Briefing

International review for September

Speed read

There is yet another digital services tax announcement this month with the stakes getting higher as the Czech Republic's announced rate is more than double any other so far. Digital taxation developments are happening globally on a daily basis. The OECD is being forced to up its game to ensure a multilateral agreement is reached as soon as possible, and there are rumours of a public consultation being held in November. In the EU, we have had expected announcements on Polish anti-hybrid rules, the launch of a new investigation into Belgium 'excess profits' tax rulings and confirmation of Ireland bringing its transfer pricing rules into line with other jurisdictions. Hearings in the Apple EU state aid case have also been taking place before the Court of Justice in Luxembourg.

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I was hoping that there would be fewer developments in digital taxation this month so that other areas could get their share of the limelight, but I think that the appetite of nations to ensure they are not left behind is strong and there are further updates this month. The digital sector has arguably been a key player in the overall economy for decades, but the pace of change in the taxation of that economy has never been faster than it is now. All the signs are that the OECD is still aiming to publish a consensus position by the end of 2020, which would be quite an achievement, but will this be enough to halt the proliferation of unilateral digital taxes around the world?

We've also seen the first ever 'OECD tax certainty day', which brought together over 200 tax policy makers, tax administrations and various other stakeholders at the OECD headquarters in Paris. The discussions covered a wide range of taxation agenda items, including the most recent mutual agreement procedure (MAP) statistics which I have summarised below.

Digital taxation

Policy developments

Circulating rumours suggest that the OECD will be holding a public consultation on digital taxation in Paris in November. This is after the director of the OECD's Centre for Tax Policy and Administration, Pascal Saint-Amans, recently indicated in an interview that the OECD would be publishing an update on its digital tax thinking in late September. It is thought that the proposal will then be the subject of discussion for the G20 finance ministers at the joint IMF & World Bank meeting in Washington on 17 October.

The interview revealed that the OECD remains committed to reaching a long-term solution by the end of 2020, as previously promised in May this year. They will need to move quickly as more and more countries are announcing unilateral approaches which may make it difficult to unwind and apply a new, more universal approach.

Czech Republic

The Czech Republic looks set to be the next nation to introduce an independent digital services tax (DST). The ministry of finance has recently prepared a bill which proposes a tax rate of 7% on selected digital services, dwarfing both the 2% and 3% rate imposed by the UK and France respectively.

The tax is intended to capture digital tech giants who have a worldwide turnover of more than €750m and are generating an income in excess of CZK 50m (approximately £1.7m) from selected digital services within the Czech Republic. These services include targeted advertising campaigns, the use of websites or mobile applications and the sale of user data.

Crucially, the DST will be imposed based on the place of registration for a computer or mobile phone's IP address rather than the service recipient's registered office address used for invoicing. For instance, if a targeted ad is viewed from an IP address registered in the Czech Republic but the advertising service is subsequently invoiced to a foreign entity that contracted the ad, then part of this income will be subject to the Czech DST. Practically, there may be difficulties for companies to determine if they have any liability here at all, let alone calculate the precise value of tax due.

The Czech ministry estimate that the tax will raise CZK 5bn (approximately £170m) annually. The draft bill is awaiting comment before being submitted to government.

EU investigation into potential Belgian illegal state aid

On 16 September, the European Commission launched separate in-depth investigations into tax rulings granted by Belgium to 39 multinational companies, to assess whether it gave the companies a selective advantage and breached EU state aid rules. The Belgian 'excess profit' tax rulings, which rely on the Belgian income tax code, allow multinationals in Belgium to reduce their corporate tax liability by the 'excess profits' that arise as a result of being part of a multinational group.

This is after the commission initially ordered Belgium to recover €700m from the companies back in 2016. The commission concluded that the tax rulings which allowed unilateral downward adjustments of their tax base constituted state aid and breached EU rules. Additionally, they had concerns that Belgium did not apply the arm's length principle appropriately. The commission also highlighted the fact that taxpayers had to make substantial investments or meet employment creation targets in Belgium in order to be granted the tax ruling, meaning the rules were not applied equally. They argued that this evidenced a selective advantage for which there is no justification.

On 14 February 2019, the General Court of the CJEU deemed that the commission failed to provide sufficient evidence demonstrating the existence of a state aid scheme. It was this annulment which has prompted the commission to relaunch the investigations separately.

The launching of these individual investigations could be expected in light of the General Court's decision of February, which did not address the existence of an aid for individual rulings and if so whether aid was unlawful. It is, however, interesting to note that the Commission is pursuing all available legal avenues, launching both new investigations into individual rulings and appealing the court's decision before the CJEU. It remains to be seen how the latter will rule and whether all proceedings will evolve in parallel.

Ireland's proposed transfer pricing rule changes

The Irish government published a 'feedback statement' at the beginning of September which summarises the proposed changes being considered to transfer pricing rules which are expected to be effective as of 1 January 2020.

The update is intended to respond to recommendations from the Coffey Review, an independent review of Ireland's corporation tax code, as well as to incorporate the 2017 OECD transfer pricing guidelines into Irish legislation.

The statement also incorporates a number of other key provisions. These include:

- Removal of the grandfathered arrangements which apply the exemption from transfer pricing rules to pre-July 2010 arrangements.
- Bringing certain non-trading transactions within the scope of TP rules. It is worth noting that these rules will not apply when both parties involved in the transaction are subject to Irish tax, effectively exempting domestic transactions.
- Bringing small and medium-sized enterprises (SMEs) into the reach of TP rules, however, there will be no formal documentation requirements for small enterprises, as well as medium-sized enterprises when one party involved in a transaction is not within the charge to Irish tax and the consideration of the transaction does not exceed €1m. There will be simplified documentation requirements applied to medium-sized enterprises that are not exempt.
- