sustained) losses; not having related party dealings involving entities in specified (e.g. tax haven) countries; not having undergone a business restructure for the year in question; and not having related party dealings involving royalties, license fees or R&D arrangements.

In practice many groups still may choose to prepare more comprehensive transfer pricing documentation in order to comply with transfer pricing regulations in other countries (i.e. to support returns of Australian subsidiaries) or where transfer pricing is part of a strategic planning review. This will be more so once the OECD country by country reporting requirements are implemented by relevant countries.

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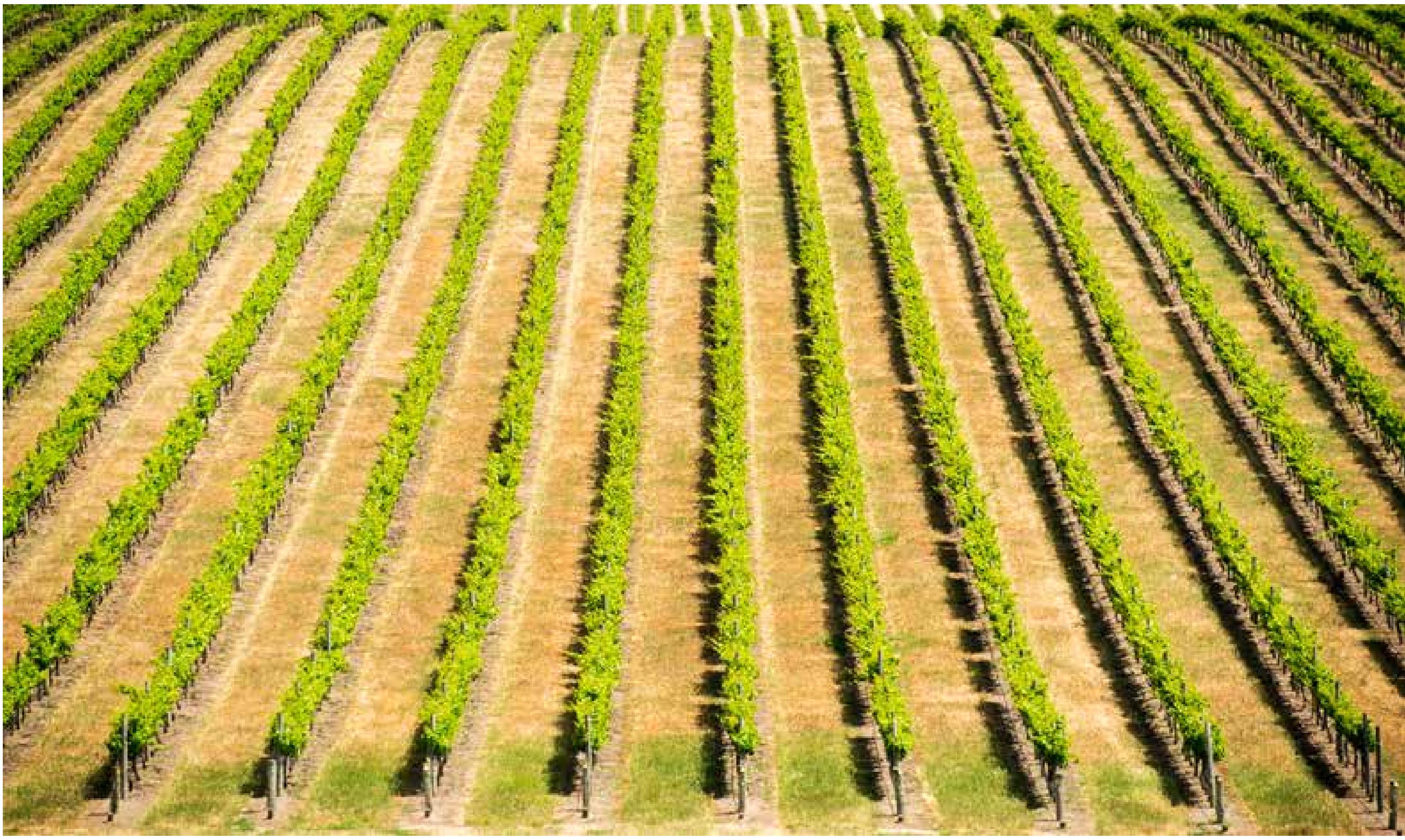

CHINA

TAX AUTHORITY VIEWS TRANSFER PRICING AS MOST IMPORTANT BEPS ACTION PLAN ITEM

BACKGROUND

The United Nations (UN) subcommittee on Base Erosion and Profit Shifting (BEPS) Issues for Developing Countries recently released China's responses to its questionnaire about countries' experiences regarding BEPS issues, along with responses received from other developing countries.

BEPS refers, in part, to tax planning techniques by companies that exploit gaps in international and domestic tax laws, as well as mismatches between different domestic tax systems, to shift profits. As a result, corporate tax rates are often unduly low and not necessarily reflective of the realities of the underlying economic transactions.

In 2013, the Organisation for Economic Cooperation and Development (OECD) and the Group of Twenty industrialised nations (G20) jointly established the BEPS project to address global concerns about BEPS. In its plan to address BEPS, the OECD set out 15 action items in areas such as transfer pricing, permanent establishment, harmful tax practices, and treaty abuse.

In response to the UN questionnaire in late 2014, the Chinese State Administration of Taxation (SAT) said that it views the transfer pricing actions of the international project to combat base erosion and profit shifting as the most important items in the project. We have summarised the SAT's responses below.

COMMON PRACTICE AND STRUCTURE

The SAT identified certain BEPS practices and structures used by multinational enterprise (MNE) groups in China to lower the profits of its Chinese subsidiaries, in its response to the UN's questionnaire. These practices and structures include the use of transfer pricing principles and methods involving related-party purchase and sale transactions, equity transfer transactions, financing transactions, and service provision transactions. In addition, the use of shell companies with no genuine economic substance in the low–tax jurisdictions and tax havens are commonly seen.

TRANSFER PRICING AND BEPS DATA ANALYSIS

The SAT views transfer-pricing-related actions as most important to China. BEPS Actions 8, 9, and 10 exist to ensure that transfer pricing outcomes are in line with value creation, with Action 8 focusing on intangibles, Action 9 focusing on risks and capital, and Action 10 focusing on other high-risk transactions.

In addition, the SAT believes that Action 11, Establishment of Methods to Collect and Analyse Data on BEPS, "will be increasingly important to us" and "is something that developing countries should work hard on." The SAT said China currently does not have a system which quantitatively analyses base erosion in China.

TRANSFER PRICING DOCUMENTATION AND COUNTRY-BY-COUNTRY REPORTING

The three-tier approach for transfer pricing documentation proposed by OECD in Article 5 illustrates a master file, a local file and a separate country-by-country reporting template. The OECD revised the transfer pricing documentation requirement expecting to reflect the implication of the BEPS action, which is to highlight those low-tax jurisdictions where a significant amount of income is allocated without proportionate presence of employees.

Now, the SAT is revising implementation rules of special tax adjustment (Circular 2) to provide guidance for China's domestic requirements on transfer pricing documentation. In addition to the country-by-country reporting template, taxpayers in China may be requested to disclose more information regarding interest, royalty and related-party service fees.

OTHER IMPORTANT BEPS ACTIONS FOR DEVELOPING COUNTRIES

The SAT stated that other BEPS actions that are important to developing countries include Action 14, which seeks to make dispute resolution mechanisms more effective. "With the increase in disputes between tax jurisdictions resulting from a rise in transfer pricing audits, more [mutual agreement procedure (MAP)] cases have emerged in bilateral negotiations." Therefore, the SAT advised laying out an action plan on how to resolve MAP cases during bilateral negotiations.

The SAT states that another important action is Action 1, which addresses the tax challenges of the digital economy. The increase in online transactions raises difficult questions about how to tax these transactions. The SAT suggested the BEPS plan should "consider how to tackle the challenges of digital economy on the existing tax systems and the revenue base."

GENERAL ANTI-AVOIDANCE RULES (GAAR)

In addition to the 15 BEPS actions, the SAT has suggested that developing countries establish GAAR to combat BEPS, close tax loopholes and deal with business activities with no genuine substance.

In December 2014, the SAT published the Administrative Measures of GAAR, which will be effective from 1 February 2015.

PRIMARY OBSTACLES

To determine whether the appropriate amount of profit is reported in China, the SAT said China will audit the MNE group's annual filing, review contemporaneous documentation, consider the profit levels of the industry and comparable companies, and perform functional analysis.

China is facing two major obstacles in assessing whether the appropriate amount of profit is reported in China and ensuring that tax is paid on such profit. First, the SAT has said, China has a lack of comparable companies. China's domestic legislation requires listed companies to make disclosures, but unlisted companies are not required to do so. The SAT said that it is not realistic to find comparables from the 2,000 listed companies in China. Second, companies are not cooperative. The SAT has said companies are not willing to provide the tax authorities with necessary information, such as resale prices. The companies' reluctance to cooperate makes it more difficult to conduct tax audits in China.

CONCLUSION

Transfer-pricing strategies involving related-party transactions will continue to be a hot topic in China and are likely to receive greater scrutiny. The Chinese tax authorities are likely to demand that a greater portion of the profits in the value chain should be allocated to China. Multinational groups should continue to evaluate any new and existing tax structures to take into account the SAT's preferred treatment of these transactions.

