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Global Tax Alert

The Latest on BEPS – 9 April 2018

OECD

On 22 March 2018, the OECD released the final Additional Guidance on the Attribution of Profits to a Permanent Establishment (the Report), under the BEPS Action 7 final report (*Preventing the Artificial Avoidance of Permanent Establishment Status*).

The Report provides additional guidance on the attribution of profits to permanent establishments (PEs) resulting from the changes to Article 5 of the OECD Model Tax Convention (MTC), as outlined in the final report on BEPS Action 7. The Report sets out general principles for the attribution of profits to PEs in light of the changes to Article 5 of the OECD MTC. The proposed analysis of the examples included in the Report is governed by the authorized OECD approach (AOA) contained in the 2010 version of Article 7. However, the Report is not intended to extend the application of the AOA to countries that have not adopted that approach in their treaties or domestic legislation. It includes examples dealing with the attribution of profits to a PE relating to warehousing activities, commissionaire arrangements, an online advertising sales structure, and procurement activities.

The key principle across the examples is that the profits attributable to a PE are those that the PE would have derived if it were a separate and independent enterprise. This principle, the Report says, applies regardless of whether a tax administration adopts the AOA or any other approach used to attribute profits.

The Report was agreed by all members of the Inclusive Framework (IF) on BEPS, and thus these principles are relevant and applicable in attributing profits to PEs to all IF members and not only to OECD member countries.

EY OECD BEPS project

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Building a better working world

See EY Global Tax Alert, *OECD releases additional guidance on attribution of profits to a permanent establishment under BEPS Action 7*, dated 28 March 2018.

On 9 March 2018, the OECD issued new mandatory disclosure rules for addressing Common Reporting Standard (CRS) Avoidance Arrangements and Opaque Offshore Structures which is consistent with the concepts on mandatory disclosure articulated in the best practice recommendations contained in BEPS Action 12 final report on mandatory disclosure rules. The new model rules require lawyers, accountants, financial advisors, banks and other service providers to inform tax authorities in certain circumstances when for example, there is a CRS Avoidance Arrangement or Opaque Offshore Structure. A "CRS Avoidance Arrangement" is defined as any arrangement for which it is reasonable to conclude that it is designed to circumvent or is marketed as, or has the effect of, circumventing CRS legislation or exploiting an absence thereof; and an "Opaque Offshore Structure" is defined as a Passive Offshore Vehicle (i.e., a Legal Person or Legal Arrangement that does not carry on a substantive economic activity supported by adequate staff, equipment, assets and premises in the jurisdiction where it is established or is tax resident) that is held through an Opaque Structure.

The information required to be disclosed includes the taxpayers using such structures or arrangements and those involved with their design and set-up. The Intermediary (broadly, any person responsible for the design or marketing of a CRS Avoidance Arrangement or Opaque Offshore Structure and any person that provides Relevant Services in respect of a CRS Avoidance Arrangement or Opaque Offshore Structure in circumstances where the person providing such services could reasonably be expected to know that the Arrangement or Structure is a CRS Avoidance Arrangement or an Opaque Offshore Structure) has to disclose the information to the tax authorities of each jurisdiction with which the Intermediary has a nexus.

In order for the new rules to meet their objective, it is necessary that a reliable exchange of information relationship is in place between the jurisdiction where the Intermediary makes the disclosure and the jurisdiction where the taxpayer is resident. The OECD is currently working on an exchange of information framework to be developed under the multilateral Convention on Mutual Administrative Assistance, which will ensure that the relevant information reaches the jurisdiction of tax residence of the relevant taxpayer in a timely and structured manner.

European Union

On 13 March 2018, the Council of the European Union (EU) removed Bahrain, the Marshall Islands and Saint Lucia from the list of non-cooperative jurisdictions in taxation matters and added the Bahamas, Saint Kitts and Nevis and the US Virgin Islands during the Economic and Financial Affairs Council (ECOFIN) meeting. Nine jurisdictions remain on the EU list (American Samoa, Bahamas, Guam, Namibia, Palau, Samoa, Saint Kitts and Nevis, Trinidad and Tobago and the US Virgin Islands).

