International Tax News

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Welcome

Keeping up with the constant flow of international tax developments worldwide can be a real challenge for multinational companies. International Tax News is a monthly publication that offers updates and analysis on developments taking place around the world, authored by specialists in PwC's global international tax network.

We hope that you will find this publication helpful, and look forward to your comments.

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In this issue

Tax Legislation
Australia

Government committed to company tax cuts

The Treasury Laws Amendment (Enterprise Tax Plan No. 2) Bill 2017 was introduced into the House of Representatives on May 11, 2017. The bill proposes to give effect to the remaining elements of the government's Enterprise Tax Plan to progressively lower the corporate tax rate to 25% for all corporate tax entities by the 2026-2027 income year.

PwC observation:
Australia's current corporate tax rate of 30% is one of the highest in the world. A progressive reduction is a step in the right direction to bring Australia in line with the lower headline corporate tax rates across the world. Australian franking entities should observe the impact that a lower corporate tax rate would have on the rate at which available franking credits may be utilised going forward.

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Australia

Extending the scope of Multinational Anti-avoidance Law

In the 2017-2018 Federal Budget, the government announced that it will extend the scope of the Multinational Anti-avoidance Law (MAAL) so that it will apply to corporate structures that interpose partnerships that have any foreign resident partners, trusts that have any foreign resident trustees, and foreign trusts that temporarily have their central management and control in Australia. This measure, intended to ensure the integrity of the original policy intent, will apply retrospectively from January 1, 2016.

PwC observation:
Given the increase in scope, taxpayers should assess the potential impact of the extension of the MAAL on their transactions and corporate structures. This will require a holistic analysis of various aspects of their arrangements including identifying the location and amount of foreign taxes paid, the non-tax rationale for arrangements, and the economic substance of all relevant entities; consideration of reasonable alternatives to the arrangements and whether a different tax outcome could have arisen.

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Australia

Major Bank Levy Bill 2017

The Major Bank Levy Bill 2017 was introduced on May 30, 2017 to the House of Representatives. The bill proposes to implement the 2017-2018 Federal Budget announcement to impose a bank levy on Authorised Deposit-taking Institutions (ADIs) with licensed entity liabilities of at least 100 billion Australian Dollars (AUD), effectively limiting the levy to the four major banks and Macquarie.

PwC observation:
The rationale for the introduction of the Bank Levy in Australia appears to be about the major banks making a fair and substantial contribution toward repairing the federal budget. While bank levies have been effective in raising revenues in other jurisdictions such as the UK, caution should be taken as taxing one segment or sector of the economy risks creating distortions and unintended consequences.

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Brazil

New federal tax debt settlement program

The Brazilian government on May 31, 2017, published provisional Measure (PM) 783/2017, introducing a special tax regularisation program (PERT by its Portuguese acronym) to incentivise companies to settle their federal tax debts.

Background

Under the PERT, individuals and legal entities may include any liabilities – tax related or otherwise – with the Brazilian Revenue Service (RFB) and National Treasury's Attorney General's Office (PGFN) due for payment up to April 30, 2017. The PERT covers liabilities subject to prior instalment programs as well as liabilities subject to administrative or judicial proceedings. The PERT may include all liabilities in the name of the individual or legal entity as either the taxpayer or liable party.

Taxpayers must enter the PERT by August 31, 2017.

Settlement of liabilities

As in previous tax regularisation programs, the PERT foresees the settlement of liabilities with both net operating losses (NOLs) and tax credits, as well as the option to pay in instalments. As a new feature, the PERT introduces the possibility of reducing late payment interest and fines, as well as legal costs, depending on the settlement option chosen.

Taxpayers that enter the PERT to settle RFB-assessed liabilities may opt to settle the liabilities under any of the alternatives below.

- Upfront payment in cash of at least 20% of the total outstanding liabilities, without reductions, in five monthly and successive instalments from August to December 2017; with the remaining balance settled with:
  - NOLs or tax credits, subject to the restrictions set forth in the PERT rules (see below)
  - payment in cash in 60 instalments.
- Payment in 120 monthly and successive instalments calculated based on certain percentage rates applied to the total outstanding liabilities.
- Upfront payment in cash of at least 20% of the total outstanding liabilities, without reductions, in five monthly and successive instalments from August to December 2017; with the remaining balance settled with:
  - single payment in January 2018, with reduction of both 90% of late-payment interest and 50% of fines
  - payment in 145 monthly and successive instalments, with reduction of both 80% of late-payment interest and 40% of fines, or
  - payment in 175 monthly and successive instalments, with reduction of both 50% of late-payment interest and 25% of fines.

A taxpayer can use NOLs generated from its own activities as well as NOLs generated by related group companies to the extent the NOLs have been (i) accrued by December 31, 2015 and (ii) declared by July 29, 2016.

A taxpayer may use group companies' NOLs only if the taxpayer and the group entities have been part of the same economic group from December 2015 until the time the taxpayer joins the PERT.

For PGFN-assessed liabilities, the settlement alternatives do not allow the use of tax losses or tax credits. Instead, taxpayers may opt to settle their liabilities as:

- Payment in 120 monthly and successive instalments calculated based on certain percentage rates applied to the total outstanding liabilities.
- Upfront payment in cash of 20% of the total outstanding liabilities, without reductions, in five monthly and successive instalments from August to December 2017; with the remaining balance settled with:
  - single payment in January 2018, with reduction of 90% of late-payment interest, 50% of fines and 25% legal costs (including attorney fees)
  - payment in 145 monthly and successive instalments, with reduction of 80% of late-payment interest, 40% of fines and 25% legal costs (including attorney fees), or
  - payment in 175 monthly and successive instalments, with reduction of 50% of late-payment interest and 25% of both fines and legal costs (including attorney fees).

It is important to note that the PERT provides additional benefits to taxpayers with total debts lower than 15 million Brazilian reais (BRL).

PwC observation:

The Brazilan Executive Branch created the PERT through issuance of a provisional measure. Provisional measures have the authority of law until and if the Brazilian Congress approves them within a prescribed 60-day period, plus an additional 60-day period, if extended. Changes to provisional measures during the process of conversion into law are relatively common. Therefore, it is important for taxpayers to monitor developments related to PM 783/2017.

Multinational enterprises (MNEs) with Brazilian subsidiaries that have past or present tax liabilities should evaluate the PERT. Taxpayers ability to use NOLs and tax credits could provide potential cash-flow benefits and reduce late payment interest/finds and legal costs.

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Cyprus

Cyprus releases updated requirements on Country-by-Country reporting

The Cyprus Minister of Finance (MoF) issued a new Decree on May 26, 2017, which has updated the country-by-country (CbC) reporting requirements for multinational enterprise group (MNE Groups) generating consolidated annual turnover exceeding 750 million Euro (EUR). MNE Groups with an ultimate Cyprus tax resident parent are required to file in Cyprus on an annual basis. A CbC report includes specific financial data covering income, taxes, and other key measures of economic activity by territory. Under certain conditions, a CbC reporting requirement may also apply for Cyprus tax resident entities belonging to an MNE Groups.

PwC observation:
The introduction of CbC reporting requirements in Cyprus will affect Cyprus-parented MNE Groups and Cyprus tax resident subsidiaries or Cyprus permanent establishments (PEs) of non-Cyprus-parented MNE Groups (if certain conditions are met).

In light of these requirements, affected MNE Groups should commence preparation to collect and analyse the necessary information required for preparing a CbC report given first notifications should be submitted by October 20, 2017 for year 2016.

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Proposed Tax Legislative Changes
Brazil

Brazil officially requests to join the OECD

Brazil presented an official request on May 29, 2017, to become a member of the Organization for Economic Cooperation and Development (OECD).

Although Brazil has been a member of the G20 and an observer to the OECD for several years, it is not a member of the OECD. However, this may change as Brazil has filed a formal request to join the OECD, which represents the first of a number of steps that must be taken before the country is accepted as a member of the organisation.

PwC observation:
From a tax standpoint, a relevant question is whether the request and the eventual accession of Brazil to the OECD may lead to changes in the Brazilian tax legislation, including its transfer pricing rules, which significantly deviate from the OECD standards.

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Hong Kong

Bill on extending the 15% stamp duty to acquisition of more than one residential property under one instrument by Hong Kong permanent residents

The Stamp Duty (Amendment) (No. 2) Bill 2017 (the Bill) was gazetted on May 26, 2017.

Previously, a Hong Kong permanent resident (HKPR) who does not own any other residential property at the time of acquisition of residential property will be subject only to ad valorem stamp duty (AVD) at Scale 2 rates (i.e. $100 to 4.25%) instead of the newly proposed flat rate of 15%. This is the case even if the HKPR acquires more than one residential property under one instrument because AVD is charged on an instrument basis.

The Bill would close this loophole by tightening the situation where a 15% flat rate does not apply. Pursuant to the Bill, unless specifically exempted or otherwise provided, any instrument executed on or after April 12, 2017 for acquisition of more than one residential property under that instrument will be subject to stamp duty at the flat rate of 15%, even if the acquirer is a HKPR who does not own any residential property in Hong Kong at the time of acquiring the multiple residential properties.

The Bill has to be scrutinised and approved by the Legislative Council before being enacted into law.

PwC observation:
The measure proposed in the Bill aims at addressing the public concern over the increasing trend where some HKPRs acquired multiple residential properties under a single instrument to avoid payment of the 15% flat rate. The above measure will have retrospective effect from April 12, 2017 upon enactment of the Bill.

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New Zealand

Strengthening New Zealand's interest limitation rules

The New Zealand government has proposed several arguably subtle, but definitely significant, changes to the regime. These include:

Limiting interest deductions on inbound related-party loans
The New Zealand government is not proposing to introduce an earning before interest, tax, depreciation and amortization (EBITDA) test as recommended by the Organization for Economic co-operation and Development (OECD) under its Base Erosion and Profit Shifting (BEPS) work programme. Instead, the government has proposed to cap the interest deductions of a New Zealand borrower by capping the interest rate on related-party inbound funding exceeding 10 million New Zealand dollars (NZD) based on the highest credit rating of the ultimate parent or main operating entity of the multinational group, or if there is no such entity, the New Zealand borrower. This rule would effectively apply in place of normal transfer pricing rules to price the funding for tax purposes.

Changing the way assets are measured
The way assets are measured for New Zealand thin capitalisation proposes will be amended to:

- require assets to be measured net, rather than gross, of non-debt liabilities (that is, all liabilities in the financial statements other than debt for thin capitalisation purposes and interest-free shareholder loans)
- limit asset values to those disclosed in the financial statements, rather than permitting other valuations allowable under generally accepted accounting principles (whether or not those values are used in the financial statements), and
- require assets to be valued quarterly or daily, rather than permitting annual valuation.

PwC observation:
We concur with the government's stance to not propose an EBITDA-based rule for thin capitalisation. However, in many situations, the proposed thin capitalisation changes could have significant consequences for overseas-owned entities operating in New Zealand (and, in some cases, outbound New Zealand groups). In our view, a number of the proposals are wider than necessary to deal with the concerns expressed and will significantly increase the compliance burden for taxpayers, including many who currently operate in New Zealand through low risk structures.

PwC has been closely engaged with Inland Revenue policy officials throughout the consultation process and made submissions on a number of proposals, including the following:

- The government should await the outcome of (a) OECD work on pricing related-party debt, and (b) strengthening the transfer pricing regime before introducing an interest rate cap.
- Concerns around unrealistically high-priced debt would be more appropriately dealt with in the transfer pricing regime as a 'safe harbor', and not the thin capitalisation regime – taking this approach would allow for consistency with accepted global transfer pricing principles and the OECD's work under its BEPS programme.
- The proposed reduction in assets by non-debt liabilities is not needed, but if it is retained the liabilities to be included should match those that a third party lender would take into account in considering whether to advance funds.
- Annual measurement should be retained – concerns around avoidance should be dealt with in another way such as using an average of opening and closing values, similar to a number of other jurisdictions around world.

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New Zealand

Permanent establishment avoidance

The New Zealand government has been concerned that sales activities conducted by associated entities of a non-resident seller often do not currently trigger a permanent establishment (PE) in New Zealand for the non-resident. In the government's view, 'activities designed to bring about a particular sale should potentially result in a deemed PE'.

New Zealand has already tightened up its agency PE rules in some of its treaties (e.g. Australia). These changes broadly will be more incorporated across New Zealand's treaty network following New Zealand signing up to the multilateral instrument (MLI). However, as not all of New Zealand's treaty partners are expected to sign up to the PE article of the MLI, the government has proposed new domestic PE anti-avoidance provisions that would apply to a non-resident, regardless of whether the non-resident is located in a jurisdiction that has adopted the PE article of the MLI. Inland Revenue policy officials have confirmed to PwC that these changes are intended to be analogous to the changes to be implemented by the MLI, and should not extend New Zealand's taxing rights beyond what is contemplated by the MLI.

The proposed rules are intended to capture large multinationals that:

- are part of a global group that has greater than 750 million Euro (EUR) (c. 1.15 billion New Zealand dollars [NZD] annual turnover)
- sell their products directly to New Zealand customers via an offshore entity
- utilise New Zealand-based staff to support the sales function through a New Zealand subsidiary, branch or 'dependent' persons or entities contracted to an off-shore entity, and
- do not record the New Zealand sales, or do not record a commercially appropriate proportion of New Zealand sales in their New Zealand accounts.

PwC observation:

The key question is how the new PE concept will be defined in the draft legislation. The risk of uncertainty and vague definitional wording is real and is being experienced in Australia currently in the context of their multinational anti-avoidance law.

We consider the best way to ensure the legislation is drafted appropriately is to adopt word-for-word the new OECD standard for dependent agent permanent establishments used in the MLI. That wording has already been through a rigorous process of negotiation between jurisdictions and an extensive submissions process on a global basis, and has been refined to ensure that the language is not wider than what the OECD considers it should be.

Clarity also needs to be provided around various other requirements of the new rules, including around where the line will be drawn in the new PE rule between sales and marketing. In principle, it sounds simple. However, there is a spectrum of customer relationship activity and it may be far from clear where the line will be drawn as to whether particular activities will result in the new rule applying, or whether an identified activity leads to a particular sale or not.

Another core issue is how profits should be attributed to the deemed PE. This issue is contentious globally, and New Zealand has made an explicit reservation against the authorised OECD approach (AOA) currently included in the OECD Model Tax Convention. With the old approach having been retained, the profit attributed to a New Zealand PE will not necessarily be 'arm's-length' under general transfer pricing principles or equivalent to the profit outcome that a subsidiary rather than a PE would have. Applying this approach to deemed PEs will exacerbate this existing issue. Furthermore, it does not accord with our understanding of the desired result, and does not align with the transfer pricing rules, which are intended to tax according to economic substance rather than legal form.

Overarching the uncertainties surrounding the scope of the deemed PE and the profit attribution rules is the concern that they are likely to lead multinationals to restructure their affairs so the new rule does not apply to them. The bigger risk is they may even choose to exit from New Zealand altogether, particularly given the size of the New Zealand market compared to their global operations.

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New Zealand

Strengthening the transfer pricing rules

The government has proposed changes that will further align New Zealand's transfer pricing legislation with the OECD's Organization for Economic co-operation and Development's (OECD's) transfer pricing guidelines, Base Erosion and Profit Shifting (BEPS) recommendations and Australia's new transfer pricing rules including:

- Transactions will now be explicitly able to be priced by Inland Revenue for transfer pricing adjustments based on the economic substance of the arrangement if this differs from its legal form.
- Inland Revenue will have the ability to disregard or reconstruct a transaction if the legal form of the transaction is not aligned with the commercial reality.
- The burden of proof will be shifted to taxpayers to encourage preparation of higher quality transfer pricing documentation (without introducing mandatory documentation requirements).
- The statute bar will be extended in respect of transfer pricing matters to seven years.