Specifically, BDO would recommend that taxpayers in China evaluate the transfer pricing position in the disclosure of annual corporate income tax filing and the transfer pricing documentation report. For multinational groups that have significant royalty and service charges from overseas, special attention must be given, starting from the design of the charge model to the implementation for remittance purpose. We are expecting more and more challenges from Chinese tax authorities on outbound royalty/service fee payments, which may result in difficulties for Chinese taxpayers to claim deductions, as well as further potential transfer pricing investigations.

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JAPAN

GOVERNMENT PLANS CORPORATE TAX REDUCTIONS

The Government has agreed a programme of corporate tax reductions over the next few years, in order to make Japan's corporate tax regime more competitive internationally, with a view to encouraging economic growth and increasing wages.

The first reduction, from the current 34.6% rate to 32.1%, is proposed for the year commencing 1 April 2015.

A further reduction, to 31.3%, is then proposed for the year commencing 1 April 2016.

It is then hoped to reduce the rate to below 30%, to a more internationally competitive level.

The proposed reductions will be partly financed by broadening the tax base, including restricting the deductibility of carried forward net operating losses from the current maximum of 80% of taxable income to 50% of taxable income in 2017, but extending the carry forward period from nine to ten years.

Although only about 30% of Japanese companies currently pay tax, the proposed rate reductions and tax base broadening measures are expected to result in net reduced tax revenue of over JPY 200 billion in the next two years.

In order to help regional growth, businesses based in Tokyo will also be offered tax incentives to relocate to other areas.

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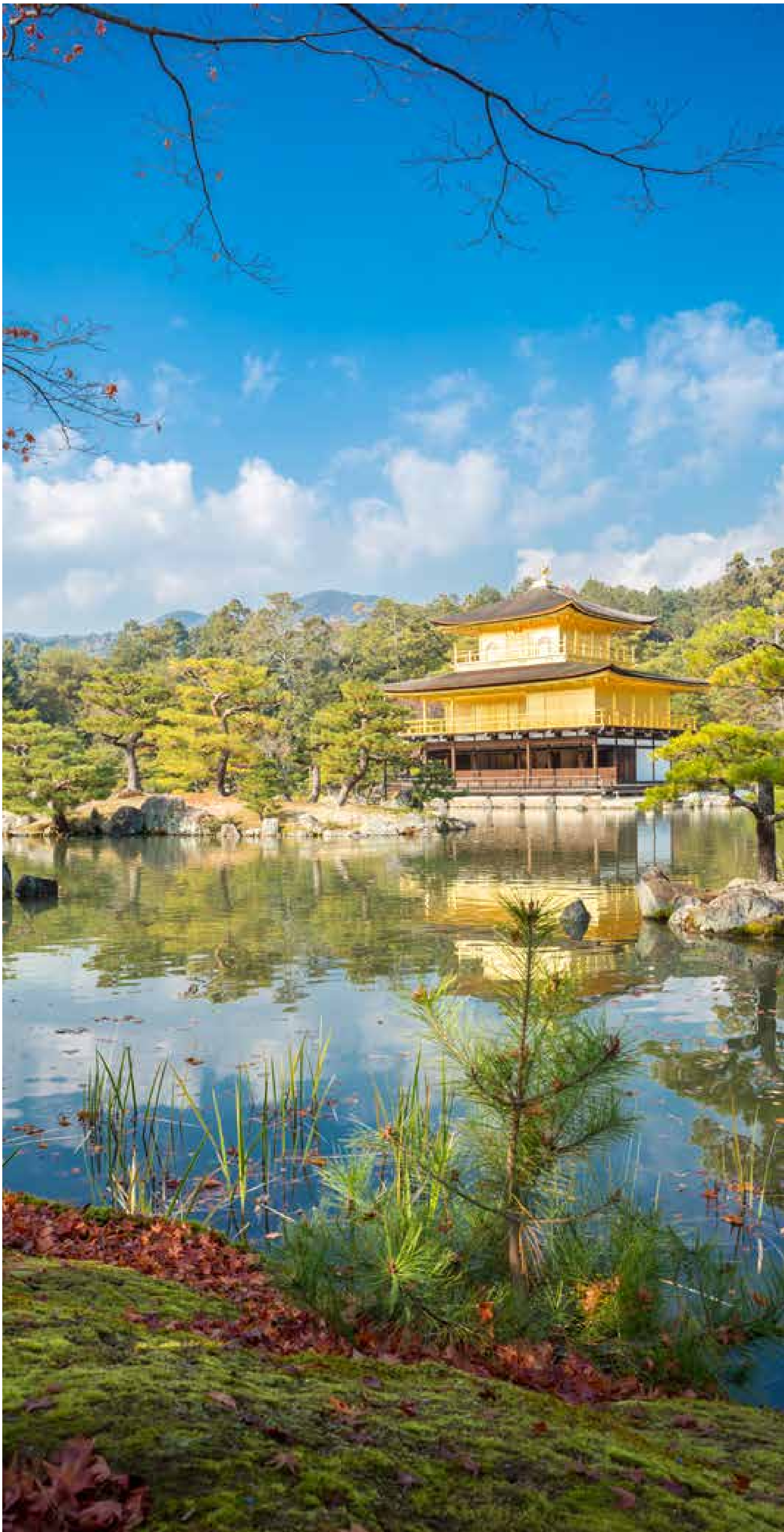

EUROPEAN UNION

EUROPEAN COMMISSION EXTENDS ENQUIRY INTO TAX RULINGS

On 17 December 2014 the European Commission (EC) announced that it would enlarge its enquiry under the state aid rules into tax rulings given by EU Member States to cover all Member States.

In 2013 the EC asked seven Member States (Cyprus, Ireland, Luxembourg, Malta, the Netherlands, the UK and Belgium) to provide information on tax rulings. As a result, formal investigations were opened in 2014 in the following cases: Ireland (Apple), the Netherlands (Starbucks), and Luxembourg (Fiat Finance& Trade and Amazon).

The Commission will now ask all 28 Member States to confirm whether they give tax rulings and, if so, to provide a list of all companies that have received such a ruling from 2010 to 2013.

The Commissioner in charge of competition policy, Margrethe Vestager, stated: "*We need a full picture of the tax rulings practices in the EU to identify if and where competition in the Single Market is being distorted through selective tax advantages. We will use the information received in today's enquiry as well as the knowledge gained from our ongoing investigations to combat tax avoidance and fight for fair tax competition.*"

The key issue in the Commission's enquiries will be whether the tax rulings in question gave the recipient a selective advantage because they were not established according to the arm's length principle. If the Commission finds that a tax ruling granted by a Member State conferred a selective advantage on the recipient and amounted to unlawful State aid, it may order recovery by the Member State of the tax that otherwise would have been paid by the recipient of the ruling.

The extended enquiry will inevitably result in a period of uncertainty for Member States and affected companies, as they wait to learn whether the EC considers that state aid rules have been breached in any cases.

The EC has also stated that in the interests of increased transparency it will seek to introduce a Directive that will require all Member States to publish details of future tax rulings as and when they are made.

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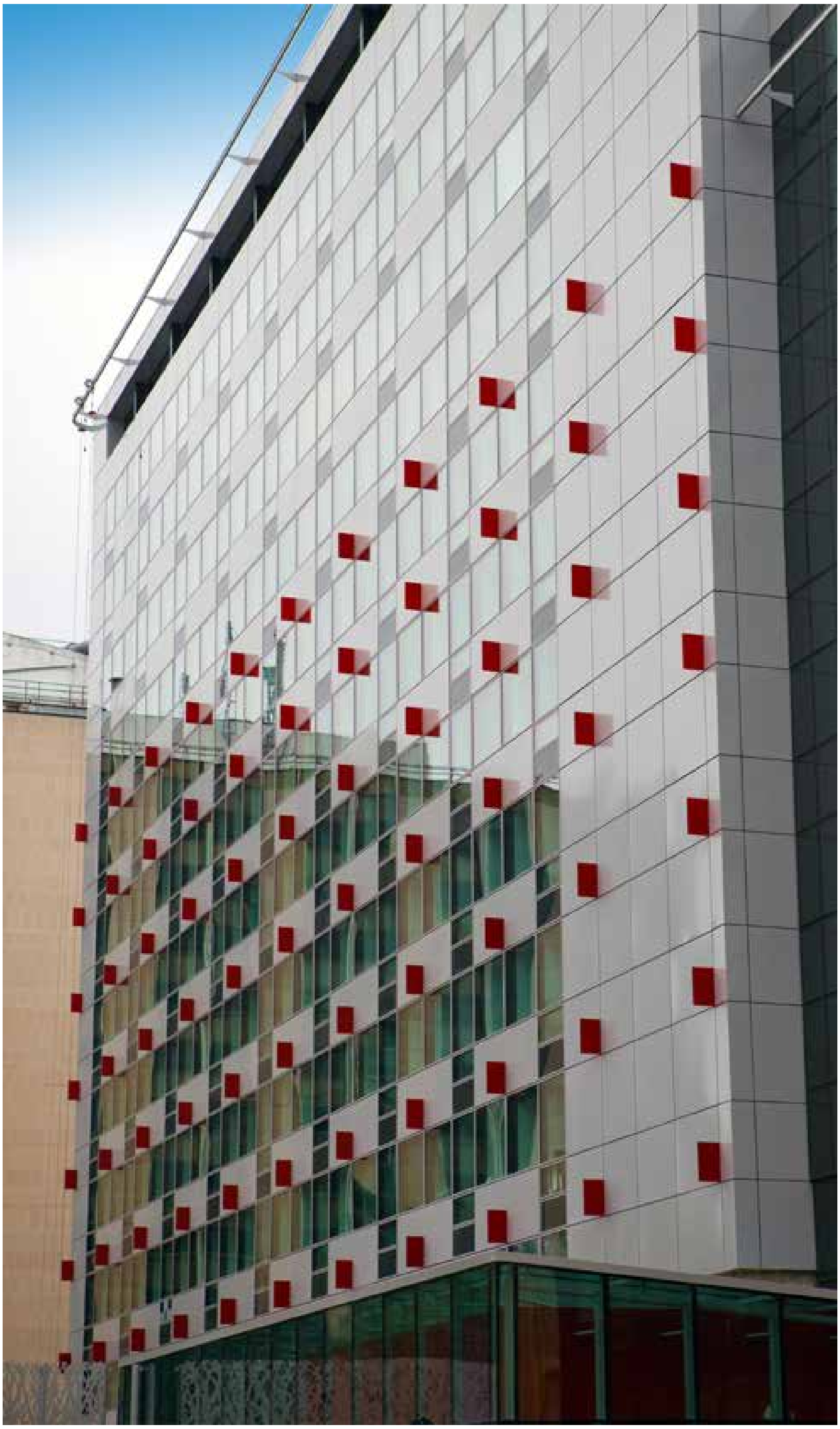

