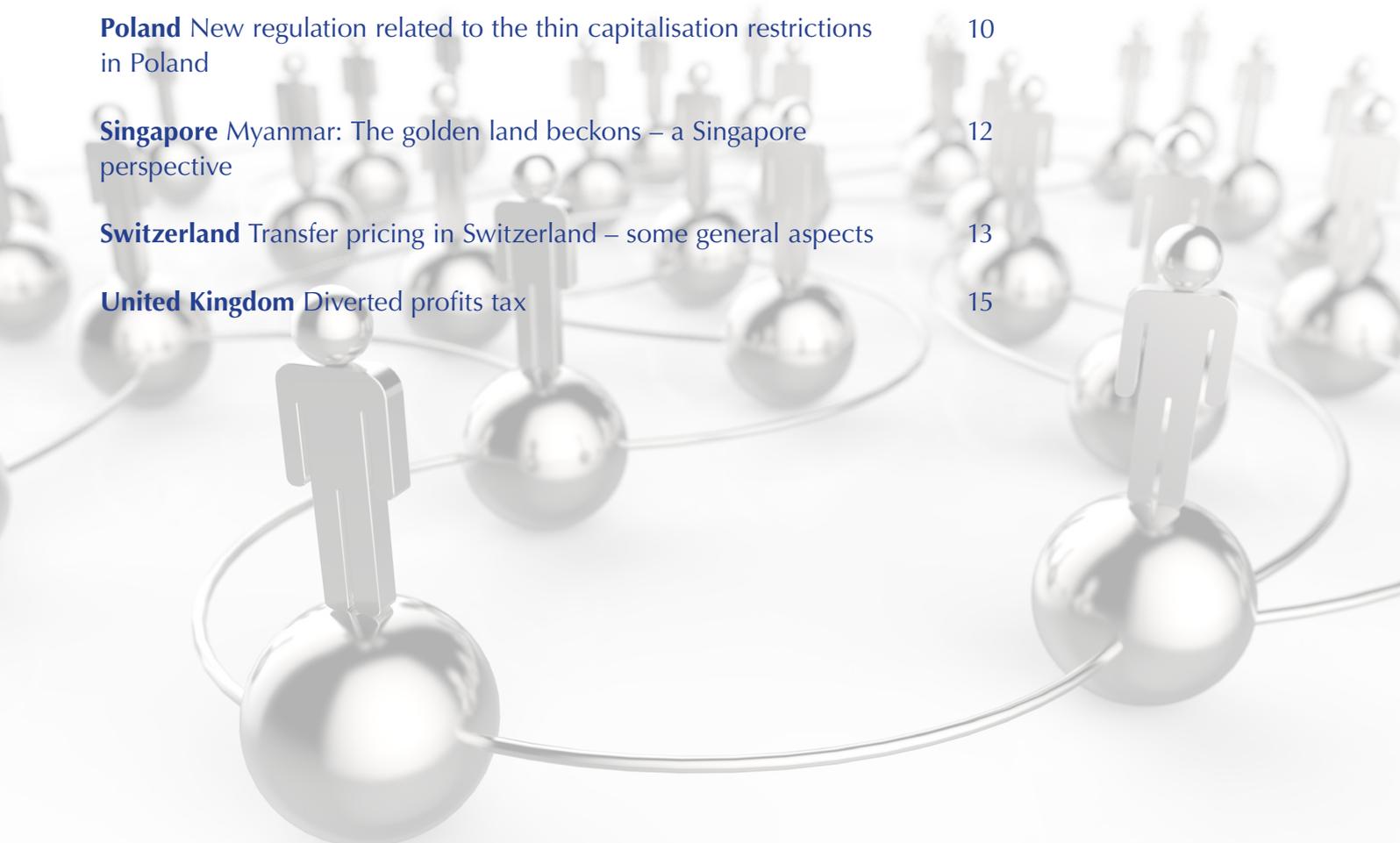


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China New rules for indirect transfers by offshore parties (Controversial SAT circular 698 updated)

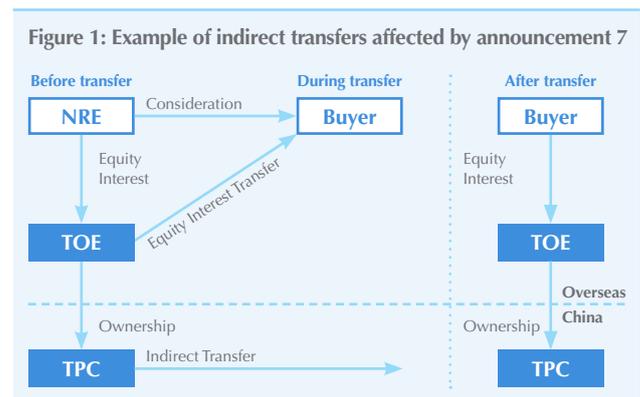
Throughout China's economic boom, foreign companies have generated considerable wealth through directly or indirectly holding equity or ownership in companies and immovable properties in the country. The practice of taxing gains on the direct transfer of such ownership has rarely, if ever, been questioned. However, when in 2009 the China State Administration of Taxation ("SAT") released Circular 698, much of the global community challenged the validity of taxing gains on indirect transfers conducted by offshore parties. The China SAT's argument was simple and consistent with its developing tax General Anti Avoidance Rules ("GAAR"). Too many foreign entities were conducting indirect equity transfers structured for the sole purpose of avoiding taxation. While Circular 698 measures have been reasonably successful in mitigating this loss of tax revenue, a lack of clarity in the rules has caused problems for offshore companies conducting legitimate transactions, as well as giving rise to a lack of standardized practices by Chinese tax authorities.

On February 3 this year, China's SAT released Announcement [2015] 7, *Matters of Corporate Income Tax on Indirect Transfer of Properties by Non-Resident Enterprises*, which took effect on the same day. These new measures replace those of Circular 698 and bring considerable clarity to all aspects of offshore indirect transfer reporting and taxation. Consistent with China's ongoing GAAR practices, "substance over form" remains as the primary guiding principle for determining tax liability. And thankfully, Announcement 7 details the factors used to determine substance or a lack thereof. Also on the plus side, new reporting requirements not only offer some increased flexibility for the transaction parties, but also provide clarity as to the documentation that transaction parties should prepare. Least attractive in the new measures is the introduction of a tax-withholding scheme that potentially increases the offshore buyer's liability, while also increasing the offshore seller's risk of incurring tax-related penalties. The SAT has also expanded the types of indirectly transferred Chinese properties that are subject to the rules.

Affected transactions in announcement 7

The Circular 698 measures applied to "income derived by non-resident enterprises from the [indirect] transfer of equity in Chinese resident enterprises, excluding shares purchased and sold on the open securities market." The meaning of the phrase "equity in a Chinese enterprise" was not explicitly defined.