PwC observation:
The key question is how the new permanent establishment (PE) concept will be defined in the draft legislation. The risk of uncertainty and vague definitional wording is real and is being experienced in Australia currently in the context of their multinational anti-avoidance law.

We consider the best way to ensure the legislation is drafted appropriately is to adopt word-for-word the new Organisation for Economic co-operation and Development (OECD) standard for dependent agent PEs used in the multilateral instrument (MLI). That wording has already been through a rigorous process of negotiation between jurisdictions and an extensive submissions process on a global basis, and has been refined to ensure that the language is not wider than what the OECD considers it should be.

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New Zealand

New administrative measures proposed in New Zealand

The government has proposed a number of administrative measures which will give Inland Revenue greater power to collect information and issue re-assessments from large multinationals whose annual global turnover exceeds 750 million Euro (EUR). These proposals would only apply to disputes in relation to transfer pricing, New Zealand source income, or permanent establishment (PE) avoidance issues. The measures are intended to make it easier for Inland Revenue to assess multinationals where there is significant and persistent 'non-cooperation.

The consequences of such classification are severe. For example, it enables Inland Revenue to issue assessments prior to completion of the statutory dispute resolution process.

Other administrative changes proposed in the discussion document include:

- Any tax payable by a member of a large multinational would be collectible from any wholly owned subsidiary of the multinational in New Zealand.
- Inland Revenue's information gathering powers will be extended to information held by group members located outside New Zealand.
- If taxpayers continue to ignore Inland Revenue activities and requests for information, then the Commissioner can impose a civil penalty of 100,000 New Zealand dollars (NZD) on large multinationals that do not comply with a formal information request.
- Amending legislation to allow the Commissioner to deem an amount of income as New Zealand-sourced income where a large multinational has failed to respond to an information request under this section.

PwC observation:
Given the severity of the consequences of non-co-operation, we consider that a high threshold should be adopted to justify the consequences. Our view is that instances of non-co-operation should be specifically connected to failures to meet legal obligations imposed in the tax legislation. Furthermore, behaviours should be able to be objectively assessed and based on clear guidelines provided by Inland Revenue.

There are various uncertainties that will need to be clarified, including how the New Zealand subsidiary can demonstrate that an overseas entity does or does not have information, and how Inland Revenue can enforce if the matter is unclear. Furthermore, imposing what could potentially be a large tax liability on a New Zealand subsidiary that may have limited assets or resources seems disproportionate. There may also be other significant consequences for the New Zealand subsidiary.

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United Kingdom

Impact of UK general election on UK tax policy and legislation

The result of the UK General Election is now known. The Conservative party won the most number of seats but does not have an overall majority in the House of Commons. Theresa May will therefore continue to be Prime Minister, but now of a minority government.

PwC observation:
At the time this item goes to press, we are still waiting for the details of the legislative programme and key policies of the new government to be revealed, but tax will be a key part of those policies. Philip Hammond has been confirmed as continuing as Chancellor of the Exchequer and he has stated that the next Budget will take place in November.

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United States

Trump Administration FY 2018 budget highlights tax reform effort

The Trump Administration on May 23, 2017, released a 4.1 trillion US Dollars (USD) FY 2018 budget proposal to Congress that proposes to balance the federal budget over ten years by promoting economic growth through tax reform, regulatory relief, and infrastructure investments, and by significantly reducing federal spending. The President's budget assumes that tax reform and other policy changes will help to increase US economic growth to 3% annually, up from the 1.9% annual growth projected by the Congressional Budget Office (CBO) and the 2.0% Blue Chip projection.

The President's FY 2018 budget assumes deficit neutral tax reform, which the Administration will work closely with Congress to enact. The budget does not provide additional details on the tax reform principles announced on April 27, 2017 by Administration officials.

PwC observation:
The Trump Administration's budget reaffirms the central role of tax reform in the Administration's plan for pro-growth policies to help reduce federal budget deficits. Nonetheless, there are difficult policy issues to resolve if Congress is to enact a sustainable reform of the US tax laws and provide a more competitive tax system for business taxpayers.

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Tax Administration and Case Law
Australia

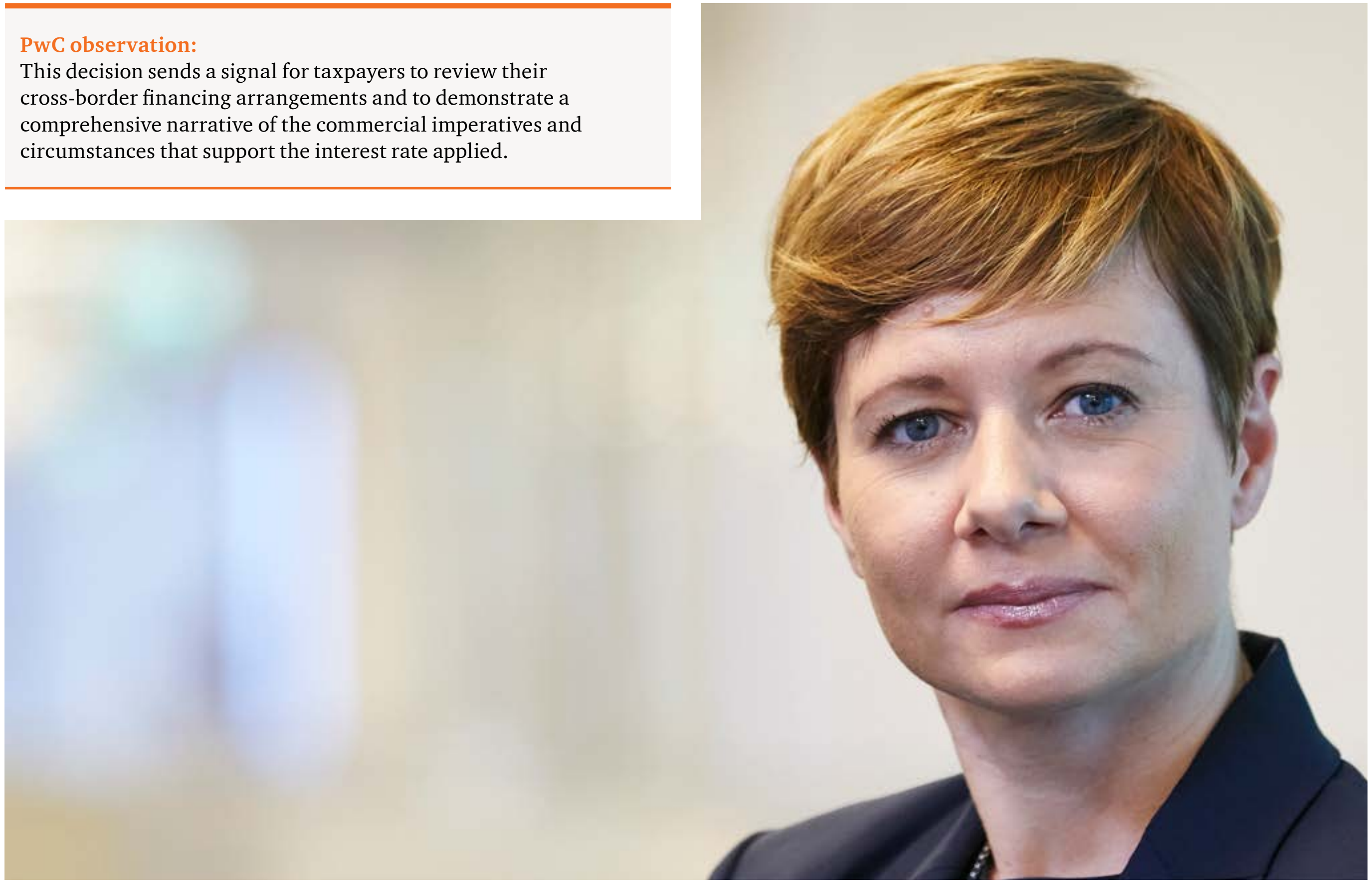
Full Federal Court dismisses taxpayer's appeal in Chevron Australia Holdings Pty Ltd v Commissioner of Taxation

The Full Federal Court in Chevron Australia Holdings Pty Ltd v Commissioner of Taxation [2017] FCAFC 62 on April 21, 2017, unanimously upheld the decision of the Commissioner to disallow a deduction claimed by the taxpayer in respect of interest incurred on loans provided to the taxpayer by a related company resident in the United States, on the basis that the interest rate applied to the loans exceeded the arm's-length rate, and thus the deductions claimed were excessive. This decision highlights the need for all taxpayers to look at the total consideration surrounding cross-border agreements when determining the arm's-length rate.