Australia

On 28 March 2018, the Government introduced Treasury Laws Amendment (OECD Multilateral Instrument) Bill 2018 (the MLI Bill) into Parliament, together with a detailed explanatory memorandum that provides useful guidance on the Australian MLI positions. The MLI bill will need to be passed by the House of Representatives and the Senate, and receive Royal Assent to be enacted in Australia. Once the domestic ratification process has been completed, Australia would need to deposit its instrument of ratification, approval or acceptance of the MLI with the OECD and confirm its MLI positions. The MLI will enter into force for Australia on the first day of the month following the expiration of a period of three calendar months beginning on the date of deposit of such instrument.

On 28 March 2018, the Government also introduced Treasury Laws Amendment (Tax Integrity and Other Measures) Bill 2018 into the House of Representatives. This Bill contains three previously announced tax measures, including toughening of the multinational anti-avoidance law (MAAL) in relation to artificial arrangements using trusts and partnerships.

Belgium

On 7 March 2018, following the recommendations that were made in Belgium's BEPS Action 14 (*Making Dispute Resolution Mechanisms More Effective*) peer review report, the Belgian tax authorities have issued Circular Letter 2018/C/27 on the existing rules for the settlement of (double taxation) disputes under tax treaties. The Circular Letter mainly provides practical guidance on the interaction between the national remedies and procedural rules on the one hand and on the bilateral remedies (the Mutual Agreement Procedure (MAP) and EU Arbitration procedure) on the other hand.

The administrative circular provides an overview of the main procedural rules as well as practical views and positions taken by the Belgian tax administration during both the administrative and (in some cases ongoing) judicial procedural phases of a (double taxation) dispute case under Belgium's competence to tax certain types of income.

Brazil

On 23 March 2018, the São Paulo State Tax Authority published Ordinance CAT 24 (Portaria CAT 24/2018) regulating the taxation of digital goods in the State of São Paulo. Said Ordinance follows the State Agreement 106/2017 (Convênio ICMS 106/2017 – issued by the Council of States' Tax authorities), which set forth general State Value Added Tax (VAT) (ICMS) rules for transactions involving digital goods.

According to Ordinance CAT 24/2018 Brazilian sellers of digital goods – including websites and digital platforms – are now subject to State VAT (ICMS) whenever sales are destined to end users established or domiciled in São Paulo State. Business to business (B2B) sales are not covered.

Digital goods are defined as: (i) software, programs, electronic games, apps, electronic files and alike, that are standard (off-the-shelf), even if they have been or can be modified, regardless of being acquired through download or used in the cloud; and (ii) audio, video, image and text content acquired through download. The Ordinance wording suggests that neither streaming nor import of digital goods fall into the scope of the regulation.

Ancillary obligations such as registration and invoicing procedures were also established.

State VAT (ICMS) on digital goods has always been a controversial topic for Brazilian taxpayers. Constitutional and legal arguments have been taken to the courts in the past. Within the context of BEPS Action 1 (digital economy) it is likely that new debates will arise. Following how the discussion will unfold is crucial for companies to position themselves towards the matter.

France-Luxembourg

On 20 March 2018, France and Luxembourg signed a new income tax treaty (the Treaty) and a new protocol, replacing the current double tax treaty signed on 1 April 1958. The Treaty contains a number of treaty-based recommendations from the BEPS project contained in Action 2 (neutralizing the effects of hybrid mismatch arrangements), Action 6 (preventing the granting of treaty benefits inappropriate circumstances), Action 7 (preventing the artificial avoidance of permanent establishment status) and Action 14 (making dispute resolution mechanisms more effective).