In contrast, and with substantial detail, Announcement 7 applies to the indirect transfer of "the properties of an establishment or place in China, immovable properties in China, equity investments in Chinese tax-resident enterprises, and other properties," which collectively are referred to as Taxable Properties in China ("TPC"). As illustrated in the example of Figure 1 below, the measures specifically apply to any transaction in which a Non-Resident Enterprise ("NRE") transfers all or part of its equity or similar interests in another overseas enterprise ("TOE") that in turn directly or indirectly owns TPC.



The language of Announcement 7 extends the rules beyond the mere purchase and sale of equity or interest in a TOE that holds TPC. Now any indirect transfer that has a similar result to that of a direct transfer transaction is captured. This includes any corporate reorganization through which a change of TOE shareholders occurs.

Announcement 7 also specifies certain safe harbor transactions, including: NRE transfer of TOE shares on a public securities exchange (but not including IPOs); NRE group reorganizations that meet certain criteria; and NRE transfers treated as direct transfers that are eligible for relief under provisions of a tax treaty. Certain conditions on the holding percentage and China-sourced income percentage apply for treaty relief cases.

Reasonable commercial purpose

Circular 698 specified that if an indirect equity transfer is conducted without "reasonable commercial objective," and with an "aim to circumvent" the payment of enterprise income tax ("EIT"), the transaction should be reclassified as a direct transfer and be taxed in China accordingly. The SAT has generally held to these ideas in Announcement 7, stating "transactions without reasonable commercial purpose" and which result in EIT avoidance shall be so reclassified and taxed. Yet unlike Circular 698, and even the most recent GAAR measures of Circular [2015] 32, Announcement 7 goes into great detail as to what does and does not constitute "reasonable commercial purpose."

Firstly, in addition to following guidelines in the latest GAAR measures, in-charge tax officials must examine several key aspects of the TOE, including, but not limited to: the portion of TOE assets or value directly or indirectly attributable to the TPC; the TOE's functions and risks; the TOE's length of operation under the current organizational structure; the TOE's extent of tax liability; tax treaties or tax benefits available to the TOE; and whether or not a similar result could have been accomplished by a direct transfer of the TPC. Under such analysis, if the following criteria are met, a given transaction is automatically considered **to lack reasonable commercial purpose**:

1. The TOE derives 75% or more of its value through direct or indirect ownership of TPC.
2. If at any time within one year prior to the indirect transfer 90% or more of the TOE's assets (not including cash) consisted of investments in China, or if 90% or more of the TOE's income was directly or indirectly derived from China.
3. The TOE (and/or its subsidiaries) is incorporated in a region to meet the required organizational form, but performs functions and undertakes risks insufficient to substantiate economic substance.
4. The effective applicable overseas income tax is less than the Chinese income tax would be for a direct transfer of the same TPC.

Conversely, an indirect transfer of TPC shall be automatically deemed **as having reasonable commercial purpose** if the NRE and the buyer of the TOE have certain shareholding relationships, such as the NRE owning all or most of the buyer, or vice versa, and if 100% of the consideration in the indirect transfer is in the form of equity. Other conditions may also apply, depending on circumstances.

Withholding tax and reporting requirements

Announcement 7 has completely overhauled the requirements that govern when and how indirect transfer transactions must be reported. Whereas Circular 698 required reporting of transactions based on the tax environment in the TOE registration jurisdiction, Announcement 7 requires the reporting of all transactions that meet the definitions in the "Affected Transactions" segment above, regardless of how the TOE may or may not be taxed.



The first point to note is, in cases where the indirect transfer involves TPC that is a tax-resident establishment or place subject to Chinese EIT, the establishment or place must include the income from the transfer in its current EIT filing. This requirement of course not only ensures payment of relevant taxes by the tax-resident TPC, but also forces further reporting about the transaction, especially if the overseas parties to the transaction wish to argue that the transaction should benefit from tax deferral, reduction or exemption.

Under the circumstances in which the transfer involves immovable property or equity interest in TPC subject to EIT only under these new measures, the buyer (or other party that is obligated to pay the NRE) must act as withholding agent, immediately withhold the relevant tax and remit it to the in-charge tax authority in China. If the buyer fails to withhold the tax from its payment to the NRE, the NRE must within 7 days report the transaction and pay the tax. Alternatively, if the buyer does not withhold the tax but within 30 days submits certain documents to the Chinese tax authorities, they may be able to avoid penalties and interest on the unpaid taxes. Among other transaction-related documents, the buyer must provide comprehensive information about the TOE, its finances, and its organizational structure before and after the transaction. Of course if the transaction is found to have commercial substance or to meet other relevant criteria, no tax will be imposed.

No matter whether the transaction falls in the EIT filing or tax-withholding realm, the parties to the indirect transfer must submit substantial documentation if making a claim that Announcement 7 taxation does not apply. The Chinese tax authority may also request extensive supporting documents from the NRE, the buyer, the TOE, the planning firm (if used), and/or the Chinese TPC being indirectly transferred. Such documents may evidence the transaction planning and decision-making process, financial statements, assets valuation reports and so on, as well as evidence that the transaction has reasonable commercial purpose as defined in these rules.

Conclusion

Announcement 7 has the effect of a double-edged sword. On one side the comprehensive definitions and instructions in Announcement 7 provide significant clarity as to how Chinese tax authorities will examine indirect transfers of TPC. This should assist all transaction parties to prepare appropriate documentation in advance to support their tax positions. There is also flexibility as to which party in a transaction may handle the reporting.

On the other side, the new withholding tax and EIT filing regulations will often result in taxes being paid before the parties have an opportunity to argue a case for reduction or exemption. Especially where withholding applies, if the correct evidentiary documentation is not available within a short period after concluding an agreement, the taxes

must be paid. Otherwise penalties and interest will apply. In the case of EIT filing by the China TPC entity, there may be sufficient time to prepare all appropriate documentation before EIT filing occurs, but again, if the documentation is insufficient or unavailable, taxes will be immediately due.

Even with the clarity offered in Announcement 7, it remains to be seen how the rules will play out in practice. Certainly during the planning stages for an indirect transfer of TPC, the transaction parties should seek the assistance of an experienced tax consultant in China. The transaction and the resulting organizational structures must be carefully examined against these current regulations in order to assess risk to the seller and buyer. At least for some months to come, such assessments will no doubt entail considerable communication with relevant tax authorities, as well as some educated guesswork. However, as happened after release of Circular 698, it is likely that the SAT will release further clarifications and practices will become increasingly predictable.

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Denmark Denmark introduces anti-avoidance rules

Denmark has taken action to actively participate in the BEPS (Base Erosion and Profit Shifting) project proposed by the OECD, and is planning to implement general anti-avoidance rules for the first time in spring 2015. So far, there have been no anti-avoidance rules under the Danish tax legislation.