The Court held that the requirement that there be arm's-length consideration requires that you look at the total consideration the taxpayer provides under the cross-border loan agreement, which includes not just the promise to repay principal and interest, but other considerations such as financial covenants, security, and guarantees that would otherwise result in a lower interest rate payable under the terms of the loan.

This analysis enabled the Court to look beyond the simple pricing of the interest payable on the loan based on its actual terms and conditions, and to have regard to whether those other terms and conditions were consistent with what the Court considered an independent party in comparable circumstances would have agreed to.

PwC observation:
This decision sends a signal for taxpayers to review their cross-border financing arrangements and to demonstrate a comprehensive narrative of the commercial imperatives and circumstances that support the interest rate applied.



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Australia

Draft ruling on the tax residency of a company

The Australian Taxation Office (ATO) on March 15, 2017, released Draft Tax Ruling TR2017/D2 setting out the Commissioner's 'preliminary but considered view' on how to apply the central management and control test for determining the tax residency of a company that is not incorporated in Australia, following the recent High Court decision in Bywater Investments Ltd & ors v Commissioner of Taxation; Hua Wang Bank Berhad v Commissioner of Taxation (Bywater).

Please refer to January 2017 edition of this newsletter for a summary of the High Court decision.

The Draft Ruling closely follows the decision in Bywater and references the High Court judgment extensively. Some of the Commissioner's key points of view include:

- It is not necessary for any part of the actual trading or investment operations from which a company's profits are made to take place in Australia, simply having the central management and control of a business is sufficient.
- The nature of a company's activities and business define which acts and decisions are an exercise of its central management and control. Central management and control is the control and direction of a company's operations, a key element of which is the making of high level decisions that set the company's general policies, and determine the direction of its operations and the type of transactions it will enter.
- The identification of who exercises central management and control is a question of fact in each case. An individual with no formal authority who dictates or controls the directors' decisions may be deemed to exercise central management and control of the company.

PwC observation:
The Draft Ruling departs from long-established authority on the application of the relevant test and is most likely to lead to uncertainty for companies that are not incorporated in Australia where there are potential decision making 'influencers' in Australia. Should the Commissioner's view in the Draft Ruling ultimately hold, it may be difficult to draw the line in many cases, for example, does an Australian parent of a foreign subsidiary merely influence the decision making of the board of directors of the foreign subsidiary, or do they actually dictate and control the decision making?

This decision should be a red flag to foreign incorporated entities whose decisions are made via consultation with Australian advisors and other personnel located in Australia. Boards and key management personnel located overseas should ensure that they are making the substantive decisions and not merely rubber-stamping or mechanically implementing the decisions made by personnel located in Australia.

PwC Australia has lodged a submission with ATO outlining our concerns with the Draft Ruling.

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Australia

Full Federal Court finds 'buy-back reserve' account is not a share capital account in Cable & Wireless Australia & Pacific Holding BV (in liquidatie) v Commissioner of Taxation [2017] FCAFC 71

The Full Federal Court in Cable & Wireless Australia & Pacific Holding BV (in liquidatie) v Commissioner of Taxation [2017] FCAFC 71 on May 1, 2017, unanimously held that a debit entry to a 'buy-back reserve' account did not record a transaction reducing a share capital account and accordingly, the return of those funds to shareholders was subject to dividend withholding tax (WHT).

The main issue in Cable & Wireless related to the characterisation for taxation purposes of an amount debited to the 'buy-back reserve' account as part of a share buyback transaction. The Full Federal Court held that whether an account is a share capital account does not necessarily turn on how that account is described. In Cable & Wireless, even though the 'buy-back reserve' account was debited, it represented the shortfall between the buy-back proceeds and the amount debited to the actual share capital account. This was because the buy-back consideration consisted both of a return of equity (the amount debited to the actual share capital account) and a return on equity (the amount debited to the buy-back reserve account). This was distinguished from the case of Commissioner of Taxation v Consolidated Media Holdings Ltd [2012] HCA 55 when the 'share buy-back reserve' account was held to be a share capital account because it only represented the return of equity. Therefore, it was held in Cable & Wireless that the amount debited to the 'buy-back reserve' was subject to dividend withholding tax (WHT) because it represented the shortfall amount which was the return on equity component.

PwC observation:
This decision highlights to entities involved in buy-back transactions with Australian entities that an emphasis should be placed on the proportion of funds used from the true share capital account for the buy-back. The mere classification of an accounting entry under the 'share capital' account would not suffice to be deemed a return of equity and instead could result in dividend WHT liabilities. More generally, it also reinforces a pre-existing approach by the Australian Taxation Office (ATO) that accounting entries in relation to dividend payments can have a material impact on their treatment for franking, WHT, and dividend participation exemption purposes.

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Australia

Draft ATO guidance on cross-border related party financing

The Australian Taxation Office (ATO) on May 16, 2017, released Draft Practical Compliance Guideline (PCG) 2017/D4 setting out the ATO's compliance approach to cross-border related party financing arrangements. It sets out a multifaceted framework for how the ATO differentiates risks (according to six colour-coded risk zones) and how it proposes to tailor its compliance approach according to the features of the related party financing arrangement, the profile of the parties and the choices and behaviours of the multinational group.

PCG 2017/D4 seeks to 'assist' taxpayers in assessing the tax risk of a related party financing arrangement in accordance with the ATO's risk framework and understand the compliance approach the Commissioner is likely to adopt given the risk profile of a related party financing arrangement. It follows the recent decision in Chevron Australia Holdings Pty Ltd v Commissioner of Taxation [2017] FCAFC 62. When issued in final, PCG 2017/D4 will apply to both existing and newly created financing arrangements, structures, and functions from July 1, 2017.

Broadly, PCG 2017/D4 details that any pricing of a related party debt should be 'in line with the commercial incentive of achieving the lowest possible all-in cost to the borrower'. This means there is an expectation that, in most cases, 'the cost of the financing should align with the costs that could be achieved, on an arm's-length basis, by the parent of the global group to which the borrower and lender both belong'.

In assessing such related party debt, a cumulative consideration will be given to the presence of various qualitative and quantitative risk indicators beyond mere pricing. These include, but are not limited to, foreign tax rate of lender, hybridity of instruments, residency of lender, and 'exotic' features.

PwC observation:
Entities with related party financing arrangements that fall outside the low risk category can expect the Commissioner of Taxation to monitor, test and/or verify the tax outcomes of such arrangements. The higher the risk rating, the more likely an arrangement will be subject to specific ATO review and scrutiny. Taxpayers are expected to document their self-assessment of risk for related-party financing arrangements.

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Canada

Country-by-Country Reports: Canada and US

The competent authorities of Canada and the United States on June 7, 2017, signed an arrangement on the exchange of country-by-country (CbC) Reports.

The arrangement implements the CbC reporting standard that the OECD developed in connection with the Base Erosion and Profit Shifting (BEPS) Action Plan adopted by the Organisation for Economic co-operation and Development (OECD) and G20 countries. CbC reports will be exchanged between the Canada Revenue Agency and the US Internal Revenue Service on the global allocation of the income, the taxes paid, and certain indicators of the location of economic activity among tax jurisdictions where multinational enterprise groups operate. This cooperation will provide each tax administration with information to assess high-level transfer pricing and other risks related to BEPS.