The New Treaty contains, for example, a provision dealing with fiscally transparent entities. Its preamble clarifies that the tax treaty is not intended to be used to generate double non-taxation or reduced taxation through tax evasion. The New Treaty has a Principal Purpose Test, while in the PE clause it contains an anti-fragmentation rule and the new definition of agency PE. Moreover, the New Treaty enables taxpayers to present a case for MAP to the competent authorities of either Contracting State. The New Treaty will have in particular a significant impact for certain investments in French real estate. For instance, dividend distributions from certain French investment vehicles such as SPPICAVs (*Sociétés de Placement à Prépondérance Immobilière à Capital Variable*) to its Luxembourg beneficial owner will be subject to a much higher withholding tax of 30% (vs. 5% under the Current Treaty). Moreover, such dividends received by a Luxembourg beneficial owner will no longer benefit from a treaty exemption as provided for by the Current Treaty.

Both France and Luxembourg have signed the BEPS Multilateral Convention (MLI) prior to signing this Treaty. For the MLI provisions to have effect on this new Treaty, both jurisdictions would need to include it first in their respective list of Covered Tax Agreements (CTAs), indicating whether the Treaty falls within the scope of any of the reservations made by that respective jurisdiction.

See EY Global Tax Alert, *France and Luxembourg sign a new double tax treaty*, dated 26 March 2018.

Hong Kong-India

On 19 March 2018, Hong Kong and India signed a tax treaty (the Treaty) which contains some treaty-based BEPS recommendations from Action 6 (preventing the granting of treaty benefits inappropriate circumstances) and Action 14 (making dispute resolution mechanisms more effective). The Treaty provides, for example, that in cases where a person other than an individual is resident in both Hong Kong and India, both competent authorities shall endeavor to determine by mutual agreement, the Contracting State of which the person shall be deemed to be a resident. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by the Treaty except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States. The Treaty also contains a corresponding adjustment provision and a saving clause, confirming that the provisions of the Treaty in no case prevent a Contracting State from the application of the provisions of its domestic law and measures concerning tax avoidance or evasion. Lastly, the Treaty contains a main purpose test which is on the lines of, though not identical to, the Principal Purpose Test as included in paragraphs no. 26 of the final report on Action 6.

Both Hong Kong and India have signed the BEPS MLI prior to signing this Treaty. For the MLI provisions to have effect on this new Treaty, both jurisdictions would need to include it first in their respective list of CTAs, indicating whether the Treaty falls within the scope of any of the reservations made by that respective jurisdiction.

See EY Global Tax Alert, *Hong Kong and India sign income tax treaty*, dated 28 March 2018.

India

On 29 March 2018, the Indian Finance Bill, 2018 (the Bill) received Presidential assent without significant changes to information previously reported on the *12 February 2018 Latest on BEPS* and *26 March 2018 Latest on BEPS*. The Bill is effective from 1 April 2018.

Japan

On 28 March 2018, the Japanese Diet (Japanese Legislature) passed the 2018 tax reform bill. The tax law enforcement orders were also published in the *Official Gazette* on 31 March 2018.

The new tax law contains modification to the domestic PE definition. The modification in general follows the OECD's recommendations in the BEPS Action 7 final report. The revision to PE will apply to fiscal years beginning on or after 1 January 2019.

See EY Global Tax Alert, *Japan releases 2018 tax reform outline*, dated 19 December 2017.

Malaysia

On 16 March 2018, the Malaysian Inland Revenue Board (IRB) issued Practice Note No. 1/2018 (the Note), which outlines the tax implications of income earned by a non-Malaysian tax resident from the provision of digital advertising. The one-page Note briefly discusses whether such payments are subject to Malaysian income tax as business income or withholding tax as royalty income or income under Section 4A(ii) of the *Income Tax Act 1967* [Income under this Section refers to fees paid for technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme].

The tax treatment would depend on whether the nonresident has a PE (where a tax treaty applies) or a business presence (where no treaty applies) in Malaysia. The treatments are as follows:

- If the nonresident has neither a PE nor a business presence, the payments may be subject to withholding tax as either royalty income or services income under Section 4A(ii).
- If the nonresident has a PE or a business presence in Malaysia, the payments constitutes Malaysian-source business income and are subject to tax under Section 4(a). However, the Note is silent on the withholding tax treatment (if any) in such an instance

The Note explains that the main criteria that determine whether the payment would be considered a "royalty" or Section 4A(ii) income to the nonresident are as follows:

- Royalty income: If the payment is for the purchase or use of (for example) an application (App) by the payor to create their own advertisement campaign.
- Section 4A(ii) income: If the payment is merely a provision of service by the nonresident and does not involve the purchase or use of Apps, since the payor solely relies on the service provider to deal with all aspects of digital advertising.