IRELAND

INTELLECTUAL PROPERTY – KNOWLEDGE DEVELOPMENT BOX

The Department of Finance has issued a public consultation paper in relation to Ireland's proposed Knowledge Development Box (KDB). The consultation period runs until 8 April 2015.

The consultation paper outlines the Irish Government's intention to introduce a "best in class" income-based tax regime for intellectual property (IP) whilst also ensuring the regime complies with relevant OECD and EU requirements. To this end, the paper notes that it appears likely that a "modified nexus approach", which links the tax benefits arising under IP regimes to the amount of R&D expenditure that is incurred by companies in developing the IP, will be adopted by the OECD and EU and, as such, the design of the KDB will need to be in line with that approach.

Rumours of a potential rate of just under 5% to 6.25% have circulated in the Irish press, with the Department of Finance keen to note that any eventual rate is just one aspect that needs to be considered when developing a competitive KDB.

The paper asks respondents to answer any or all of seven queries outlined (see the full paper here: http://www.finance.gov.ie/news-centre/press-releases/department-finance-launches-consultation-process-knowledge-development).

Kevin Doyle of BDO Ireland is currently collating input on the queries raised, and welcomes international comment or queries from interested parties.

FINANCE ACT 2014 – CORPORATE TAX CHANGES

CORPORATE RESIDENCE – SO CALLED "DOUBLE IRISH" STRUCTURE

The 2015 Budget announced the elimination of the so called "double Irish" structure from an Irish tax perspective through the amendment of Ireland's corporate tax residence rules. The legislation, as initiated, was relatively straightforward in that companies incorporated by 31 December 2014 would apply the existing residence rules until 31 December 2020 (i.e. the "grandfathering" period), whereas companies incorporated from 1 January 2015 would be considered Irish tax resident by default and could only be non-Irish tax resident if they were considered resident in another jurisdiction under an Irish tax treaty.

As the draft legislation moved through the Irish Parliament, amendments were made so that the grandfathering period does not apply until 31 December 2020 if there is a change in ownership of the Irish incorporated company and a major change in the nature of the trade or activity carried on by that company to include the commencement of a trade and/or the acquisition of property and/or an interest in, or right over, property.

CAPITAL ALLOWANCES/TAX DEPRECIATION FOR INTANGIBLES

Irish tax law permits a tax deduction for the cost of expenditure on certain qualifying intangibles including patents, copyrights, trademarks and associated acquired goodwill. The write-off is on the basis of the accounting amortisation period, or an election can be made to write off expenditure over a fixed period of 15 years.

Any trade associated with the exploitation of the qualifying intangible is deemed to be a separate trade, and until the changes proposed in Finance Bill 2014, the total capital allowances, plus any deduction for related interest, was restricted to 80% of the profits of that IP trade. The 80% restriction is removed. Customer lists are also included in the assets qualifying. These changes have effect from 1 January 2015.

CREDIT RELIEF FOR R&D

Changes made in the Finance Act mean that the 25% R&D tax credit regime moves from an incremental spend basis to a volume basis through the removal of the 2003 base year. This should positively impact companies which were carrying on R&D activities in Ireland pre-2003.

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POLAND

CORPORATION TAX REFORMS

TAXATION OF CONTROLLED FOREIGN CORPORATIONS

Introduction

From 1 January 2015, Polish Corporate Income Tax (CIT) and Personal Income Tax (PIT) payers are obliged to pay tax in respect of income derived from controlled foreign corporations (CFCs) deriving their predominating revenues from sources such as dividends, shares in profits, interest, copyrights and disposal of financial instruments (so-called "passive income").

So far, Polish businesses have used CFCs to minimise tax on such income, generally by transferring CFCs to tax havens which offer preferential taxation of passive income. The new rules have been introduced to both the Corporate Income Tax Act and the Personal Income Tax Act in order to tighten the tax treatment of passive income.

However, the regulations do provide for certain exemptions, enabling avoidance of the application of the CFC rules.

Effective date

There has been a significant change compared to the original plans, in that the new regulations came into force on 1 January 2015. Originally, they were to apply from August 2015. This considerably limits the time to prepare for the application of the new rules.

Definition of CFCs

A wide definition of controlled foreign corporations has been adopted.

The new regulations apply to Polish taxpayers that control a foreign company with its registered office or management in a so-called tax haven, as well as with its registered office or management in a state that is not a tax haven, with which Poland or European Union has not signed a double tax treaty or a tax information exchange agreement.

The same rules apply when a Polish taxpayer controls a foreign company, where:

- At least 50% of revenue comes from passive income (e.g. dividends, interest, license receivables; "the passive income criterion"); and
- At least one type of passive income is subject to taxation in the state of the company's registered office or management with a nominal rate of 14.25% or lower, or is fully exempt from income tax ("the low tax criterion").

The rules will not apply to taxpayers controlling companies located in the EU or EEA, provided the entity carries on a genuine economic activity there.

Deciding whether an entity is controlled

The new regulations give a detailed description of situations when a Polish taxpayer controls a foreign company. Having such control means:

- Holding any share (applies to foreign companies with their registered office or management in a so-called tax haven or a state that is not a tax haven, with which Poland or European Union has not signed a double tax treaty or a tax information exchange agreement – so-called "black list"); or
- Holding for an uninterrupted period of no less than 30 days, directly or indirectly, at least 25% of shares, or 25% of voting rights, or 25% of profit participation rights (applies to foreign companies located in states from outside the black list; "the level of control criterion").

Exemptions

The main exemption – applicable to all CFCs – relates to the revenue threshold (if the revenue reported by the CFC in given tax year is less than EUR 250,000, Polish CFC regulations would not apply). The second exemption relates to the substance of business activity – if the CFC carries on a genuine economic activity (using qualified personnel, certain premises, management present at site, etc.), the Polish CFC regulations would not apply either (the full exemption is available for EU and EEA countries, whereas other countries are obliged to fulfil additional circumstances in order to benefit from exemption). In other cases, Polish taxpayers should verify whether their foreign related entities qualify as CFCs.

Tax liability on income of CFCs

If it is determined that a Polish taxpayer controls a foreign company that meets the criteria to classify it as a CFC, the income earned by such a company should be separately (using a different tax return) taxed in Poland. The income will be calculated in accordance with Polish regulations, as a rule as at the last day of the tax year. Importantly, it will not be possible to deduct losses incurred by the CFC in prior years. Tax will be payable at the rate of 19%.

Action required

An analysis of existing tax optimisation plans needs to be carried out, as some plans may now need to be modified.

- The structure of the group needs to be analysed in order to identify companies that have the status of CFCs as defined by the new regulations. This is necessary due to the likely difficulties in classifying companies for CFC purposes, due to the specific nature of foreign entities, and also due to ambiguities in the new rules.
- Taxpayers must prepare required documentation standards. Groups identified as having entities classified as CFCs need to prepare appropriate procedures for the payment of tax on the CFC's income, as well as CFC related record keeping, and need to get ready to present the necessary documents within 7 days of being requested to do so by the tax authorities.
- It would be advisable to consider whether it is possible to modify the structure of the group in a way that would either reduce or eliminate the tax and administrative burdens arising out of the new regulations. The CFC regulations make it possible to avoid taxation in some cases.

THIN CAPITALISATION PROVISIONS

The thin capitalisation provisions are now more restrictive, and will be imposed on loans paid after 1 January 2015.