PwC observation:
Canada continues to take necessary actions to implement the CbC reporting standard. CbC reports will first be exchanged for the fiscal years of multinational enterprise groups that begin on or after January 1, 2016. The reports will be exchanged no later than 15 months after the last day of the fiscal year of the group that the report relates to. However, reports for the 2016 year benefit from an extra three months and need only be exchanged within 18 months.

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Cyprus

Cyprus clarifies rules on embedded IP income for the new, nexus compliant Cyprus IP Box

The Cyprus Tax Authorities (CTA) have recently issued a circular that clarifies that Transfer Pricing (TP) studies based on the methodologies of the latest Organisation for Economic co-operation and Development (OECD) TP Guidelines (as approved by the OECD on May 23, 2016) are required to support the level of embedded intellectual property (IP) income (e.g. IP income embedded in the income from sale of goods or services) for the application of the new, nexus compliant Cyprus IP box. The Circular further clarifies that the TP study will have to be submitted to the CTA only upon request. Taxpayers should ensure that such TP study is readily available for submission if requested.

PwC observation:
This development clarifies how to determine the level of embedded IP income for the purposes of claiming the 80% deemed deduction under the new, nexus compliant Cyprus IP box. PwC is available to assist you in the preparation of the required TP studies.

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United States

Tax Court says foreign refunds affect foreign tax credits even if not yet finally adjudicated

The Tax Court held in Panagiota Pam Sotiropoulos v. Commissioner, T.C. Memo. No. 2017-075, that a United Kingdom income tax refund the taxpayer had received but was subsequently challenged by the UK tax authority must nevertheless be treated as a refund under Section 905(c). Accordingly, the Internal Revenue Service (IRS) could reduce the taxpayer's claimed foreign tax credits (FTCs) for the year in which the UK tax had originally been paid.

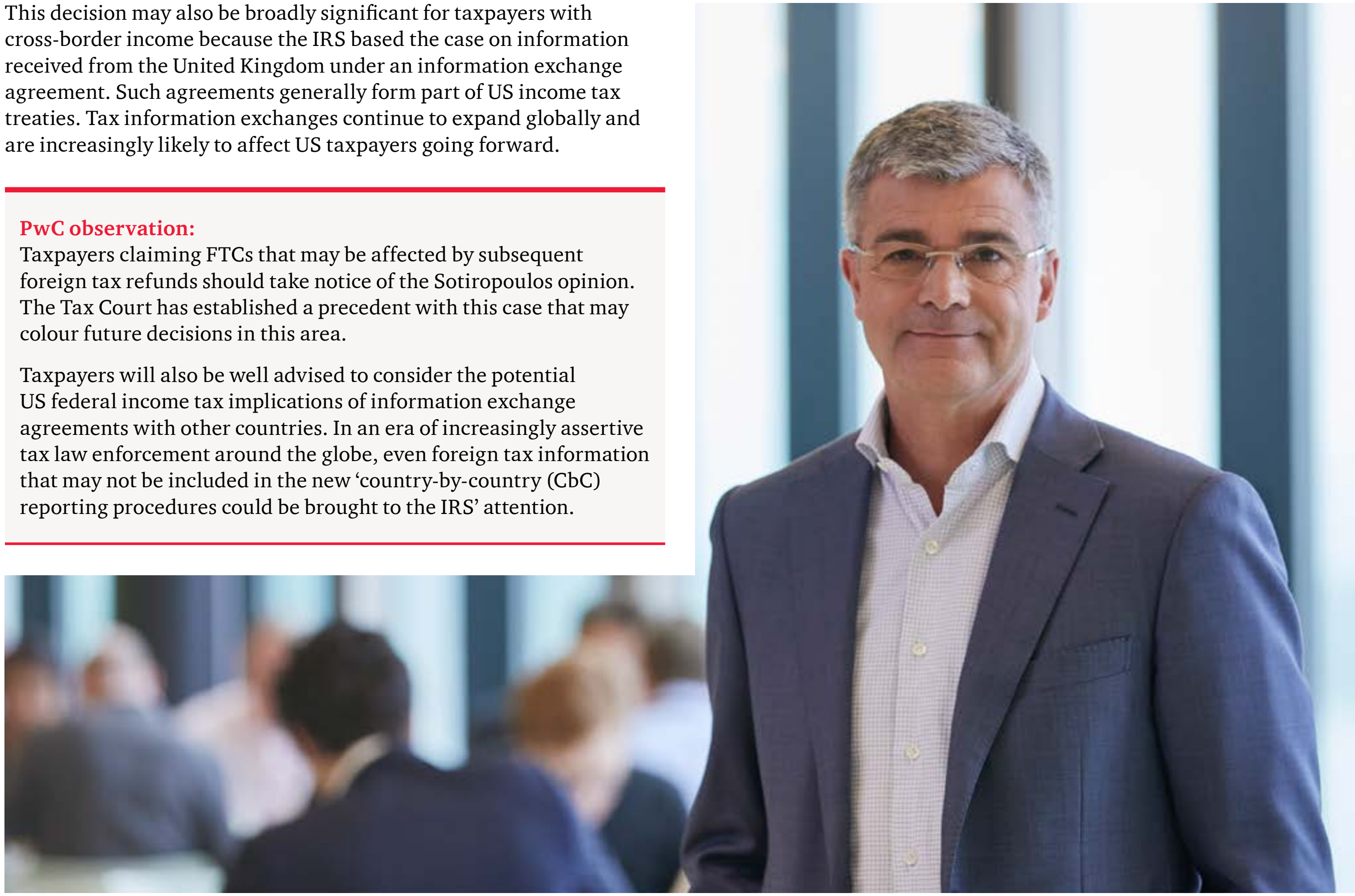
This opinion may colour future Tax Court decisions regarding the treatment of foreign tax refunds that have not yet been ultimately adjudicated. The decision applies Section 905(c) to cash-basis taxpayers using principles similar to Rev. Rul. 84-125, which means that the decision will have an impact on both corporate and individual taxpayers.

The key finding in the opinion is that the term 'refund' does not connote finality or the final determination of a tax liability for US federal income tax purposes. Just because a taxpayer might ultimately need to repay foreign taxes that were initially refunded does not mean that the taxpayer did not receive a 'refund.' The Tax Court provides the policy rationale for its opinion. If the FTCs that the taxpayer claimed on her 2003-2005 US income tax returns were not reduced to reflect the UK income tax that was refunded, she would effectively receive a double credit for the same tax."

This decision may also be broadly significant for taxpayers with cross-border income because the IRS based the case on information received from the United Kingdom under an information exchange agreement. Such agreements generally form part of US income tax treaties. Tax information exchanges continue to expand globally and are increasingly likely to affect US taxpayers going forward.

PwC observation:
Taxpayers claiming FTCs that may be affected by subsequent foreign tax refunds should take notice of the Sotiropoulos opinion. The Tax Court has established a precedent with this case that may colour future decisions in this area.

Taxpayers will also be well advised to consider the potential US federal income tax implications of information exchange agreements with other countries. In an era of increasingly assertive tax law enforcement around the globe, even foreign tax information that may not be included in the new 'country-by-country (CbC) reporting procedures could be brought to the IRS' attention.



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Treaties
Brazil

Brazilian Senate ratifies new Double Tax Treaty with Russia and amendment to existing Double Tax Treaty with India

The Brazilian Senate on May 24, 2017, ratified the text of the Convention to avoid Double Taxation between Brazil and Russia, signed on November 22, 2004, as well as the amendment to the protocol of the double tax treaty (DTT) between Brazil and India, signed on October 15, 2013.