See EY Global Tax Alert, *Malaysia issues practice note on tax treatment of digital advertising provided by nonresidents*, dated 9 April 2018.

On 15 March 2018, the IRB updated its website with general information on the taxation of the digital economy. The digital economy is referred to as the economy based on the use of digital technology. Any trade transactions conducted through digital technology, including supply of information, promotion and advertising, marketing, supply or delivery of goods or services (even if the payment and delivery of these transactions may be carried out offline) are considered as being part of the digital economy. As the digital economy is not limited to online trading, the IRB has provided a sector-based list of activities which should be seen to be part of the digital economy, which include, among others, groceries sales, transportation and logistics, education, broadcasting and media, advertisement, sharing economy, sale of digital goods and digital currency.

In summary, the IRB clarifies that the tax treatment of the digital economy business should be similar to the "conventional" economy whereby income from business operations in Malaysia is subject to income tax pursuant to the Malaysian *Income Tax Act 1967*. This includes registration for an income tax number, submission of the income tax returns, payment of income taxes and record-keeping.

The scope of taxation is based on the Guidelines on Taxation of Electronic Commerce issued by the IRB on 1 January 2013. The guidelines can be retrieved from the IRB's official website. There are several basic models identified in the aforementioned guideline to provide guidance as to whether or not income from e-commerce is derived from Malaysia and would be subject to Malaysian tax. Among the examples, the following situations are identified as generating taxable business income in Malaysia:

(i) A resident person with business operations in Malaysia sets up a website in or outside Malaysia. Where business operations of the person are substantially carried on in Malaysia, business income from e-commerce is deemed to be derived from Malaysia and thus, subject to income tax in Malaysia. Even if the activities to maintain the website are performed outside Malaysia, the business operations are considered to be carried on in Malaysia.

(ii) A resident company with business operations in Malaysia sets up a website and branch outside Malaysia. Where the substantial business activities are carried on in Malaysia, income of the company derived from its operations in Malaysia is liable to tax in Malaysia. However, income attributable to the branch outside Malaysia will not be subject to Malaysian tax.

(iii) A nonresident person with business operations in Malaysia sets up a website in or outside Malaysia. Where the business operations are carried on in Malaysia, the income generated from e-commerce is deemed to be derived from Malaysia and subject to tax in Malaysia.

Monaco

On 14 December 2017, the Principality of Monaco issued the Sovereign Ordinance No. 6.713 which implements Country-by-Country (CbC) Reporting (CbCR). According to the Sovereign Ordinance, CbC reporting is required annually for reporting fiscal years beginning on or after 1 January 2018 and the filing date would be 12 months after the last day of the reporting fiscal year. All Monegasque tax resident entities that are Ultimate Parent Entities (UPEs), or Surrogate Parent Entities (SPE), of a multinational enterprise (MNE) group with annual consolidated group revenue equal to or exceeding €750 million, will need to submit a CbC report to the Monegasque Tax Services Department. Any constituent entity tax resident in Monaco must notify the Monegasque Tax Services Department of whether it is the UPE or SPE by the last day of the Reporting Fiscal Year. Where a Constituent Entity of an MNE Group that is resident for tax purposes in Monaco is not the UPE nor the SPE, it shall notify Monegasque Tax Services Department about the identity and tax residence of the Reporting Entity. Monaco signed the OECD Multilateral Competent Authority Agreement (MCAA) on the exchange of CbC reports on 2 November 2017, thus Monaco will be exchanging CbC reports with other tax authorities provided an exchange relationship between Monaco and the other jurisdictions has been activated under the CbCR MCAA.

Failure to comply with the CbCR rules shall entail monetary fines which vary based on the circumstances: (i) in the event of failure to submit the CbC report within the 12-month period after the last day of the reportable fiscal year, the Reporting Entity is liable to a penalty of €10,000; (ii) if the Reporting Entity files the declaration within 30 days following notification of a formal notice, a penalty of €50,000 is imposed, while if it does not file it within this period, the penalty is €100,000; (iii) In the case of incomplete or inaccurate information, the penalty is €150 per omission or inaccuracy. This amount is increased to €250 when the Reporting Entity does not rectify its situation. The cumulative amount of these penalties, for omissions or inaccuracies, cannot exceed €100,000; and (iv) in the event of a failure to notify, the Constituent Entity concerned shall be liable to an administrative penalty of €750. According to the Sovereign Ordinance, for CbC reports due for the year 2018, penalties are not applicable when the considered Reporting Entity regularizes its situation spontaneously or within a period of 30 days following a notification of a formal notice.

Sweden

On 21 March 2018, the Swedish Government submitted a draft bill regarding important changes in the corporate taxation area to the Council on Legislation for their consideration. Among others, the Government intends to introduce legislation to align Sweden's rules on corporate interest deductions with the EU Anti-tax Avoidance Directive (ATAD) and BEPS Action 4 (*Limiting Base Erosion Involving Interest Deductions and Other Financial Payments*). In this respect, it is proposed to limit the deductibility of the net interest expense to 30% of the EBITDA (earnings before interest, taxes, depreciation and amortization). The proposal also includes a safe-harbor rule on a group allowing a deduction of net interest expense of SEK5m. It would also be possible to offset net interest income and expenses among companies that can exchange group contributions. Any non-deductible net interest would be available for carry forward for six years in the current proposal (subject to a change of control provision). The rules should apply next to the existing interest deduction limitation rules between affiliated companies. The definition of interest will be aligned with the interest definition included in BEPS Action 4 and the ATAD. Also, the current corporate income tax rate of 22% would be further reduced to 21.4% in 2019 and to 20.6% as from 2021. As the draft bill includes a general interest limitation rule, it is also proposed that the interest limitation rules regarding hybrid mismatches provided in BEPS Action 2 and the ATAD will be implemented simultaneously (in first instance only applicable for affiliated companies). The new rules are proposed to come into effect as from 1 January 2019.

See EY Global Tax Alert, *Sweden proposes draft bill with major corporate income tax changes*, dated 26 March 2018.

On 26 February 2018, the Swedish Ministry of Finance (MoF) issued a memorandum proposing changes to the current Swedish controlled company (CFC) legislation, in light of the adoption of the EU ATAD. Under the current Swedish legislation, Swedish residents, both individuals and legal entities as well as nonresidents with a PE in Sweden, are subject to current taxation in Sweden if they hold a certain level of interest (25% of the votes or capital) in certain foreign low-taxed legal entities. However, such foreign income is not subject to current Swedish taxation, if the foreign legal entity is a tax resident of, and subject to tax in, a jurisdiction listed in an appendix to the *Swedish Income Tax Act* – the Whitelist. In order to reach full compliance with the ATAD, the MoF has proposed three notable legislative changes. The proposed changes include:

- A revised definition of associated persons
- Elimination of double-taxation when a taxpayer disposes of its participation in a CFC
- Amendments to the Whitelist with regard to the classification of the jurisdictions

The new legislation is proposed to enter into force on 1 January 2019 (applicable for fiscal years starting after 31 December 2018).

See EY Global Tax Alert, *Swedish Ministry of Finance proposes amendments to CFC legislation,* dated 19 March 2018.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP, International Tax Services, Washington, DC

- Arlene Fitzpatrick arlene.fitzpatrick@ey.com

Ernst & Young LLP, Global Tax Desk Network, New York

- Gerrit Groen gerrit.groen@ey.com
- Jose A. (Jano) Bustos joseantonio.bustos@ey.com
- David Corredor-Velásquez david.corredorvelasquez@ey.com

Ernst & Young Belastingadviseurs LLP, Amsterdam

- Konstantina Tsilimigka konstantina.tsilimigka@nl.ey.com

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