However, a general disregard of pro forma transactions has been effective, i.e. transactions that in the civil law have not been considered legally binding.

Some also argue that a doctrine called the “reality principle” is prevailing, which means that transactions without financial reality in fact can be ignored according to tax law.

This doctrine creates great uncertainty. Due to this uncertainty, it has in some cases led to an affirmative answer from the Supreme Court to the Danish tax authorities that a series of transactions that individually are in accordance with the tax law should be regarded as one unit, and thus the total transaction should be assessed from a total point of view.

Measures against hybrid mismatch arrangements

Denmark has preferred the implementation of specific rules combating actual attempts to avoid or exploit specific tax rules, including rules that prevent the accidental exploitation of foreign tax law.

An example is § 2A of The Danish Tax Assessment Act. A Danish company, although it is usually subject to corporation tax, can, for tax purposes, be considered to be a transparent company (branch) if its foreign parent (for tax purposes according to the company’s rules) decides to treat the Danish company as transparent for tax purposes in the parent’s home country (e.g. the US’ “check-the-box rules”)

Implementation of the first amendment of the EU parent-subsidiary directive, which prevents exploitation of hybrid securities and companies, adopted by the Council on 4 July 2014, was implemented in Denmark with effect from 1 March 2015 in law no. 202 of 27 February 2015. The law determines that dividends from subsidiaries, which under general rules would be tax-exempt (because of a 10% or greater ownership), are no longer tax-exempt if the dividend-paying company can deduct the distribution of dividends from its tax bill in its home country.

This provision had previously been in force, but the tax liability was exempt only if the dividends were covered by the parent-subsidiary directive. This exemption has now been cancelled as the parent-subsidiary directive has at this point been amended.

Introduction to 2 anti-avoidance rules

The Danish Government has obtained support from some of the other parties in the Danish Parliament and issued a draft bill L 187 on 20 March 2015, introducing various proposals to combat the use of tax havens. The draft bill is expected to be adopted by the Danish Parliament by June .

The actual proposals in the draft bill are rather limited, but contain two important new anti-avoidance clauses:

- A clause against the exploitation of the EU parent-subsidiary, merger and royalty directives, as well as provisions in double taxation treaties.
- Legislation providing the Tax Authorities with the option to disregard binding response (rulings) for the valuation of assets, where the Danish tax authorities subsequently can demonstrate a significantly higher value.

1. Stop abuse of EU directives and DTAs

The new anti-avoidance rule inserted in § 3 of The Danish Tax Assessment Act, reads as follows with effect from 1 May 2015:

»§ 3. Taxpayers do not have the benefits arising from directive 2011/96/EU on the joint system of taxation applicable to parent companies and subsidiaries of different member states, directive 2003/49/EC on a joint system of taxation applicable to interest and royalty payments made

between associated companies of different member states and directive 2009/133/EC on the joint system of taxation applicable to mergers divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different member states and to the transfer of a SE or SCE's registered office between member states as implemented in Danish legislation, event or series of events organized with the main purpose, or one of its principal objectives, to obtain a tax advantage, which works against the content or purpose of the directives, which are not reliable, taking into account all relevant facts and circumstances. An event may involve several steps or sections.

Paragraph 2. Bringing paragraph 1 into use, events or series of events are considered not reliable to the extent they are not organized by justified commercial reasons that reflect the financial reality.

Paragraph 3. Taxpayers do not benefit from a double tax treaty, if it is reasonable to conclude, with regard to all relevant facts and circumstances, that the achievement of the benefit is one of the main purposes of any arrangement or transaction that directly or indirectly benefit, unless it is proved that the grant of benefit under these circumstances would be consistent with the content and purpose of the relevant provision of the agreement.

Paragraph 4. Irrespective of the use of paragraph 3, paragraphs 1 and 2 must be used to assess whether a taxpayer is excluded from the benefit of a provision in a double tax treaty with a country that is a member of the EU if the taxpayer could alternatively refer to an advantage in one of the directives on direct taxation.«

2. Possible cancellation/withdrawal of binding response on valuation

The draft bill says that the provisions on binding responses in the Tax Administration Act include an option to cancel/withdraw a binding response:

»Unless otherwise provided by the tax authorities, the rule, in addition to binding response on valuation of an asset, applies that the response is not binding where it is based on information from a subsequent direct or indirect sale of the asset or where the size of the subsequent return of asset can be justified that the value of the asset at the time of submission of the binding response differed at least 30 %, and at least 1m DKK from the value in the binding response.«

This rule applies to binding responses from 1 July 2015 onwards.

Binding responses on valuations are often obtained prior to the transfer of assets between associated parties, for example by consolidated sales or transfers between family members or between individuals and the companies controlled by them.

According to general rules, binding responses provided by the Danish tax authorities or the Tax Board are in force for a period of 5 years.



However, the rule stipulates that the Danish Tax Authorities may cancel/withhold the binding response, if it by subsequent transfer to foreigners or otherwise it turns out that the valuation was too low.

Although the Government's justification for the new provision refers to cases where a Danish individual make a transfer of shares to a family member abroad and where the transfer of intangibles to group companies abroad are performed, this provision shall apply to all transactions including transactions with no parties from abroad involved (to avoid criticism from the EU).

This wording is rightly criticized, as transfers of shares between family members would be subject to great uncertainty as it would be unclear whether the Danish tax authorities would follow the previously approved valuations or not, and consequently, a legally binding response would not be obtainable.

Uncertainty about the administration

The fact that these initiatives are innovations in the Danish tax law, leads to great uncertainty about how these rules will be applied by the Danish tax authorities, once adopted.

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Hungary Efficient tools of the Hungarian tax authority

Over the past few years, Hungary has introduced a number of new rules designed to improve the efficiency of tax inspections and the detection of tax fraud. As a result, the powers of the Hungarian tax authority have been expanded and new techniques have been adopted as part of its inspection practices. Some of these new means have been tried and tested in other countries as well, while others are Hungarian “inventions”. Below we will present a couple of these audit methods of tax control; according to the tax authority’s guidelines for 2015, they will be used frequently during this year’s tax audits.

Electronic Road Transportation Control System (EKÁER)

Any road transportation related to the intra-Community acquisition of goods (imports), intra-Community supply of goods (exports) and the first taxable sale transaction in Hungary must be registered in advance in the EKÁER system. If the goods transported do not have a valid registration number, they may be held up on the road and/or seized. In the case of products with a high risk of VAT fraud, their road transportation may only commence if a payment guarantee is provided in advance. This system allows the tax authority to carry out efficient inspections of goods transported by road, and to identify fictitious transactions by comparing the data of the EKÁER system with that of the VAT returns and recapitulative statements. Fictitious transactions, especially given the high VAT rate in Hungary (27%), have a particularly negative impact on the state’s fiscal revenues. Data from the EKÁER system may also be compared with recordings from the system of electronic road-toll video cameras, allowing the authorities to check the routes of shipments indicated in VAT returns.