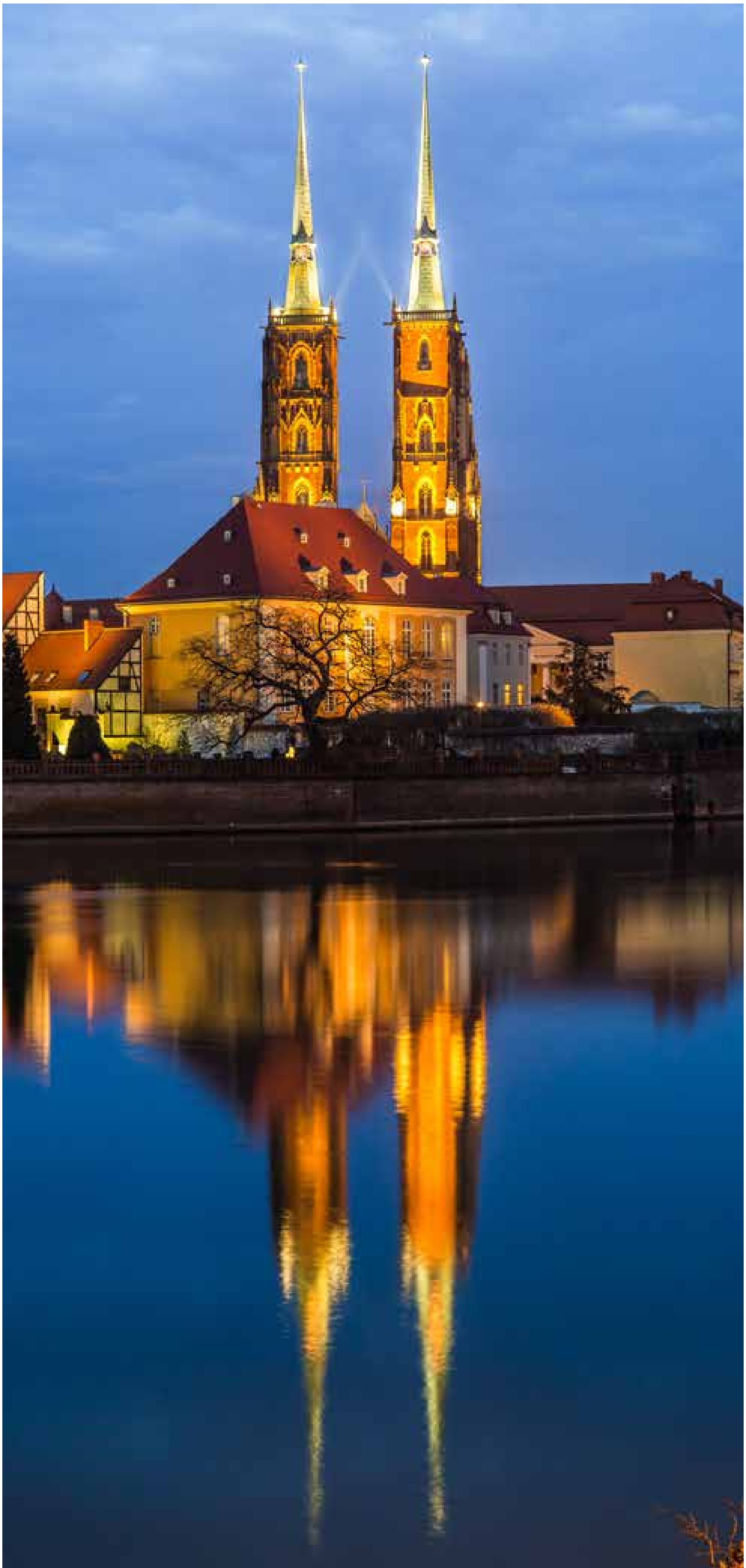
Currently, only loans from a direct shareholder and/or direct sister company are subject to thin capitalisation restrictions. The new rules will limit the deductibility of interest on a much broader range of loans (and generally on all intra-group financing).

The amended provisions introduce a 1:1 debt to equity ratio (previously 3:1) and a new definition of equity. In addition, taxpayers will have an option to use an alternative thin capitalisation calculation method based on a reference rate of the National Bank of Poland and the value of assets capped at EBIT.

TRANSFER PRICING AND TAX DOCUMENTATION

There are also amendments to provisions relating to transfer pricing and tax documentation requirements. In particular, the amendments binding from 1 January 2015 extended the transfer pricing requirements to partnerships, joint ventures or other contracts of a similar nature, including agreements with entities having their place of management in a tax haven. Starting from January 2015, the above-mentioned will constitute "transactions" triggering the obligation to prepare transfer pricing documentation.

There is also now a new requirement to document operations between a Polish taxpayer and its permanent establishment.



DIVIDEND EXEMPTION RULES

Changes to the dividend exemption rules binding from 1 January 2015 will ensure that the exemption from tax will not cover dividends received by Polish taxpayers if a tax deduction has been claimed in the country from which the dividends were paid. This may restrict using hybrid financial instruments (i.e. payments treated as interest in the country of source and as dividends in Poland).

The recent OECD Action Plan regarding hybrids provided recommendations for hybrid mismatch rules that would adjust the tax outcome in one jurisdiction to align with tax consequences in another. It suggests that domestic law provisions may:

- Deny a deduction for a payment that is also deductible in another jurisdiction;
- Prevent exemption or non-recognition for payments that are deductible by the payer; and
- Deny a deduction for a payment that is not included in ordinary income by the recipient (and so not subject to tax under CFC or similar rules).

The Action Plan recommended that the primary response is for the deduction to be denied in the payer's jurisdiction. However, in the event that the payer does not respond to the mismatch, a defensive rule can be adopted which requires the payment to be included as ordinary income in the payee's jurisdiction.

Broadly, the changes proposed by Poland (which would preclude the domestic dividend exemption from applying where a tax deduction has been claimed in the country where the dividends were paid) seem to be in line with the recommendations made by the OECD.

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SWITZERLAND

CORPORATE TAX REFORM III

Switzerland's privileged taxation system of holding, mixed and domiciliary companies has been under increasing international pressure from the European Union (EU) and the Organisation for Economic Co-operation and Development (OECD) for some years. In order to meet international taxation standards and to change the current Swiss taxation system to gain acceptance by the EU and OECD, Switzerland was forced to take some action. In December 2013, therefore, the Federal Council issued a final report on "Measurements to Strengthen Competitiveness of the Swiss Tax System", also known as "Corporate Tax Reform III (CTR III)".

The latest news on this CTR III is that on 19 September 2014 the Swiss Federal Council published a draft legislative text of a new "Federal Tax Law for Competitiveness of Business Location Switzerland". The primary goals of this new Federal Tax Law are to stabilise and keep Switzerland as a competitive business location for international firms, re-establish an international acceptance of the Swiss tax system, and protect the yield of corporate income taxes. Even if Switzerland abolishes the current tax privileges, such as those for holding, mixed, domiciliary and principal companies, it is the clear intention to keep Swiss corporate taxes competitive.

CTR III comprises an introduction to new regulations for specific earnings as well as changes to the current tax system.

Intended new regulations are:

- Introduction of an "IP Box", which reduces taxable income on IP revenue by up to 80% and which means a tax rate of approximately 10%;
- Introduction of a Notional Interest Deduction, which allows a company to deduct fictitious interest on so called "security equity";
- Reductions in current cantonal tax rates, to enforce international competitiveness of corporate tax rates.

Intended changes to the current tax system include:

- Improvement of the present participation exemption, by changing the current indirect exemption method to a direct method;
- Abolition of stamp duties;
- Change of the current 7-year limitation period for carrying forward losses to an unlimited carry-forward period for up to 80% of the annual taxable income;
- Possible tax neutral "step-up" of hidden reserves to market value, within the change from a privileged taxation to an ordinary taxation;
- Reducing the privileged taxation of dividends received by an individual to 70%, and extending its application to portfolio investments;
- Application of a capital gains tax on privately held securities for individuals.

The legislative process in Switzerland is very open and transparent. The next step is that interested parties will be able to comment on the proposed CTR III paper ("consultation process"). Afterwards, it is expected that in mid-2015 the Federal Council will issue a message on the proposed new law. Parliamentary debates are expected to start in 2016. Final enactment of the CTR III law is not expected before 2018/2019.

It is important for each company in Switzerland with an international basis to analyse the impact of CTR III on its business structure.

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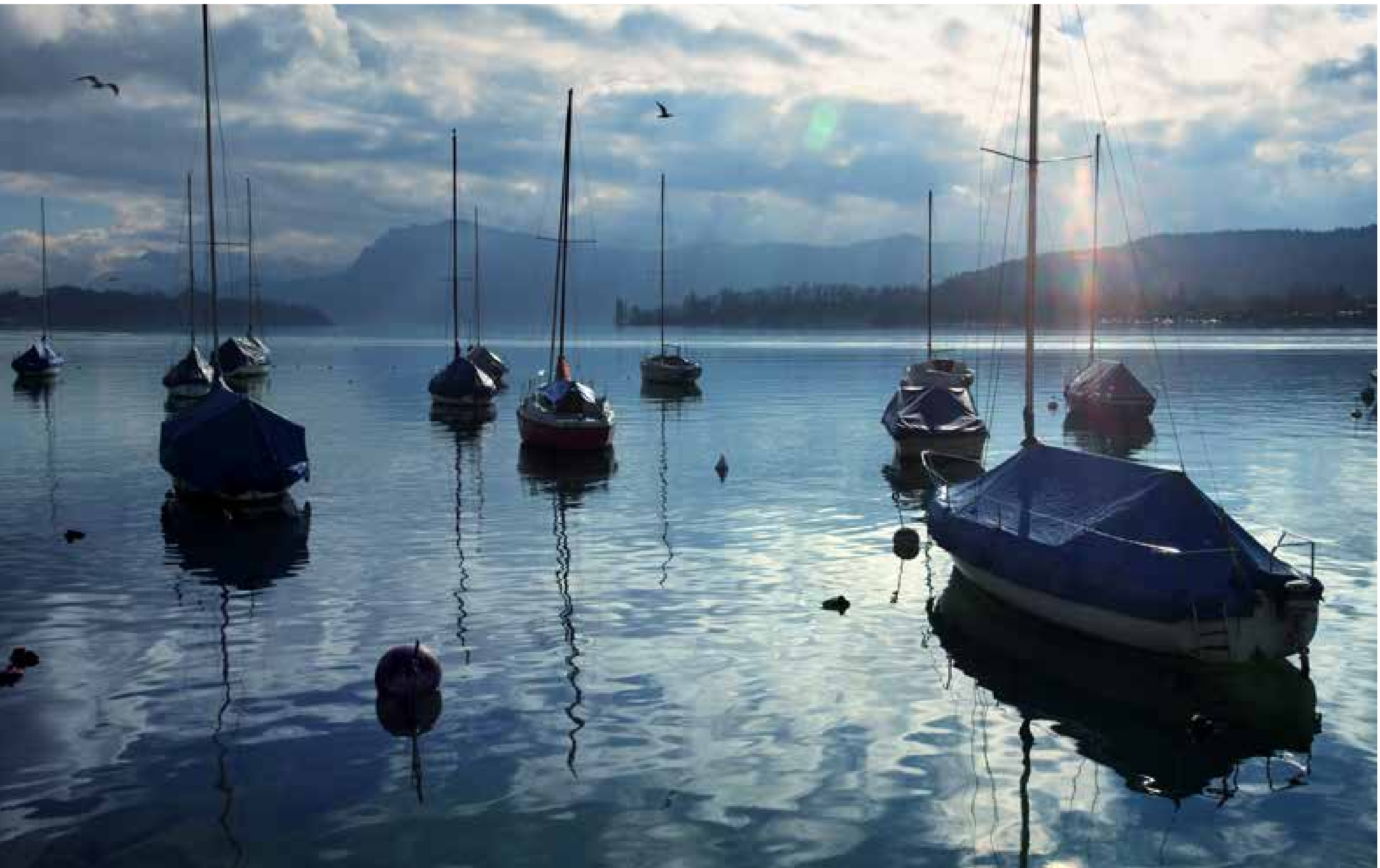


UNITED KINGDOM

DIVERTED PROFITS TAX – A REAL CONCERN FOR GLOBAL BUSINESS

In the 2014 Autumn Statement, the Government announced plans to introduce a new tax to counter the use – by large multinational enterprises – of arrangements considered to divert profits from the UK. Draft legislation, published on 10 December 2014, sets out the new Diverted Profits Tax (DPT), dubbed the 'Google tax' by the Press, that will apply to profits arising on or after 1 April 2015.

The new law targets two distinct situations:

1. OVERSEAS COMPANIES SELLING TO THE UK

The new rules will apply where an overseas company makes sales of over GBP 10m a year to UK customers but is not subject to UK corporation tax, while another person is carrying on activity in the UK in connection with supplies of goods or services made by the foreign company. An overseas company in this position will have a duty to notify HMRC that it is potentially within the charge to DPT.

Tax will be charged if HMRC believes it is reasonable to assume there is a tax avoidance purpose for, or a tax mismatch created by, these circumstances. There will be a 25% charge on the profits that are deemed to be diverted from the UK.

Large online businesses, financial service groups and IP-rich retail businesses are most likely to be affected.

2. UK COMPANIES MAKING PAYMENTS OVERSEAS

The second situation which is targeted by the new rules is where a UK company makes payments to a connected party which secure a 'tax mismatch' (see below), and where the overseas entity contributes little substance to the transaction. A company in this position will have a duty to notify HMRC that it is potentially within the charge to tax.

Tax will be charged if HMRC believes it is reasonable to assume that the overseas company's involvement was intended to result in a tax reduction of more than 20% of the tax that would otherwise have been paid.

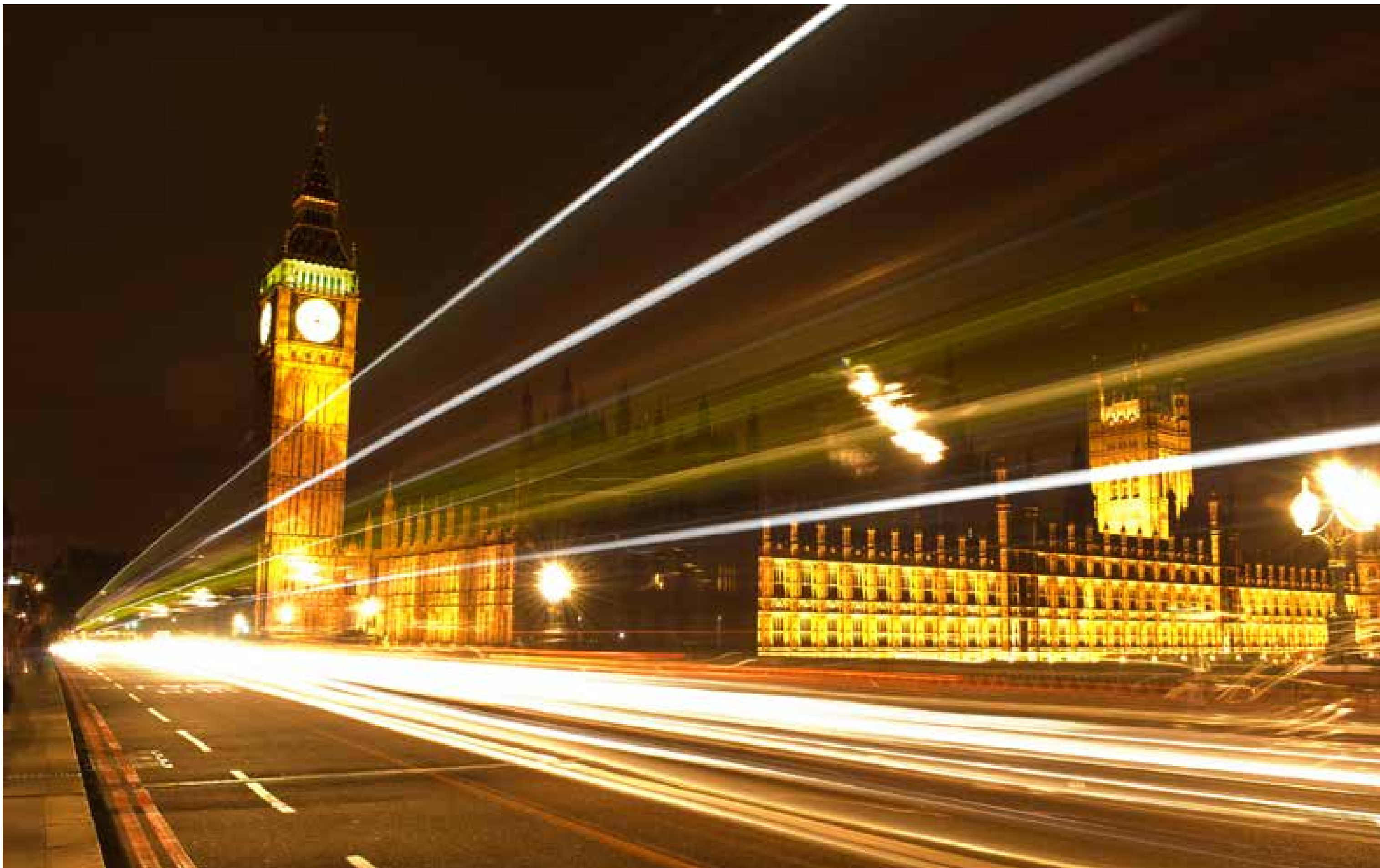
As this second rule targets UK companies making payments to low-tax overseas affiliates, it will have a broad impact, potentially affecting groups using central IP companies, centralised purchasing structures and limited risk distributors.

Example 1

A foreign company (OSco) based in a low tax jurisdiction sells goods to UK customers but has no place of business in the UK. A UK subsidiary (UKsub) provides sales support to OSco but does not conclude contracts with UK customers. There is no commercial reason why the operations are split in this way – other than to ensure that OSco avoids creating a taxable presence in the UK – so the DPT will apply.

Example 2

A UK company (UKco) and a Dubai company have a common parent. The Dubai company buys some expensive plant and machinery and leases it to UKco. The lease payments leave UKco with relatively little UK profit. The Dubai company has no full-time staff nor business activities other than leasing the machinery to UKco, and it is reasonable to think it is only involved to obtain a tax reduction – so the DPT will apply.



WHAT IS A 'TAX MISMATCH'?

Broadly, a tax mismatch will arise where a payment gives the payer a deduction at a higher tax rate, while the company receiving the payment pays tax on it in a different country at a lower rate (or is not taxed at all). However, a tax mismatch will only result in a tax charge where any one of three 'insufficient economic substance' conditions is met:

– For a single transaction, considering both parties combined, is the tax reduction greater than any other financial benefit?