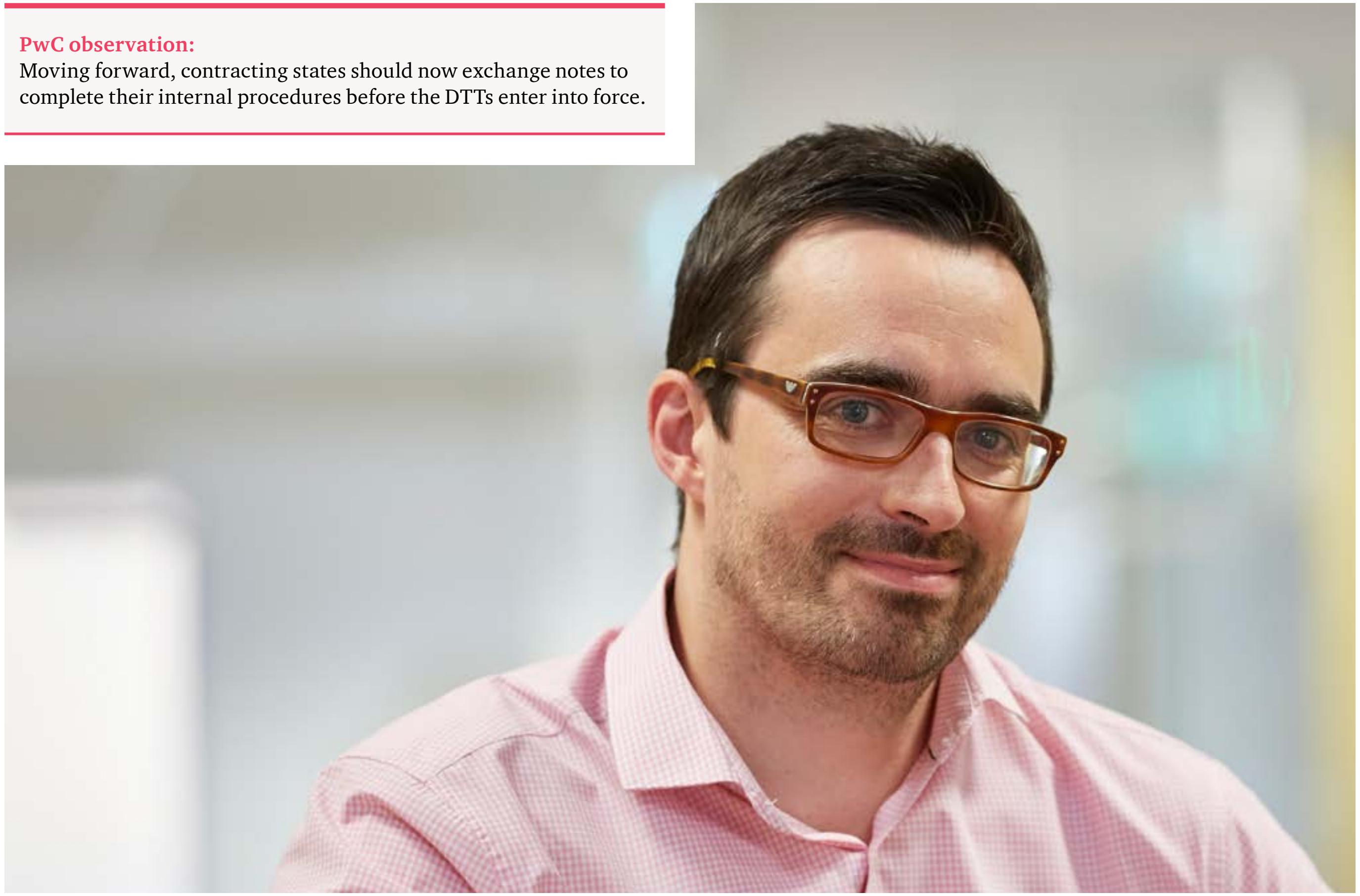
As it has become common in Brazilian DTT practice, the DTT between Brazil and Russia treats technical services and technical assistance as royalties. Further, it does not restrict the application of thin capitalisation and controlled foreign corporation (CFC) rules.

In contrast with other DTTs signed by Brazil, remittances of interest on net equity (Juros sobre capital próprio - JCP) are expressly regarded as interest, leaving no room to potential discussions on their characterisation for DTT purposes.

Finally, the DTT between Brazil and Russia includes a provision on Limitation of Benefits (LoB), aimed at preventing treaty abuse.

With regard to the ratification of the amendment to article 26 of the DTT between Brazil and India, the exchange of information (EoI) between the competent authorities is expected to improve.

PwC observation:
Moving forward, contracting states should now exchange notes to complete their internal procedures before the DTTs enter into force.



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Canada

Multilateral Instrument

Canada on June 7, 2017, joined 67 other territories in signing The Multilateral Convention To Implement Tax Treaty-Related Measures To Prevent Base Erosion And Profit Shifting (BEPS) (the MLI). The MLI covers the minimum standards and various other recommendations of Action 6 (treaty abuse) and Action 14 (dispute resolution). It also optionally covers some of the other best practices of Action 2 (hybrids) and Action 7 (permanent establishments [PE]), as well as a new optional standard on binding arbitration for cross-border treaty disputes. Canada chose to have the MLI apply to 75 of its 93 tax treaties (the Covered Tax Agreements).

PwC observation:
Canada's participation in the June 7, 2017 signing ceremony was expected and had previously been expressed by the Department of Finance. Canada has selected options to meet the minimum standards for treaty abuse and dispute resolution but has reserved on all other provisions which are considered optional. With respect to treaty abuse, Canada will adopt a principal purpose test (PPT) rule into the Covered Tax Agreements as an interim measure and Canada intends to adopt a limitation on benefits provision, in addition to or in replacement of the PPT, through bilateral negotiation. To meet the minimum standards for dispute resolution, Canada has agreed to implement a mutual agreement procedure and binding arbitration. We will have to wait for further guidance from the Department of Finance regarding which optional measures of the MLI will be adopted. The timing of when the MLI provisions and territory choices would take effect depends on how quickly it can be ratified domestically. Based on comments from the Department of Finance, the MLI could come into effect on January 1, 2019 with respect to withholding taxes (WHT) and June 30, 2019 with respect to all other taxes.

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China

China signs the Multilateral Convention and reveals provisional positions

The Commissioner of China State Administration of Taxation (SAT) together with representatives from 67 jurisdictions on June 7, 2017, attended the Organisation for Economic Co-operation and Development (OECD) signing ceremony on the Multilateral Convention (the MLI), which aims to swiftly modify bilateral tax treaties to implement the tax treaty related to Base Erosion and Profit-Shifting (BEPS) recommendations. It should be noted that when signing the MLI, China also signed on behalf of Hong Kong.

Upon signing the MLI, China submitted provisional MLI positions regarding options to be deposited with the OECD. These provisions include, but are not limited to, the following:

- China put all of its 102 existing tax treaties into the covered tax agreement except for the one with Chile, which is believed to have already adopted BEPS recommendations in many aspects. Three tax arrangements with Hong Kong, Macau, and Taiwan (not effective) are not included as they are not signed between sovereign countries.
- China opted into all the provisions of the MLI which represent the minimum standards (i.e. the principal purpose test for preventing treaty abuse and the requirement for the full implementation of Mutual Agreement Procedures) and opted out of some of the provisions that are not mandatory (such as artificial avoidance of permanent establishment (PE), simplified limitation of benefits provision under treaty abuse, mandatory binding arbitration provision, etc.).
- The MLI needs to go through the legal ratification process in a jurisdiction domestically and will then notify the OECD of the completion of the ratification process before the MLI's implemented changes on the covered tax agreements become effective. In this respect, China will need to go through the necessary domestic legislative process to ratify the MLI and deposit its instrument of ratification to the OECD. In addition, the effective date of the MLI with respect to a particular covered tax agreement of China will depend on when the MLI enters in force in both China and the other contracting jurisdiction of the covered tax agreement. According to the OECD, the first modifications to tax treaties are expected to enter into effect in early 2018.