Cash registers on-line connected to the Tax Authority

Since 2014, it has been obligatory in Hungary to connect cash registers to the tax authority’s system via the internet. This allows tax inspectors to keep a constant watch (even by software) on sales data entered into any cash register, and to use more effective risk analysis processes to select companies and the ideal period (including the time of day) for tax inspections. This new inspection method now makes it possible to monitor retail units and catering establishments on site, meaning that, at any given moment, a tax inspector may be present incognito at the site and can use a tablet computer or laptop to check whether the purchase transaction of a particular customer is recorded in the cash register connected to the internet, or whether the customer receives a non-official receipt or no receipt at all.

Itemised domestic recapitulative statement

Since 2015, it has been obligatory to submit itemised (invoice-based) recapitulative statements as part of the VAT returns on all domestic supplies of goods with a VAT content of 1 million

HUF (approximately 3,300 EUR) or more. The rule originally took effect in 2014, but in the first year the threshold was set higher at 2 million HUF. By now, the tax authority has developed an IT system that allows it to connect invoice issuer and recipient data, therefore enabling it to identify the “route” of invoicing. This allows the authority to identify taxpayers that issue or accept fictitious invoices as well as suspicious chains of invoicing. A number of circumstances must be taken into account in connection with the 1 million HUF limit. For instance, invoices received from a particular partner over a given period of time must be summed together, and companies are obliged to report any corrections to previously-issued invoices totalling at least 1 million HUF of VAT (even if the effect of the correction on the payable VAT is less than 1 million HUF). If the monitoring of the 1 million HUF threshold presents too much of a burden to a company, it may choose to include all issued and accepted invoices in the recapitulative statement. In the medium term, this option will likely become the mandatory rule, and all invoices will have to be reported.

Testing the accounting system

For some time, the tax authority has been allowed to request the entire bookkeeping data set during tax audits. Under the new rules, the authority may also inspect the accounting system itself. This means that the tax authority is allowed to check settings, automatic entries and system processes. If a tax inspector identifies an error in these, it will lead the inspector to all entries that have been incorrectly entered and taxed based on the given algorithm. The tax authority has also developed its own data analysis software tool, which has been in use since last year. This tool no longer simply audits individual transactions and documents. Instead, as with procedures already used frequently for statutory auditing purposes, system tests are run on the data files to check the internal relations of the data structure. With the help of the software this allows the identification of noticeable errors and inconsistencies.

How can we, as consultants, help our customers?

With targeted IT audits we can check if systems provide adequate protection and determine if the data stored in the system is reliable. Using data analysis tools we can validate the completeness of data. Our data analysis software makes it possible to work with large data files within a short period of time even if the data comes from different systems in various file formats.

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India Union budget 2015 – venturing India into the global economy

Ever since Prime Minister Narendra Modi's landslide election victory, there was mounting pressure to deliver on the country's high expectations. Amid these expectations, Hon'ble Finance Minister Arun Jaitley (the "FM") tabled the first full Budget for the FY 2015-16 on 28th February 2015.

With the world envisaging India's chance to fly, the numbers tabled during the budget stacked up pretty well. The FM forecasted that growth would accelerate to 8-8.5 percent in next fiscal year, up from 7.4 percent this year. However, he pushed back by a year to 2017-18, the deadline for cutting the fiscal deficit to 3 percent of GDP while maintaining the target of 3.9 percent for 2015-16. The Inflation target was also set at 5 percent for the fiscal year ending March 2016 thereby creating room to cut interest rates. The Infrastructure Sector has been a big beneficiary with increased Budgeted spending of INR 700 billion (USD 11 Billion) during year 2015-16. The economic survey noted that India is today in a sweet spot which is largely relieved of the vulnerabilities associated with an economic slowdown.

Corporate tax rates in India

It was proposed that the corporate tax rate will be reduced from 30% to 25% over the next four years, commencing from the next financial year which would witness a higher level of investment & industrial growth in India. The FM also proposed the abolition of Wealth Tax in India from FY 2015-16 in lieu of which the rate of surcharge has been increased by 2% for persons having an income over INR 10 Million (USD 0.2 Million). However, the rate of surcharge has been kept untouched for foreign companies.

One of the most significant reforms in the Budget was a reduction in Withholding Tax from 25% to 10% on payments made to non-residents for royalties or Fees for Technical Services. This should facilitate a greater inflow of foreign technology to Indian businesses at lower costs.

Make in India

Following the launch of the "Make in India" campaign, a controversial set of new rules to fight tax avoidance via General Anti-Avoidance Rules (GAAR) has been deferred for two years.

The Government has also included in the Budget provisions where fund management activity of offshore funds carried out in India through an eligible fund manager acting on behalf of such a fund shall not constitute a Permanent Establishment of the said funds in India. This would facilitate the relocation of offshore funds in India.



The FM also announced special provisions in the Budget for granting a "pass through" status to certain types of Alternative Investment Funds (AIF) which would rationalize their taxation regime.

An extension of two years up to June 30, 2017 was granted by the FM for availing the benefit of the lower withholding tax rate of 5% on interest on Government Securities and Corporate bonds earned by Foreign Institutional Investors (FII) and Qualified Foreign Investors (QFI).

The Government has also been working to bring Forwards Markets Commission under the ambit of Securities & Exchange Board of India to reduce the volatility due to speculation in Commodity Forward Markets and to encompass a greater control on capital flows in the form of Equity. The confidence of the investors in this previously unregulated market should be enhanced by virtue of this.

Ease of doing business

The much awaited Direct Tax Code (DTC) has been kept in the cold storage though most of the major issues under the DTC have been covered under the Income Tax Act itself.

The retrospective insertion of indirect transfer provisions in Budget 2012 has been a matter of concern among foreign investors. Due to several ambiguities on the applicability of provisions relating to indirect transfer of shares of a company this had a negative impact on investor sentiments. In order to enhance investor confidence in India, the FM has proposed that the indirect transfer of shares by a foreign company shall be taxable in India on a proportionate basis, and only if the value of Indian assets represents at least 50 per cent of the value of the global assets and the minimum value of such Indian assets is INR 100 million (USD 1.6 Million). Further, certain exemptions have also been provided for the rules on indirect transfers.

The Transfer Pricing areas were left untouched except for increasing the threshold for Domestic Transfer Pricing from INR 50 Million (USD 0.8 Million) to INR 200 Million (USD 3.2 Million). Further, rules relating to foreign tax credits are to be clarified by the Tax Authorities.

The Government has also proposed that Withholding Tax would be applied to interest payments made by a branch of a Foreign Bank in India to its head office. However, this provision would negatively affect investment in India in form of branches of foreign banks.

It has been proposed to treat a Foreign Company as Tax Resident of India if it has Place of Effective Management (POEM) at any time of the year situated in India. This has provided the Tax Authorities with more room to bring a greater number of foreign companies under the Indian tax net thereby negatively hurting the foreign investor sentiments.

Measures to curb black money

The Government, with a view to combat the menace of black money, has recently introduced the Black Money Bill in the Parliament which specifically deals with such money stashed away abroad, or in India, by providing for hefty penalties and non-compoundable prosecution with rigorous imprisonment of up to 10 years. However, a one-time compliance opportunity for a limited period has been proposed to be provided to persons who have any undisclosed foreign assets which have hitherto not been disclosed for the purposes of Income-tax. The Government has also proposed to provide safeguards for those holding foreign accounts with balances less than INR 0.5 millions (USD 8,000).

Swachhh Bharat (Clean India)

Various policy measures have been taken to achieve the Prime Minister's vision of "Clean India" like proposed deductions for the donations made to *Swachhh Bharat Kosh* (Clean India Fund) & Clean Ganga Fund of the Government of India.

Indirect taxes

The changes in the Indirect Tax Proposals are in line with the overall focus on the implementation of the Goods & Service Tax (GST) from April 01, 2016. Keeping GST in mind, the service tax rate has been proposed to be increased from 12.36% to 14% while significantly trimming the exemption list. However, this move of a sharp increase in the rate of Service Tax has been receiving negative reactions from industry as this would amount to inflation.

Being termed as a "make or break" Budget, it has been drawing mixed reactions from the industry. In a nutshell, it seems that the Government is keen to help business and liberalize various hurdles thereby creating a suitable climate for foreign investors. One can say that no "big bang" reforms were introduced in this budget however the budget was for growth and investment.

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Mauritius Global business incentives and BEPS

Mauritius introduced global business incentives in 1992 and is now recognized as a leading regional financial centre, efficiently regulated and free from the suspicion often associated with tax havens. It has always featured on the G-20 white list for international financial centres.

There are two types of Global Business Companies that can be incorporated in Mauritius, known as the Global Business Category 1 Licence Company (GBC1) and the Global Business Category 2 Licence Company (GBC2).

A GBC1 is a tax resident company in Mauritius and enjoys benefits under the extensive Double Taxation Avoidance Treaties (DTAs) network of Mauritius. This type of company will be subject to income tax on its profits at the rate of 15% with a deemed foreign tax credit of 80%, which will effectively reduce the income tax rate to 3%.

GBC1 Companies are allowed to conduct business both inside and outside Mauritius. However, for their domestic operations, they will be paying the same tax as domestic companies, i.e. 15%.

A GBC1 is normally used if you wish to have access to the DTAs and in general when overseas income is predominantly in the form of dividends, royalties, interest and capital gains.

On the other hand, a GBC2 is not tax resident in Mauritius and therefore cannot benefit from the DTA network. It is completely exempt from paying taxes in Mauritius. Companies that are engaged in invoicing, marketing and international trading activities will often use a GBC2 structure.

GBC2 Companies cannot deal with Mauritian residents and activities must be conducted in currencies other than the Mauritian rupee.

Many foreign investors have used Mauritius as an investment platform to be able to benefit from the various tax treaty advantages and this has led to the belief that there is treaty abuse, especially the India-Mauritius Tax Treaty. The Treaty has been under intense criticism for a number of years. This has led to discussions between India and Mauritius with regard to the treaty revision for quite sometime now.

Moreover, the OECD's Action Plan on BEPS, which was published in July 2013, with the aim to tackle the problem of tax avoidance around the world, has identified "Treaty Abuse" as one of its major concerns. The report states that



Poland New regulation related to the thin capitalization restrictions in Poland

The Polish thin capitalisation regulations, referring to the limitations in deductibility of the interest cost on loans granted by related entities, have been subject to significant changes that entered into force as of January 1, 2015. It is not clear how the thin capitalisation restrictions apply on cash pooling schemes – both binding provisions as well as the position of the Polish tax authorities are unclear in this respect. In addition, the Polish administrative courts present contradictory standpoints in this respect.

According to the “old regulations”, applicable to financing granted before the end of 2014, non-deductibility concerned interest arising on loans granted by:

- i. a direct shareholder or
- ii. a sister company (the qualifying shareholding in each case was 25%).

The safe threshold was a 3:1 debt to equity ratio, with consideration of the following conditions:

- i. The threshold was verified as of the interest repayment/capitalisation date.
- ii. As debt a total indebtedness to shareholders, sister companies, grandmother companies was considered, with direct or indirect shareholdings of at least 25%.
- iii. Equity was understood as paid in registered share capital.

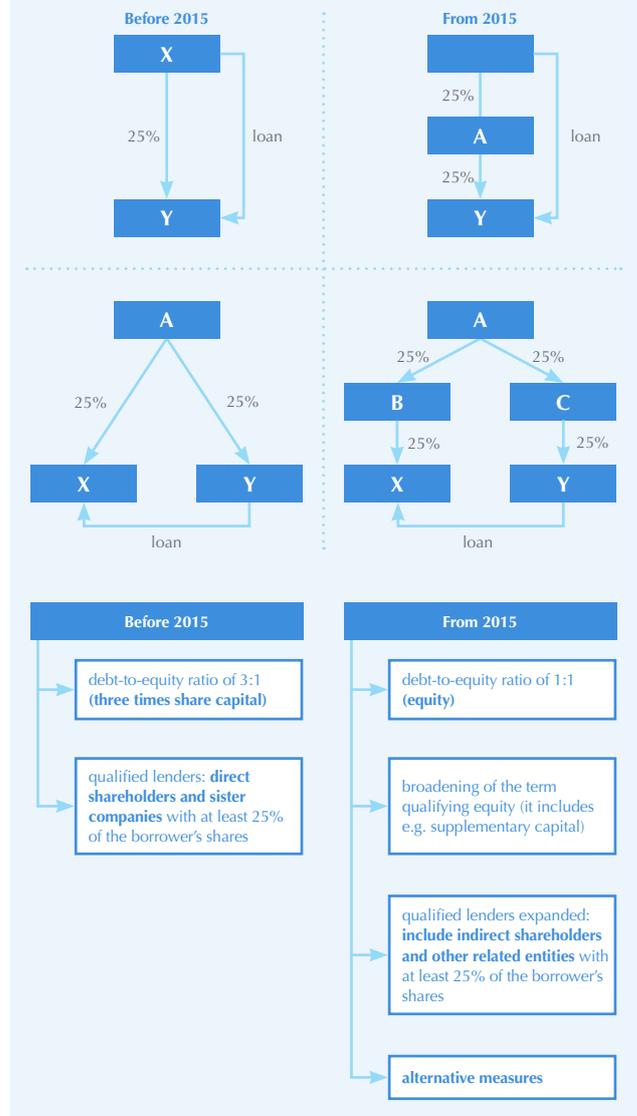
Should the indebtedness exceed three times the value of the share capital, the interest related to the surplus could not be considered tax-deductible.