– For a series of transactions, is the tax reduction greater than any other financial benefit?

– Is the overseas entity's contribution of economic value to the transaction/s (i.e. the functions performed and activities of its staff) less than the value of the tax reduction, and was the entity only involved to secure the tax reduction?

Where DPT is charged in respect of a tax mismatch, HMRC can tax the profits it would expect to have arisen in the absence of the arrangements that cause it. HMRC will have considerable latitude to assume what arrangements would have been in place in its absence.

SME EXEMPTION

The DPT will not apply where all parties to the relevant arrangements are small or medium sized enterprises.

PAYMENT BEFORE APPEAL

If HMRC issues a preliminary assessment notice, it will include an estimate of the tax due. Taxpayers have 30 days from the date of receipt of a preliminary assessment notice to make representations, but only for strictly limited reasons.

HMRC then has 30 days to issue a charging notice or confirm that no tax is due. Tax must be paid within 30 days of receiving the charging notice: there is no right to defer payment. Both penalties and interest on late paid tax will apply if the tax is not settled when due.

HMRC has 12 months from the date of issuing the charging notice to review and potentially amend it based on information provided to it by the company. There is no right to appeal against this notice when it is issued or during the review period but, once the 12 month review period expires, the company will have 30 days to appeal the charging notice, otherwise it will become final.

INTERNATIONAL LAW

As a unilateral measure, the timing of the DPT might seem surprising, given the government's strong support for the G20/OECD BEPS project and advocacy of international cooperation to address perceived tax avoidance by multinational groups.

It may also be questioned whether the DPT complies with European law, and there may be challenges in the courts.

The Government sees the DPT as a new tax which, accordingly, will not be subject to any of the UK's existing double tax treaties. Some of the UK's treaty partners may challenge that view.

LEGISLATIVE PROCESS

The draft legislation is subject to a formal consultation process (ending on 4 February 2015) but it is not expected that the substance of the proposed rules will change significantly.

Final legislation will be included in Finance Bill 2015, and the Government has indicated its intention to bring the DPT into law in March 2015, before the general election in May 2015.

IMPLICATIONS

HMRC believes the new tax will give it more and earlier information regarding tax planning structures and transfer pricing arrangements. Taxpayers have a duty to notify HMRC if they might be within DPT within 3 months of the end of their accounting period.

As the tax must be paid within 30 days of issue of a charging notice, affected companies will see a direct impact on their cash flows, and a requirement to pay tax based on an inspector's estimate, which can only be appealed after 12 months.

Furthermore, as the rate of DPT (25%) will be higher than the rate of corporation tax (20%), there will be an added incentive for groups to avoid profits being treated as "diverted", perhaps by bringing them on-shore into the scope of UK corporation tax.

WHAT SHOULD MNCS BE DOING?

Multinationals should carry out a detailed review of their existing structures and transactions with UK customers to establish to what extent the DPT may affect them. The review should identify:

– Whether the tax is likely to apply, and the potential liability

– Whether there is likely to be a duty to notify HMRC within 3 months of the end of the accounting period, as this reporting obligation has a lower threshold than the tax charge itself.

Multinationals which are affected will then wish to consider whether to approach HMRC, how best to present their case in a proactive manner to seek to avoid the imposition of an estimated tax charge (which, as noted above, cannot be appealed for 12 months), and whether or not to restructure to reduce or avoid a risk of the DPT applying.

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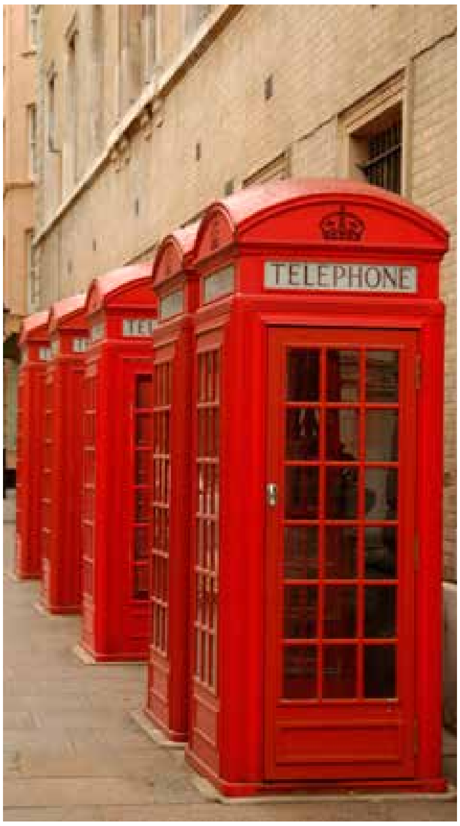

CHILE

TAX REFORMS

Law N° 20.780, published on 29 September 2014, introduced various changes. The most important changes for businesses are summarised below.

NEW TAX REGIMES

From 2017, Chilean businesses will have to choose one of the following regimes:

a. **Attributed income regime**[1]
Income will be subject to the Corporate Tax, with full credit being given on amounts attributed to shareholders. Choosing this regime will affect shareholders, who will pay taxes (Complementary Global Tax – personal tax on total income, or Additional Tax – Chilean Withholding Tax on persons not resident or not domiciled in Chile) on an attributed basis[2] from the company.

b. **Semi integrated regime**[3]
Income will be subject to the Corporate Tax, with partial credit being given towards the taxes payable by shareholders on income received on a cash basis.

In addition, a new unified regime for small and medium enterprises ("SMEs") is created. Letter A of article 14 of the Income Tax Law ("ITL") establishes a special regime for investment, working capital and liquidity. A main feature is that, as a general rule, taxpayers will pay taxes on the difference between income received and expenses paid during the relevant period.

Requirements for joining and remaining in the regime are modified; for example, an increase to 50,000 UF[4] in the limit of the annual average of received or accrued income from business sales and services:

INCREASES IN CORPORATE TAX RATE

The Corporate Tax rate will gradually be increased:

EXPENSES

Article 31 of the ITL is modified as follows[5]

a. **Related parties abroad**
Additional requirements are introduced for the deduction of expenses for amounts referred to in article 59 of the ITL, when these result from operations with parties directly or indirectly related abroad, for example, that the AT affecting such amounts is paid.

b. **Goodwill**
The tax treatment of the difference arising on a merger changes when this cannot be distributed among the non-monetary assets received from the company being acquired. In such cases, the undistributed difference will constitute an intangible asset instead of a deferred expense, as it was previously.

DISALLOWED EXPENSES

From 1 January 2017, the rate of the Sole Tax in article 21 of the ITL is increased from the current 35% to 40%.

INTERNATIONAL TAXATION

a. Articles 41 F and 59 of the ITL
The Thin Capitalisation rules are replaced[6].

b. Article 41 G of the ITL
Passive income from companies controlled abroad is taxable as received or accrued income (CFC rules)[7].

c. Article 41 H of the ITL
Regulations are introduced for determining whether or not a particular territory or jurisdiction has a preferential tax regime[8].

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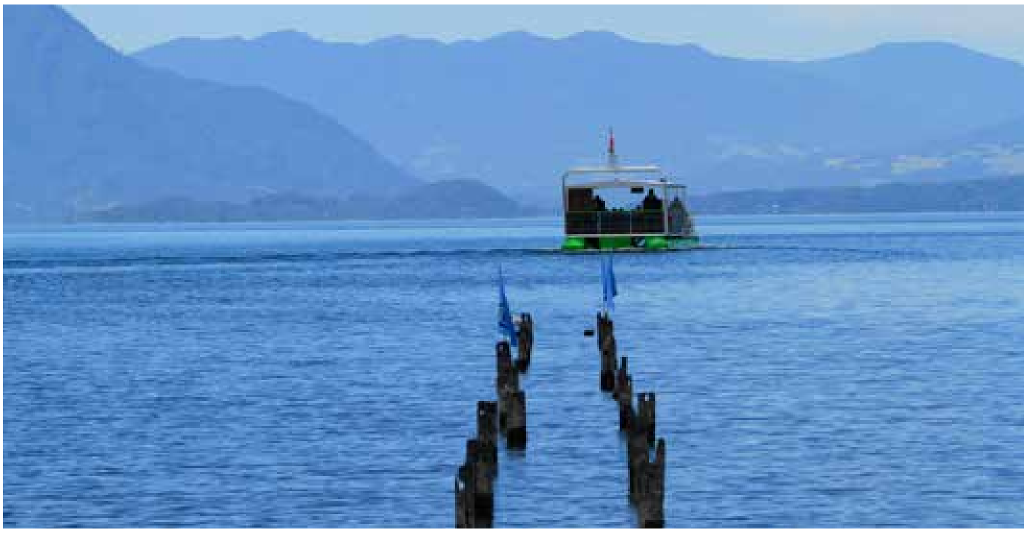

Business year	Corporate Tax rate		
	Attributed Income System	Semi Integrated System	SMEs System
2014	21%	21%	21%
2015	22.5%	22.5%	22.5%
2016	24%	24%	24%
2017	25%	25.5%	25%
2018	25%	27%	25%

[1] *Art. 14 A of the ITL (from 1 January 2017).*
[2] *Art. 2° of the ITL (from 1 January 2017).*
[3] *Art. 14 B of the ITL (from 1 January 2017).*
[4] *UF: Chilean economic unit, equivalent to USD 39, approximately.*
[5] *From 1 January 2015.*
[6] *From 1 January 2015.*
[7] *From 1 January 2016.*
[8] *From 1 January 2015.*

EGYPT

NEW INCENTIVES FOR INVESTMENT IN EGYPT

A proposed investment law is currently being drafted in Egypt. The proposed law names one authority to be in charge of investment in Egypt – the General Authority for Free Zones and Investments (GAFI) – and introduces some types of incentives that will encourage current and potential investors in Egypt.

