Briefing

International review for July

Speed read

Once again, the taxation of the digital economy is the focus of this update as the US reveals its intentions to fiercely defend large US corporations that are likely to pay the bulk of the new European taxes. The US has also released new GILTI regulations which give taxpayers a high tax exception and a change to the treatment of partnerships. The UAE is attempting to align itself with international taxing standards with the introduction of CBCR rules and substance requirements and we also have a corporate tax rate reduction to 25% for small and medium sized companies in India. There have also been further EU state aid developments in the last month including a notice of a targeted investigation into Nike in the Netherlands.

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Taxation of the digital economy continues to dominate international tax news. This month, we have confirmation of the previously announced French tax on tech giants and, more interestingly, the Trump administration's immediate and retaliatory response. No longer only tax news, the actions threatened by the US have the potential to ramp up into a full blown trade war with one of its previously strong trading partners. There is also the release of the draft UK digital services tax legislation which throws the tax net more closely than France, highlighting the issues that can arise from taking unilateral action to tackle an international problem.

Digital services taxes

In my May update, I mentioned the proposed 3% tax on the revenue of large digital companies that earn more than €750m in global digital revenue and at least €25m from digital sales in France. This has now been approved by the French parliament, making France the first European country and G8 member to enact a digital services tax (DST). The new tax is to be retrospectively applied from early 2019, and it is expected to raise about €400m this year.

France has stated it plans to repeal the tax when international agreement is reached within the OECD on how to tackle digital taxation. Many countries, including the UK, Austria, Spain and Italy, have become impatient at the slow progress being made with agreeing a universal approach to taxing the digital economy and have announced unilateral rules. This creates a lack of uniformity in approach and there have been calls for the international community to find a compromise and agree a method that can be implemented more widely.

Draft legislation has also been published this month on the UK's DST which will apply a 2% tax on revenue to groups with worldwide digital revenue of more than £500m and more than £25m derived from UK users. In contrast to other territories' approaches to similar laws, the UK will be focused only on social media platforms, online marketplaces, and internet search engines. There has been general consensus that the digital economy should not be ring-fenced, so the UK now stands as something of an outlier by focusing only on these three categories of digital business.

As with the French tax, there has been a suggestion that the tax will be repealed when a more universal approach is agreed upon. However, there is no legislative obligation for this, just a commitment that the tax will be reviewed before the end of 2025.

The US reaction to the announcement of the French approval of its DST has been severe. On 11 July, President Trump ordered an investigation into the French tax with his trade representative saying the US was 'very concerned' that the tax 'unfairly targets American companies'. France has held firm and has stated that it is free to decide how it applies taxes and that the tax does not specifically target US companies.

The US will now investigate the effects of the tax and determine whether it is discriminatory or unreasonable and negatively affects and restricts US commerce.

It has been suggested that the application of s 891 of the US tax code is a possibility. This would allow for a double rate of US tax to be imposed on citizens and corporations of foreign countries engaging in discriminatory taxation of Americans. If this were to be enacted this would be a bold and aggressive move against French companies and individuals and equal treatment would likely be imposed on the various other territories that have announced similar taxes.

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Arguably, the recent US tax policy changes have been more protectionist that any digital taxes announced in Europe. The base erosion and anti-abuse tax (BEAT) caused controversy when it was announced as part of the wider US tax reform which enforces a minimum tax on certain, mainly passive income, payments to foreign related parties. Trump's administration perhaps wants the best of both worlds with the US tax base protected but with US companies overseas sheltered by the US's hostile stance on other territories' actions against BEPS.

This month's announcement may be a warning that further, similar, investigations by the US are likely in the future and will involve other governments that have announced similar taxes, including the UK. The investigation is fully supported by both Republican Senate Finance Committee chairman Chuck Grassley and Senator Ron Wyden, the senior Democrat on the committee. They issued a joint statement: 'the digital services tax that France and other European countries are pursuing is clearly protectionist and unfairly targets American companies in a way that will cost US jobs and harm American workers.'

While the outcome of this investigation is unknown, similar inquiries have been used in the past for the Trump administration to impose new trading tariffs on countries involved. An international consensus on digital taxation should be agreed as a priority. A unified approach – such as at an EU level – will be a much stronger defence against

aggressive US actions and may avoid various trade wars which are never good for international relations and trade.