PwC observation:
It seems that China has opted out of many of the provisions that are not required under minimum standard, especially PE. However, even if double tax treaty (DTT) texts are not to be revised by the MLI, it is likely that China's tax authority would be more cautious when offering treaty benefits under this new landscape. More importantly, the final impact of the MLI on a particular DTT of China may depend not only on the MLI position of China but also the MLI position of the other contracting jurisdictions.

For Chinese enterprises having or planning to have cross-border transactions, the MLI can be used not only as an instrument for mitigating cross-border tax risks and enhancing tax compliance, but also as a support for resolving international tax disputes to protect taxpayers' rights. In light of this, Chinese enterprises are recommended to assess the impact on their existing or potential business structures against the measures in the MLI, as well as the relevant countries' or jurisdictions' provisional positions.

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Cyprus

Cyprus - Barbados double tax treaty signed

The first double tax treaty (DTT) between Cyprus and Barbados was signed on May 3, 2017. Cyprus subsequently ratified the treaty on May 12, 2017. The DTT will take effect beginning on January 1 of the year following that in which all legal formalities to bring thet DTT into force are completed.

The DTT provides for zero percent withholding tax (WHT) rates on dividends, interest, and royalties.

Per the terms of the DTT, Cyprus retains the exclusive taxation right for capital gains on disposals by Cyprus tax residents of shares in Barbados companies (including Barbados companies holding immovable property located in Barbados), except in cases where the value of the shares derives directly or indirectly to certain offshore rights or property relating to exploration or exploitation of the seabed or subsoil or their natural resources in Barbados.

PwC observation:
This treaty further expands the Cyprus DTT network and opens the way for new investment opportunities and trade relations between the two parties.

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Cyprus

Cyprus signs the OECD/G20 BEPS project 'Multilateral Convention'

Cyprus on June 7, 2017, co-signed the Multilateral Convention (MLI) to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS) along with other signatories covering 68 territories.

Cyprus made a 28-page provisional list of notifications and reservations upon signing the MLI (Cyprus' MLI Position) and the Organisation for Economic co-operation and Development (OECD) published it on June 7, 2017. This remains subject to confirmation by Cyprus upon Cyprus' ratification of the MLI.

The main points from Cyprus' MLI Position include:

- Cyprus included all of its bilateral double tax treaties (DTTs) to be covered under the MLI except for the recently signed DTT with Luxembourg, which already incorporates the relevant BEPS project minimum standards. Whether a particular bilateral DTT of Cyprus is ultimately covered under the MLI will depend upon whether the other treaty partner to the bilateral DTT also signs the MLI and also lists the relevant DTT as covered under the MLI.
- With regard to the key minimum standard under BEPS Action 6, Cyprus' approach is to adopt the Principal Purpose Test (PPT). The PPT provides that a DTT benefit shall not be granted, if it is reasonable to conclude and considering all relevant facts and circumstances, that obtaining that DTT benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the DTT. This measure is designed to tackle 'treaty shopping' and puts a strong emphasis on ensuring that operations are supported by appropriate substance and reflect a principal commercial rationale. Cyprus has not opted for the restrictive provisions of the Simplified Limitation on Benefits (SLOB) and, based on the options of Cyprus, a SLOB will not apply to Cyprus' bilateral DTTs under the MLI (even in cases where the other party to a particular bilateral DTT has opted for a SLOB under the MLI).
- Concerning the minimum standard under BEPS Action 14 on Mutual Agreement Procedures (MAP), Cyprus' approach is to follow the improved procedures as set out in the MLI and accordingly update the bilateral DTTs of Cyprus covered by the MLI, to the extent that they require updating.

Cyprus has made full reservations (opt-outs) with regards to the following articles of the MLI and these articles will not apply to Cyprus bilateral DTTs due to Cyprus' full reservation, even in cases where the other party to a particular bilateral DTT has opted for them:

- Article 3 – Transparent entities
- Article 4 – Dual resident entities
- Article 5 – Methods for elimination of double taxation
- Article 8 – Dividend transfer transactions
- Article 9 – Capital gains from the alienation of shares/interests of entities deriving their value principally from immovable property
- Article 10 – Permanent establishments (PEs) situated in third jurisdictions
- Article 11 – 'Saving clause'
- Articles 12-15 – 'PE related provisions'
- Articles 18-26 – 'Arbitration'

PwC observation:
The timing of when the MLI provisions will take effect for a particular bilateral DTT will depend upon how quickly Cyprus and the other treaty partners to the particular bilateral DTT carry out the necessary domestic procedures to ratify the MLI and their relevant choices. It is possible that the MLI will be effective for a particular bilateral DTT of Cyprus beginning on January 1, 2018, however, January 1, 2019 is more likely.

We note that in essence Cyprus has opted not to go beyond the minimum standards of the MLI, and therefore has limited the impact that the MLI will have on its network of bilateral DTTs.

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Cyprus

First Cyprus - Luxembourg double tax treaty signed

The first double tax treaty (DTT) between Cyprus and Luxembourg was signed on May 8, 2017. The DTT is fully compliant with the Base Erosion Profit Shifting (BEPS) minimum standards and will take effect beginning January 1 of the year following that in which all legal formalities to bring the DTT into force are completed.

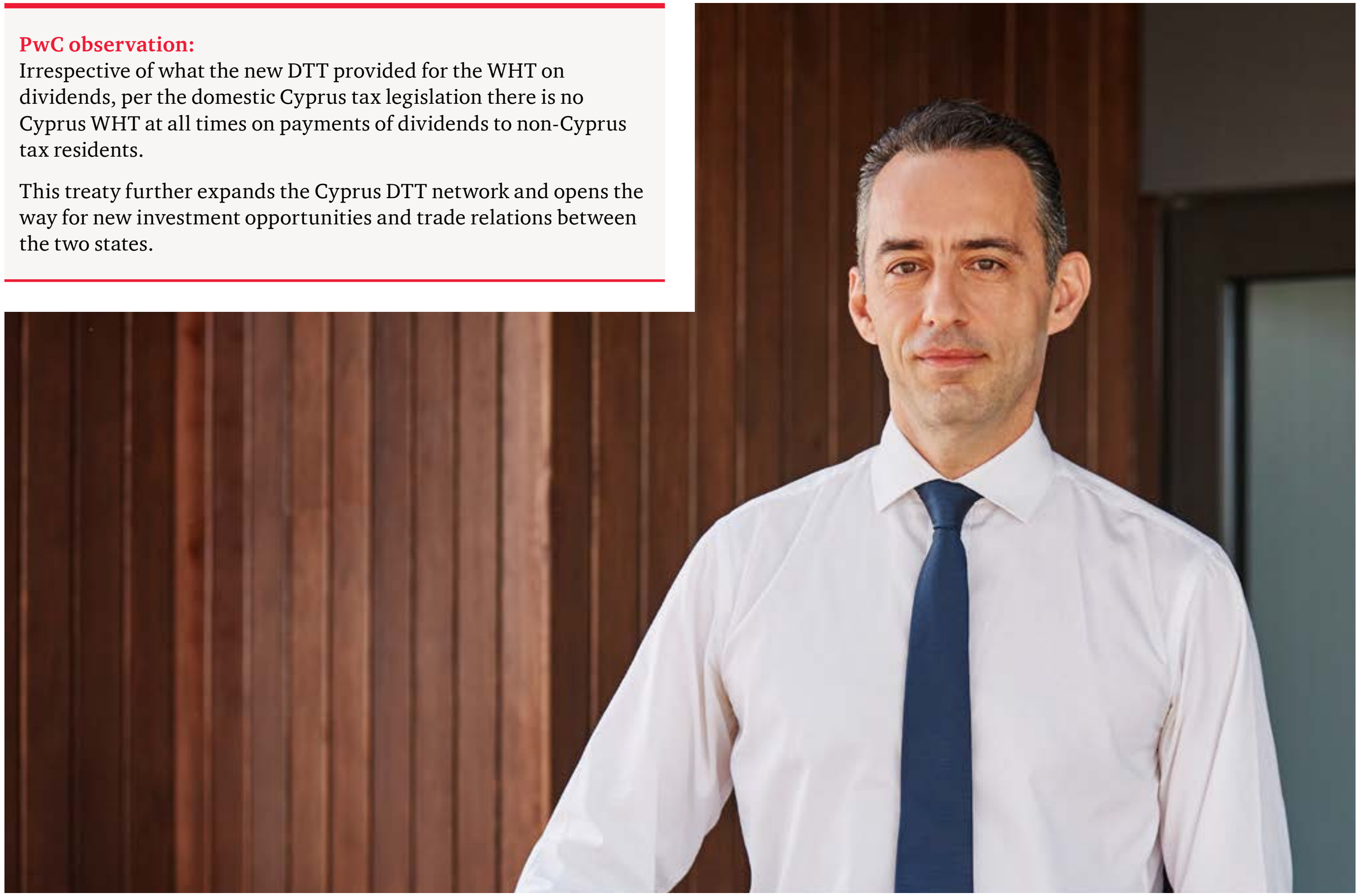
The DTT provides for zero percent withholding tax (WHT) rates on interest and royalties. For dividends, a zero percent WHT rate applies for corporate investors holding directly at least 10% of the capital of the paying company; a five percent WHT rate applies in all other cases of dividends.