TAX INCENTIVES AND EXEMPTIONS

Under the proposals, companies will be exempted from stamp tax and all types of notarisation fees, including those related to land registry for a period of five years from the date of inception.

It is also proposed to introduce a reduced custom duty at a fixed rate of 5% on all imported machinery, equipment and tools necessary for the company's incorporation, expansion, and renovation projects.

The law is also expected to exempt companies from sales tax on machinery, equipment, etc., necessary for the company's incorporation, expansion and renovation, in fields to be specified by detailed regulations.

The proposed law grants a five year exemption period from income tax for some activities to be specified in the detailed regulations. There are further proposed tax incentives, with a 50% tax reduction to encourage the tourism industry and industrial entities with an increased local content in the final product and labour-intensive activities.

NON-TAX INCENTIVES

Non-tax incentives include a provision that companies or establishments cannot be nationalised or confiscated. The proposed law also provides that no administrative body will interfere with the pricing of the company's or establishment's products, or determine its revenue.

The ability to remit foreign currency funds will also be guaranteed.

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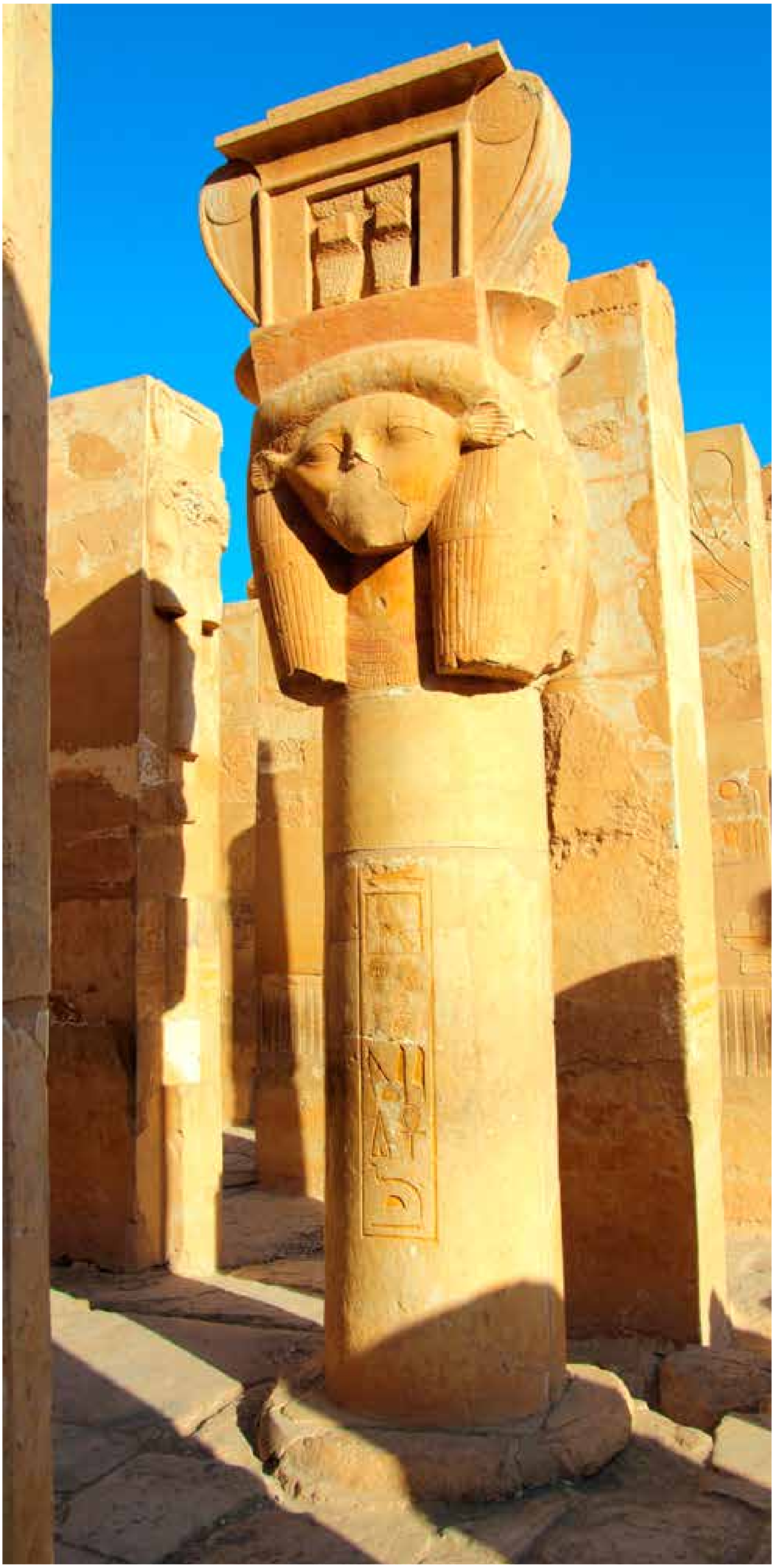

UNITED STATES

PROPOSED RESEARCH TAX CREDIT – DEVELOPMENT OF SOFTWARE

INTRODUCTION

On 16 January 2015, the Internal Revenue IRS (IRS) proposed long-anticipated and taxpayer-friendly regulations concerning the section 41 research tax credit (research credit) and its treatment of expenditure related to the development of software, both internal-use software (IUS) and non-IUS.

Under the new regulations and historically, IUS development generally must meet a higher standard to qualify than non-IUS development. The proposed regulations, however, narrow considerably the definition of IUS and thereby broaden considerably the range of software development expenditure eligible for the credit.

We outline below this and other major changes and recommended action items. Please consult the regulations for all details potentially relevant to your particular circumstances.

IUS V NON-IUS

Under the new regulations, whether software is IUS depends on the initial intent of the taxpayer and the facts and circumstances at the beginning of the software development.

The regulations move the definition of IUS closer to the language of section 41, defining IUS as software that is developed by (or for the benefit of) the taxpayer for internal use if the software is developed by the taxpayer for back-office functions of the taxpayer, namely financial management functions, human resource management functions, and support IRSs functions as internal use.

Significantly, the regulations provide that software will not be treated as IUS if it is developed to either:

- Be commercially sold, leased, licensed, or otherwise marketed to third parties
- Enable a taxpayer to interact with third parties, or
- Allow third parties to initiate functions or review data on the taxpayer's system.

Thus, if the software benefits third parties, it may not be treated as IUS as it would have been under prior law. Examples of such non-IUS software, per the new regulations, include software developed to allow third parties to execute banking transactions, track the progress of a delivery of goods, search a taxpayer's inventory for goods, store and retrieve a third party's digital files, purchase tickets for transportation or entertainment, and receive IRSs over the Internet.

DUAL FUNCTION COMPUTER SOFTWARE

The regulations provide that software that serves both general and administrative and non-general and administrative functions – "dual function computer software" – is presumed to be for internal use. However, if a taxpayer can identify a subset of elements of the dual-function software that enables third-party interaction, then the presumption will not apply to the related expenses. The research expenses identified as a third-party subset may be eligible for the research credit.

A safe harbour may be applied if a taxpayer cannot identify a third-party subset or to the remaining subset after the third-party subset has been separated – "dual function subset." The safe harbour enables a taxpayer to include 25% of the subset's qualified research expenses, as long as the third-party functions are reasonably anticipated to constitute at least 10% of dual function subset's use.

HIGH THRESHOLD OF INNOVATION TEST

Certain IUS development may qualify for the research credit if it meets the additional three-part test outlined in legislative history from 1986 and importantly modified in the new regulations.

First, the software must be innovative, as where the software results in a reduction in cost, or improvement in speed, that is substantial and economically significant. Notably, the proposed regulations abandon the higher standard of earlier regulations requiring that the software be unique and novel, and differ in a significant way from prior software implementations.

Second, the software development must involve significant economic risk, as where the taxpayer commits substantial resources to the development and there is substantial uncertainty, because of technical risk, that such resources would be recovered within a reasonable period. Importantly, the new regulations require capability or methodological uncertainty for there to be substantial uncertainty because of technical risk. Uncertainty regarding only appropriate design, sufficient for purposes of non-IUS development, is insufficient for IUS development to meet this test.

Third and finally, the software must not be commercially available for use by the taxpayer, as where the software cannot be purchased, leased, or licensed and used for the intended purpose without modifications that would satisfy the first two requirements.

EFFECTIVE DATE

The proposed regulations, once finalised, would be prospective only and effective for taxable years ending on or after the date the final regulations are published in the *Federal Register*. However, the regulations state that the IRS will not challenge return positions consistent with the proposed regulations for taxable years ending on or after 20 January 2015, the date they were published in the *Federal Register*.