Starting from January 1, 2015, new thin capitalisation restrictions have been introduced, applicable to all loans concluded after that date (the date of transfer of funds is relevant). Taxpayers can choose between two methods, presented below as a “general” method and an “alternative” method.

In the case of a “general” method, thin capitalisation limitations apply to interest arising on loans granted by related entities with qualifying direct or indirect shareholdings of at least 25%. In practice, loans granted by all indirect shareholders, or by creditors having the same indirect shareholder as the borrower, in both cases holding at least 25% shares, fall within the thin capitalisation restrictions. The debt to equity ratio has been changed: it is now 1: 1. The equity is calculated as the sum of share, supplementary, and reserve capital, it includes as well financial results (loss/profit) from previous and current year. Whenever such calculated equity is negative, no interest can be treated as a tax deductible cost. The above debt to equity ratio shall be calculated as of the last day of the month preceding the date of interest payment or capitalization.

The comparison of the old and changed thin capitalisation rules have been presented in the below schemes.

Figure 1: Thin capitalisation rule schemes



Taxpayers have the choice to apply the “general” or an “alternative” method to the loans granted after January 1, 2015. In the case of the “alternative” method, a limitation of interest tax-deductibility applies to all loans received by a taxpayer, granted by both related and unrelated parties. The threshold for the interest deductibility is the tax value of assets, calculated in accordance with the rules indicated in the Polish corporate income tax law: the interest cost cannot exceed the product of the Polish National Bank reference rate, increased by 1.25 p.p., and the sum of the taxpayer's assets:

$$\text{annual statutory limit for tax deductible interest costs} = [\text{reference rate of Polish National Bank} + 1.25\%] \times \text{the value of taxpayer's tax assets}$$



On top of the above condition, an additional requirement is that the amount of tax deductible interest cost cannot exceed 50% of the profit on operational activities. Where the taxpayer generates losses on operational activities in a given year, no interest can be treated as a tax deductible cost.

The interest that could not be deducted in a given year, due to the above conditions, can be carried forward and deducted within five consecutive years, provided that it fits within the limits indicated above.

Once chosen, the “alternative” method cannot be abandoned nor changed for the following three years. It applies then to all interest, irrespective of whether the underlying financing was granted before or after January 1, 2015. After the taxpayer decides to quit the application of the “alternative” method, he cannot choose it again before the expiry of a period of three years.

In relation to the thin capitalisation restrictions, a question arises on whether they apply as well to settlements of related entities participating in a cash pooling system.

Polish tax authorities tend to claim that activities carried out under a cash pooling arrangement are analogous to loans within the meaning of income-tax regulations and therefore the thin capitalization restrictions should apply to them as well. It should be noted that Polish tax authorities demand the application of such limitations also when it is not possible to determine which particular entity (falling within thin cap regime or not) granted the funds to the particular participant being in a debt position (whenever funds are transferred within the pool, it is – as a rule – not possible or difficult to track them).

However, recently an opposite standpoint in this respect has been presented by the Polish Provincial Administrative Court (judgment dated January 9, 2015, file no. I SA/Wr 2080/14). The Court stated that thin capitalisation restrictions are not applicable in the case of a cash pooling system, as participants of this agreement do not know when the funds will be used, to which extent and by whom. Therefore, the flows within the cash pooling system cannot be treated as loans and the deductibility of related interest shall not be restricted.

Objectives of the new tax code in Poland

In March 2015, the Polish Government passed assumptions for the new Tax Code for consultation to relevant bodies. After the assumptions are accepted by the Government, a new bill shall be prepared.

After being binding for the last 15 years, the present Polish Tax Code shall be replaced with a new code with its main goal to reconcile the interests of both the public finances and taxpayers and entrepreneurs. Thus, on one hand the new bill shall include a charter of taxpayers’ rights in order to increase the taxpayer’s protection in relations with the tax authorities. On the other hand, the new tax code should also increase the effectiveness of tax assessment and collection.

The published assumptions provide for numerous changes, including:

- Introducing a catalogue of general principles of tax law, in particular the principle of resolving doubts in favor of a taxpayer (in dubio pro tributario).
- Introducing a charter of taxpayers’ rights and obligations (among others: the right to a just, impartial and prompt settling of a tax case, the right to reconciliation of damages, the right to information, the right to professional, kind and fair treatment).
- Implementing a general anti-avoidance provision.
- Introducing so-called non-imperious forms of settling tax cases (in particular, so-called tax mediations).
- Changing provisions regarding termination of tax liabilities.
- Extending deadlines for appealing against a decision or a resolution.
- Introducing a general power of attorney in tax proceedings.

It has not been announced yet when the works on the new Tax Code might be finalised.

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¹ Currently 1.5%.



Singapore Myanmar: The golden land beckons – a Singapore perspective

It was once remarked that Yangon in the early 1920s was the city of gold, dreams and blood. In the intervening years since then, Myanmar largely fell into obscurity at the hands of its military custodians. But now almost a century later, it would seem that the country has finally come full circle. Today, the unfolding story of Myanmar's economic rise from its slumber vies for attention alongside the many challenges it faces in plugging itself back into the mainstream international community. The story is indeed exciting. And what of the opportunities that lie ahead?

The economy is growing

Official growth forecasts for the 2014/2015 fiscal year stand at 9.1% which slightly exceed the IMF and World Bank forecasts of 8.5%. Foreign direct investment is on track for a 70% year-on-year increase, an impressive jump by any standards. Indeed, Myanmar's Foreign Investment Law (MFIL) allows foreign investment into nine different sectors (disallowing it in twelve specific sectors). A foreign investor may establish a business presence in Myanmar in various forms including by way of a limited liability company, branch or representative office and partnership or joint venture with a citizen, cooperative society or state-owned economic enterprise (SEE). Reforms announced in 2014 are slated to bring significant changes to Myanmar's fledgling financial sector, spearheaded by the opening up of the banking segment to foreign lenders. Other areas are also experiencing the winds of liberalisation, most notably the telecoms sector, which saw the launch of two foreign operators being granted licenses in early 2014.

With a tax framework that is supportive

Resident companies are taxed on their worldwide income. The exception to this is resident companies registered under the MFIL. Such companies are not taxed on their foreign income. Non-resident companies are taxed only on income sourced within Myanmar.

A competitive corporate tax rate of 25% applies to companies incorporated under local company law, enterprises operating under the MFIL and foreign organizations that have obtained special permission to be engaged in state-sponsored projects, enterprises or undertakings. Branches of foreign corporations are taxed at a higher rate of 35% on Myanmar sourced income. Capital gains are generally taxed at the rate of 10% for resident companies and 40% for non-resident companies.