For capital gains, under the DTT Cyprus retains the exclusive taxing rights on disposals of shares in companies except in those cases when more than 50% of the value of the shares is derived directly from immovable property situated in Luxembourg.

For collective investment vehicles (CIVs), the accompanying protocol to the DTT provides that, under certain conditions, exempt CIVs are to be considered as residents of a contracting state if they are considered as residents by the local law of that state, and as the beneficial owners of the income the CIV receives.

PwC observation:
Irrespective of what the new DTT provided for the WHT on dividends, per the domestic Cyprus tax legislation there is no Cyprus WHT at all times on payments of dividends to non-Cyprus tax residents.

This treaty further expands the Cyprus DTT network and opens the way for new investment opportunities and trade relations between the two states.



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Hungary

Hungary signed the Multilateral Instrument

Hungary on June 7, 2017 became a signatory to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS) (the MLI).

Hungary chose 66 of its 80 effective double tax treaties (DTTs) to be covered by the MLI. As it was expected, Hungary only applied the mandatory provisions of the MLI, notably Article 7 on the Prevention of Treaty Abuse and the provisions of Article 16 on the Mutual Agreement Procedure (MAP).

In regards to Article 7, Hungary chose to apply the Principal Purpose Test (PPT) only (Paragraph 1 of Article 7). In addition, Hungary chose to apply Paragraph 4 of Article 7, which gives the right to the competent authorities of each jurisdiction to grant the treaty benefits to a person (after the examination of all relevant facts and circumstances) even if such benefits would have been denied by the PPT clause. According to the notification made by Hungary, the aforementioned provisions also will be applicable to those covered DTTs that already contain provisions that are equivalent to the PPT included in the MLI, provided that both parties make such a notification. Otherwise, the MLI's PPT will replace the existing provisions of a covered DTT only to the extent that those provisions are incompatible with the wording of Paragraph 1 (and when applicable, Paragraph 4).

Pursuant to the reservation made by Hungary regarding the MAP, Hungary holds that a person only should be entitled to present its case to the tax authority of the state in which such person is a resident or national.

The provisions of the MLI with respect to withholding taxes (WHT) on amounts paid or credited to non-residents should be applicable from the first day of the calendar year after the year in which the MLI enters into force in both concerned jurisdictions. With respect to all other taxes, the provisions of the MLI should apply to taxable periods beginning on or after January 1 of the next year beginning on or after the expiration of a period of six calendar months (nine months for newly notified DTTs) from the time the MLI enters into force for the respective covered DTT.

PwC observation:
Based on the provisions Hungary chose and the reservations made, it can be concluded that Hungary aims to maintain the accessibility to the benefits of its extensive and advantageous treaty network as well as its favourable tax environment for multinational companies.

Ireland

Publication of the text of the new Kazakhstan - Ireland Double Tax Treaty

The text of the new Kazakhstan - Ireland Double Tax Treaty (DTT) was published recently. This is the first DTT between the two countries and will enter into force after the exchange of the ratification instruments. This treaty provides that dividends will be taxed at a maximum of five percent if the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends or 15% in all other cases. A maximum rate of 10% will apply in the case of interest and royalties.

In Ireland, negotiations have concluded on new DTTs with Azerbaijan, Ghana, Oman, and Turkmenistan and for a Protocol to the existing DTT with Mexico. These are expected to be signed shortly.

PwC observation:
This recent signing signals Ireland's commitment to expanding and strengthening its DTT network. Ireland has signed comprehensive DTTs with 72 countries, all of which are now in effect and negotiations are ongoing with other territories at this time.

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OECD

68 countries and jurisdictions sign up for the OECD BEPS MLI

On June 7, 2017, 68 territories signed The Multilateral Convention To Implement Tax Treaty-Related Measures To Prevent Base Erosion And Profit Shifting (BEPS) (MLI). They also lodged with the Organization for Economic Co-operation and Development (OECD) their provisional decisions on various choices available under the MLI on amending the effect of existing bilateral and other double tax treaties (DTTs). The impact will depend on a degree of 'matching' those choices and with a suitable lag time after the parties to a particular treaty have ratified their positions.

The MLI introduces considerably more complexity and uncertainty into the international tax system. The choices available to each territory are extensive and, at least initially, matching the approaches of particular territories may be challenging. The OECD's role is to publish information on territories' choices, irrespective of whether the territories do so themselves. We have seen some helpful material already, though any additional assistance from the OECD may come later.

The first 68 territories that signed have typically listed nearly all their 3,500 or so treaties for potential application at some future time. Of the 3,500, we estimate that 1,100 or so treaties involve just those initial territories. Additional territories are expected to sign later. Once effective, the impact will be significant. Most territories have listed nearly all their existing treaties as potentially within the MLI's scope, as it makes the process of approval much easier even if there is not imminent prospect of the other territories signing the MLI (some have been much more selective). Furthermore, it is not surprising that there are treaties listed in the notifications of one territory for potential modification, while another territory excludes any such modification. The notification does not attempt to record any agreement between the parties; it solely identifies those covered tax agreements that contain wording that, according to the compatibility clause, would potentially be affected.

The timing of when MLI provisions and territory choices would take effect for particular provisions in a bilateral treaty is complicated. The timing depends on how quickly territories carry out the necessary Parliamentary or other domestic processes necessary to ratify the MLI and their choices. A minimum of five territories must ratify before the changes can enter into force. Once both parties to an existing DTT have ratified, the MLI allows for relatively short periods for taxpayers to learn about the ratifications and for the tax administrations to prepare their staff.

PwC observation:
Business decisions on organisational structures, financing, or other arrangements depend on many factors. Tax is just one cost to consider. Changes resulting from the MLI may lead to a different tax outcome, but there will be greater future uncertainty about the tax burden with more subjectivity in the application of bilateral treaties following the MLI. For example, businesses will need to consider the potential application of withholding taxes and the extent to which they are dependent on a principal purpose test.

Interpreting the MLI is very complicated. However, the territory notifications of which treaties fall within particular provisions will be a great help. The wording of reservations and notifications is rather technical, referring to Article, paragraph and sub-paragraph numbers rather than their purpose; however, this does make them shorter.

Determining the consequences of the territories' choices will take some time. The OECD is working on enhancing its published materials. Businesses may not wish to wait and may prefer to analyse the existing information as a matter of urgency.

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Worldwide Tax Summaries:
Corporate taxes 2016/17

If you're operating globally, are you aware of changes to the myriad tax rates in all the jurisdictions where you operate? If not, we can help – download the eBook of our comprehensive tax guide, or explore rates in over 150 countries using our online tools, updated daily.

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