COMMENTS AND PUBLIC HEARING

A public hearing has been scheduled for 17 April 2015, at the IRS Auditorium in Washington. The IRS has requested written or electronic comments, due on 23 March 2015, approximately 60 days after these proposed regulations were published. Comments on all aspects of the proposed regulations are requested, but comments on the following are specifically invited:

- The appropriate definition and treatment of connectivity software;
- The dual function computer software safe harbour; and
- Other facts and circumstances to be considered in determining whether IUS satisfies the high threshold of innovation test.

RECOMMENDATIONS

Taxpayers who pay for the development of software should:

- Review their development efforts to address specific issues and opportunities the proposed regulations create (for example, whether software treated as IUS under the old rules would be treated as IUS under the new rules, whether the significant economic risk test's clarified "substantial uncertainty" test is met, and whether any software is "dual function" software);
- Consider whether and how the proposed regulations, notwithstanding their effective date, might be leveraged to support any software development expenses under examination; and
- Consider whether and what comments or questions might be usefully submitted to the IRS to help improve the regulations.

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UGANDA

TAX TREATY OVERRIDES UNDER UGANDA'S INCOME TAX LAW

INTRODUCTION

Tax treaties are agreements between sovereign nations for the avoidance of fiscal evasion and double taxation. The treaties may be multilateral or bilateral and they generally cover taxes on income and capital.

Currently, Uganda has concluded tax treaties with Mauritius, South Africa, UK and Ireland, India, Italy, Netherlands, Norway, Zambia and Denmark. The tax treaties with Belgium, China, the East African Community (EAC), UAE, Egypt and Seychelles have not yet come into force.

Although one of the core objectives of tax treaties is to prevent fiscal evasion, they may easily be abused as they offer irresistible tax planning opportunities for non-residents. For instance, non-residents who structure their investments in Uganda through India, Mauritius, Denmark, Norway, Netherlands or South Africa would reduce the withholding tax on interest or royalties by 5%, as the applicable withholding tax rate is 10% as opposed to the standard Income Tax Act (ITA) rate of 15%. On the other hand, residents of Zambia investing in Uganda would be exempted altogether from withholding tax on dividends, interest and royalties.

Due to the propensity for abuse, many treaty contracting states, including Uganda, have enacted domestic anti-treaty abuse provisions which override the tax treaties.

In Uganda, the provisions of the tax treaties have the same efficacy as the provisions of the ITA (Section 88 (1) of the ITA). In the event of an inconsistency between the ITA and the tax treaty, the tax treaty prevails, unless the inconsistency relates to Section 88 (5) of the ITA or Part X of the ITA which deals with tax avoidance (Section 88 (2) of the ITA).

CHANGES FROM 1 JULY 2014

From 1 July 2014, Uganda has broadened its treaty override by amending Section 88 (2) of the ITA with the effect that in addition to the Section 88 (5) and Part X tax treaty overrides as explained above, any other law of Uganda dealing with the matters covered by the tax treaty, would prevail in case of an inconsistency with the tax treaty.

According to Section 88 (5) of the ITA, where an international agreement provides that income derived from sources in Uganda is exempt from Ugandan tax, or the application of the treaty results in a reduction in Ugandan tax, the benefit of that exemption or reduction is not available to any entity which, for the purposes of the agreement, is a resident of the other contracting state, where 50% or more of the underlying ownership of that entity is held by an individual or individuals who are not residents of that other contracting state for the purposes of the agreement.

Therefore, any persons (particularly companies wishing to benefit from the advantages of Uganda's tax treaties) should ensure that the majority ownership of the vehicle through which the investment is structured is held by residents of Uganda's treaty partner state, in order to comply with the provisions of Section 88 (5) of the ITA above.

EFFECT OF CASE LAW

As a result of the broadening of Uganda's treaty override provisions as explained above, the Uganda Revenue Authority (URA) has wide powers to challenge any tax planning centred around Uganda's tax treaties, not only through Section 88 (5) of the ITA and Part X of the ITA which deal with tax avoidance but also through any other law of Uganda dealing with the matters covered by the tax treaty.

In case of a legal challenge of the tax treaty override under the ITA, the ruling of the Commercial Court Division of the High Court, in the *Heritage Oil & Gas Ltd v Uganda Revenue Authority case* (Civil Appeal No. 14 of 2011), (where the contractual obligations of the Government of the Republic of Uganda regarding arbitration, arising from a Production Sharing Agreement for petroleum exploration, development and production, were discussed in so far as they relate to the provisions of statute law), would provide persuasive authority in favour of the URA.

In that case, while agreeing with the judge's position in *K.M. Enterprises and Others v Uganda Revenue Authority* (HCCS No. 599 of 2001) that the exercise of statutory powers cannot be fettered or overridden by agreement, the High Court decided that taxation (which is the most reliable source of funds for most developing economies) should not be subjected to the whims and negotiation skills of contractors and government officials, as this would create uncertainty and inequity over amounts payable, and cause economic instability.

While tax treaty overrides are controversial – as they tend to be unilateral and they undermine the certainty with respect to tax matters which the treaty contracting states and the international investors expect – it may be argued that as the prevention of fiscal evasion is just as important as the avoidance of double taxation, the tax treaty overrides which protect against treaty abuse only offer an extension of the core objectives of the tax treaties.

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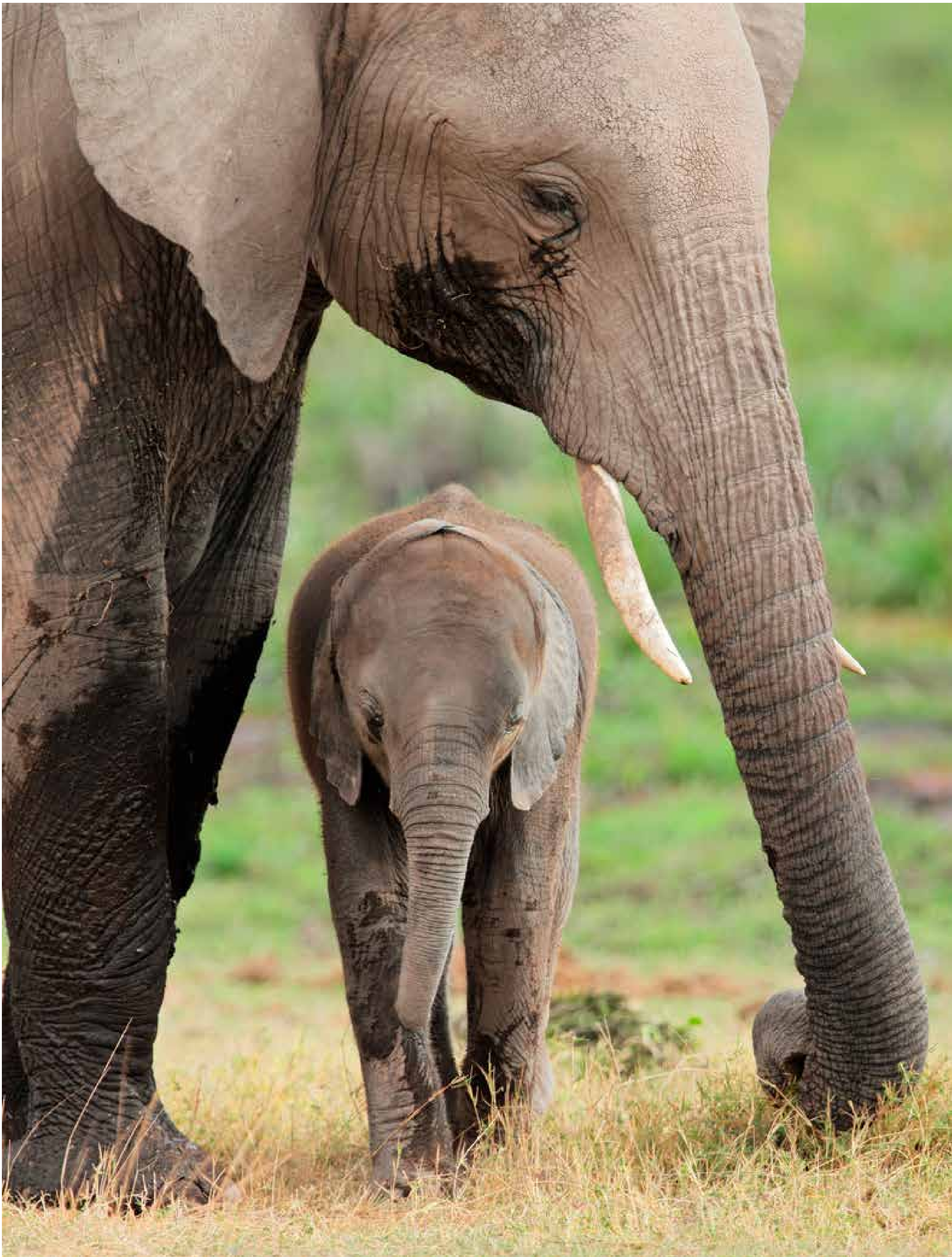

CURRENCY COMPARISON TABLE

The table below shows comparative exchange rates against the euro and the US dollar for the currencies mentioned in this issue, as at 10 February 2015.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
Australian Dollar (AUD)	0.68786	0.77904
British Pound (GBP)	1.34512	1.52349
US Dollar (USD)	0.88286	1.00000

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