Incentives are accorded primarily through the MFIL and Special Economic Zone Law (SEZ). Under the MFIL, incentives ranging from five-year income tax exemption to the right to carry forward and set off losses for up to three consecutive

years are possible. Amongst other things, the SEZ offers income tax holidays and customs duty exemptions for business operating within the exempted zones.

It is also worth noting that Myanmar does not impose withholding tax on dividend payments. And while interest and royalties paid to non-residents are subject to withholding tax at the domestic rates of 15% and 20% respectively, Myanmar has concluded double taxation treaties with a number of jurisdictions (including Singapore) which potentially offer reduced rates of withholding and/or exemption.

Singapore's eminence as the preferred holding company jurisdiction in Asia is clear. Foreign investors keen to gain access into the markets in Myanmar should naturally consider setting up a Singapore holding company.

The following table provides a quick snapshot on some possible ways to maximize the use of Singapore-Myanmar double taxation treaty for a Singapore holding company structure:

Types of income	Domestic rate	Treaty rate (Myanmar)
Dividends	0%	0%
Interest [Beneficial owner]	15%	10%
Royalties [Beneficial owner]	20%	Either 10% or 15%
Capital gains on disposal of shares/investments	10%	0% [subject to specific conditions]
Service provision by Singapore entity in Myanmar	3.5%	0% if no permanent establishment

Adopting a Singapore holding company structure may present substantial tax savings for group companies. However, it should be highlighted that the Singapore tax authorities do not condone the use of a Singapore holding company with little commercial substance. In fact, it is this vigilance that has helped Singapore maintain its standing as a credible holding company jurisdiction in the international tax arena.

With Singapore's geographical proximity of being within the same region, political stability, advanced information, communications infrastructure as well as business-friendly tax system, it has made Singapore a compelling choice for investors to hold their Myanmar investments.

But challenges still lay ahead

Myanmar has foreign exchange controls which investors do need to be mindful of. Citizens, foreigners and companies in Myanmar generally must obtain permission from the Foreign Exchange Management Department (FEMD) for all foreign exchange dealings. Companies registered under MFIL, however, are allowed to repatriate investments and profits in the foreign currency in which such investments were made, subject to the approval of the Myanmar Investment Commission (MIC) and the central bank.

On a broader level, Myanmar is currently ranked 177 (out of 189 economies) for ease of doing business by the World Bank, which portends to the challenges it still faces in making itself business-friendly.

The recent re-igniting of conflicts between the army and certain minority ethnic groups may give reason for pause among investors to evaluate if the momentum for economic growth and investment is still intact or if it is showing signs of stalling.

In conclusion

Myanmar holds tremendous promise as one of the last untapped investment frontiers. Endowed with bountiful natural resources and the demographic dividend of a young population, its emergence from economic obscurity to become a key destination for foreign investment in recent years is perhaps unsurprising. Whether it continues to do so will largely depend on the measures and policies that are undertaken by Myanmar's successive future governments.

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Switzerland Transfer pricing in Switzerland – some general aspects

Introduction

Transfer pricing affects most types of Swiss taxes. Interestingly enough and contrary to the worldwide trend, there is no specific legislation for transfer pricing in Switzerland. Rather, each tax act has its own way of addressing transfer pricing matters for the respective type of tax. The usual approach to adjusting inadequate transfer pricing in Switzerland is the prohibition of harmful profit shifting between related taxpayers.

Legal basis

Swiss taxes are levied at three different governmental levels:

- Federal level: Federal Income Tax, Withholding Tax, Stamp Duty, Value Added Tax, Customs duties, etc.
- Cantonal (state) level: State and Local Income Tax, Wealth Tax, Tax on Capital, Inheritance and Gift Taxes.
- Municipal (local) level: Real Estate Capital Gain Tax, Real Estate Transfer Tax.

Transfer pricing may affect all of the mentioned taxes. However, most important in this context are corporate income taxes, withholding tax and value added tax.



The federation, the cantons and the municipalities have the right to legislate for tax rules within their competencies. None of them, however, has issued a special tax act regarding transfer pricing. The VAT Act is currently the only Swiss tax act that explicitly states the principle of dealing at arm's length for transactions between related parties. Nevertheless, most Swiss tax acts include a legal basis for the adjustment of profit shifting. Additionally, the principle of dealing at arm's length is recognized and applicable in practice.

Administrative statements and guidelines

As a member of the OECD, Switzerland accepted the transfer pricing report elaborated by the OECD fiscal committee in 1995 (OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 1995), as well as all the updated OECD guidelines on transfer pricing. In 1997, the Swiss Federal Tax Administration (SFTA) officially instructed the cantonal (state) tax authorities to follow these guidelines.

In 2004, the SFTA issued another circular letter reminding the cantonal (state) tax authorities that the OECD guidelines are to be considered. The circular letter contains an explicit statement that the principle of dealing at arm's length is applicable.

Hereafter is a list of the most important guidelines in connection with transfer pricing published by the SFTA:

- Safe harbour rules for financing: thin capitalization, interest rates for Swiss currency financing, and interest rates for foreign currency financing.
- Determination of the recipient of benefits for withholding tax purposes.
- Taxation of service companies (abolition of the traditionally and generally applied cost plus 5% approach).
- Abolition of lump sum deductions in the field of foreign related business (abolition of the so-called fifty-fifty-practice).
- Treatment of foreign domicile companies in the financial industry for VAT purposes.

Documentation requirements

There are no particular transfer pricing documentation requirements in Switzerland. However, this does not mean that a transaction between related parties does not have to be documented. Rather, the general documentation requirements of each tax act have to be fulfilled for the respective type of tax. This basically means that a taxpayer is required to provide all documents necessary for a proper assessment of the taxable basis. In the case of transactions between related parties, a taxpayer has to demonstrate that the transfer prices used are based on sound economic reasoning as well as on valid contracts.

Audit procedures

There are no specific transfer pricing audit procedures within the Swiss tax legislation. Rather, transfer pricing aspects are pursued on the basis of the normal tax audit procedure. A taxpayer under tax audit is asked to provide any information that is relevant for properly assessing the taxable basis (e.g. profit). If a taxpayer does not cooperate with the tax authorities, the taxable basis is estimated at the discretion of the tax authorities and fines may be imposed.

Penalties

There are no specific transfer pricing penalties within the Swiss tax legislation. In particular, there are no penalties for a lack of transfer pricing documentation. Rather, the general penalty provisions of each tax act are applicable for the respective type of tax.