US tax

As well as new announcements attempting to protect US companies from what the US perceive as unfair overseas taxation, the US Treasury and IRS have recently issued regulations on the global intangible low-taxed income (GILTI) regime, which aims to protect the US tax base by creating a new type of inclusion for GILTI, which is based on a broad class of controlled foreign corporation (CFC) income.

As a reminder, the recent major US tax reform introduced a new tax on GILTI to attempt to prevent multinationals shifting such profits to low tax jurisdictions. GILTI is broadly speaking calculated as the total active income earned by a US company's foreign subsidiaries that exceeds 10% of the company's depreciable tangible property. A corporation can generally deduct 50% of the GILTI (resulting in an effective tax rate of 10.5%) and claim a foreign tax credit for 80% of foreign taxes paid or accrued on GILTI.

The new regulations have clarified and amended some of the potential issues that were noted for the previous proposals, most notably the new regulations:

- adopt a high tax exception for GILTI (an election to exclude all items of a CFC's gross income that are subject to an effective rate of foreign income tax greater than 18.9% (i.e. 90% of the US corporate tax rate, which is currently 21%)); and
- treat US partnerships as an aggregate of partners for GILTI purposes and, therefore, the partners in the partnership will not have a distributive share of any GILTI inclusion. Rather, partners in a domestic partnership are treated as owning proportionately the interest of a CFC owned by the partnership, and a partner would be subject to GILTI inclusion only if its ownership interest in the underlying CFC (including its indirect ownership through the partnership) causes it to be a (10%) US shareholder with respect to the CFC.

With the reduction in the corporate tax rate to 21% and the number of countries now considered 'high tax jurisdictions' for these purposes increasing, the new high tax exception should benefit many CFCs and US shareholders or partners in US partnerships owning CFCs.

The policy rationale behind the change for partnerships appears to be simplifying the complexity of administering the rules in the proposed regulations as well as the difficulty partnerships faced in complying. This change has been a bit of a surprise, given the principles apply not only to GILTI but also the Subpart F rules (which have been in place since 1962).

Country by country reporting requirements in the UAE

Elsewhere, the United Arab Emirates (UAE) has introduced country by country (CBC) reporting requirements as well as economic substance regulations. Multinationals headquartered in the UAE have thus far been relatively sheltered from the global shift towards greater transparency and information sharing which may now be coming to an end. The UAE is taking significant steps to bring itself into line with international standards.

There will now be a legal requirement for all UAE entities to locally maintain 'economic substance' in line with the level and type of activity they undertake. Economic substance can broadly be considered to consist of employees, premises, management and costs. There are also various regulatory filing requirements that need to be met in order to comply with the regulations.

The UAE is the third Gulf Cooperation Council (GCC) member state to adopt CBC rules. Previously, Saudi Arabia included CBC reporting requirements in the transfer pricing rules, and Qatar introduced CBC reporting requirements.

CBC reports will be required of entities that are 'tax residents' in the UAE and also part of a multinational enterprise having consolidated revenues equal to or exceeding AED 3.15bn (approximately £690m) in the preceding financial year.

UAE based multinationals should therefore be considering the impact of the new requirements on their group and in what way the information may be interpreted by tax authorities (not just including the UAE tax authority).

India Budget announcement

Along with a new government in power, a new pro-growth Union Budget was announced this month which aims to boost infrastructure and foreign investment against the backdrop of a slowing economy, weak consumption demand, rural distress, high unemployment, and lack of private investment.

The key tax announcement is that corporate tax will be reduced to 25% from 30% for domestic companies that have an annual worldwide turnover of up to $58m. This will mean that tax rates are reduced for over 99% of Indian companies with the aim of stimulating growth and investment.

EU state aid roundup

Netherlands: Nike investigation

The Commission's investigation concerns the tax treatment of two Nike group companies based in the Netherlands. The Dutch tax authorities issued five tax rulings, two of which are still in force, endorsing a method to calculate a royalty to be paid by the two companies for the use of intellectual property owned by two other Dutch entities which are transparent and therefore not taxable in the Netherlands.

The European Commission has now published the non-confidential version (originally announced in January) of its decision to open an investigation into the five tax rulings granted between 2006 and 2015.

UK: CFC decision

There have been reports that at least 15 groups have filed annulment applications with the EU General Court in Luxembourg.

Businesses that have benefitted from the exemption have already begun receiving letters from HMRC to start the process of recovering the aid. These letters include comprehensive information requests that cover all periods affected (from 1 January 2013 to 31 December 2018) and the deadline for a response submission has typically been 30 days from the date of the letter. ■

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