Apart from the formal types of penalties (monetary fines, imprisonment in severe cases), there are two scenarios which the taxpayer may perceive as factual penalties:

- If in the course of a tax assessment the taxable basis cannot be justly determined (e.g. due to inappropriate documentation), the taxable basis is estimated at the discretion of the tax authorities. It goes without saying that the tax authorities generally do not try to assess the taxable basis in favour of the taxpayer in such cases.
- In the case of a constructive dividend by a Swiss taxpayer, a withholding tax of 35% is imposed. According to the Swiss practice, in most cases, the right to refund of such withholding tax is with the recipient of the constructive dividend. In international cases where the recipient is not the direct parent company, this approach permits a higher non-refundable withholding tax even if a double tax treaty is available. This is due to the fact that double tax treaties generally require a direct investment in order to receive the higher refund rate.

Dispute resolution mechanisms

National options

It is common practice to clarify the taxation of critical or complex transactions in a binding *ruling* with the Swiss tax authorities in advance. Therefore, Swiss taxpayers often clarify the Swiss tax treatment of potential transfer pricing issues by way of a ruling. As a result of the Swiss ruling practice, the number of dispute resolution processes can be reduced.

However, if a transaction was not subject to a ruling, or if a ruling was not properly implemented, dispute resolutions may become an issue. Moreover, if transfer prices are adjusted by foreign tax authorities, conflicts with Swiss tax authorities may occur in order to avoid double taxation. Many tax disputes can be settled by negotiating with the Swiss tax authorities in the course of the tax assessment or tax audit. Thus, the number of court cases can be reduced.

Once a taxpayer is finally assessed for a tax year, the taxable basis is fixed. This means adjustments for this period can only be made if qualified conditions are fulfilled. Basically, the adjustment of a transfer price by a foreign tax authority does not fulfil the condition to re-assess the final assessed tax year for a corresponding adjustment in Switzerland. However, if the dispute on the transfer price is settled in a Mutual Agreement Procedure (cf. below), the Swiss taxpayer is entitled to revision of the final assessed tax year and to claim the adjustment in his favour.

International options

Though no formal procedure for *Advanced Pricing Agreements (APA)* exists in Switzerland, APAs with foreign tax authorities have become a favoured option for Swiss-based multinational groups with complex and/or high volume transactions. Bilateral APAs are conducted under the corresponding mutual agreement provision in the applicable double tax treaty. The State Secretariat for International Financial Matters ("SIF") has proven very helpful in supporting the interests of Swiss taxpayers in APA negotiations with foreign tax authorities.

Mutual Agreement Procedures (MAP) are conducted with jurisdictions that have entered into double tax treaties with Switzerland. Usually, there are one or two meetings with each of the most important trade/industrial countries per year in order to negotiate pending cases. In past years, the SIF dealt with approximately 40-50 cases per year regarding transfer pricing.

The possibility of conducting an international dispute regarding double taxation in an arbitration court is stated in the double tax treaties renegotiated by Switzerland since 2010. In general, the condition of such an *arbitration procedure* is that no solution was found to avoid a double taxation by the contracting states within three years. In other words, the arbitration procedure is only possible if the MAP failed. Unlike the MAP, the arbitration court has to deliver a judgement that avoids double taxation.

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United Kingdom Diverted profits tax

Multinational corporations are accused of avoiding taxation by arranging their affairs through complex structures with little commercial purpose. The debate has now shifted to the politicians and supranational organisations. The G20 group identified the need to prevent “base erosion and profit shifting” (BEPS) and commissioned the OECD to review the existing framework which was designed in the 1920s to avoid double taxation but which is now said to allow double non taxation. In February 2013, the OECD published their report on BEPS which identified the root cause of the current tax mismatch to six areas:

- Use of hybrid instruments.
- Problems with the use of the traditional model for profits derived from the digital economy.
- Intragroup financing arrangements.
- Transfer pricing.
- Erosion of anti-avoidance rules owing to tax competition within jurisdictions.
- Preferential tax regimes.

In July 2013, the OECD identified 15 specific action plans designed to give governments the appropriate instruments to combat tax avoidance which will in turn drive amendments to the Transfer Pricing Guidelines, the OECD Model Convention and recommendations for changes to domestic tax legislation over the next few years.

In advance of the outcomes from the OECD’s BEPS initiative, the UK Government has introduced the Diverted Profits Tax (DPT) to combat aggressive tax planning that erodes the UK tax base through one of the following circumstances:

- The avoidance of UK permanent establishments (“PE”), or
- The creation of intragroup arrangements that lack economic substance.

Avoided UK PE

This will apply to situations where the affairs of the foreign company are organised in a manner to avoid a UK PE and either a tax mismatch or tax avoidance condition is met. A tax mismatch occurs whenever the reduction in the amount chargeable to tax in the UK affiliates is greater than the increase in the amount chargeable to tax in the foreign company or its affiliates and the amount of tax paid by the foreign company and affiliates as a result is less than 80% of the reduction in UK tax. The tax mismatch condition also requires the arrangements to have insufficient economic substance. This will be the case where the tax benefit of the arrangement is greater than any non-tax benefit made by one of the parties.



The amount taxable is the amount that is just and reasonable based on the OECD PE profit attribution principles. Where the non-resident itself makes base eroding payments, they may be disregarded for the purposes of determining the tax base to be used for the above calculation.

Intra-group arrangements

The second charge applies where there are arrangements between a UK company and other affiliated persons (whether UK resident or not) where there is a transaction or a series of transactions together with a tax mismatch outcome involving arrangements with insufficient economic substance determined as outlined for the avoided UK PE circumstance.

In this situation, arm’s length pricing should prevail, unless it can be demonstrated that the transaction would not have been made in the absence of the tax mismatch. Any profits reported in the UK tax return would be taken into consideration to determine the additional profits subject to DPT.

Administrative arrangements

There are exclusions from a charge for both circumstances for small and medium-sized enterprises. There is also an exclusion from a charge for the first circumstance where either the UK related sales revenue of the foreign enterprise (and its foreign affiliates) do not exceed £10 million in a 12 month period, or the UK related expenses of the foreign company (and its affiliates) do not exceed £1m in a 12 month period.

The DPT will be levied on profits within the charge that arise from 1 April 2015, at a rate of 25% compared to the 20% rate for corporation tax applicable from that date. It requires HMRC to make a preliminary assessment based on its knowledge of the arrangements, whether from disclosures made by the taxpayer or otherwise. This charge will be based on the best estimate of the diverted profits that are subject to UK tax. DPT will be payable within 30 days of the issue of the demand. The amount charged will include interest from a period six months after the end of the

accounting period to the date of the charging notice. The charge cannot be postponed in the event that the company seeks to challenge the amount payable.

HMRC have taken the view that the DPT is a separate tax from income or corporation tax such that DPT payments are ignored for the purposes of computing the income or corporation tax liabilities of an entity and that double tax treaties do not apply to it.

There has been some consternation that the DPT regime seeks to pre-empt the work being done by the OECD on the BEPS project. However, HMRC have argued that the DPT is a more targeted approach to tax avoidance by multinational companies. Indeed, Australia has also announced that it will use similar measures and it is expected that other countries will follow suit.

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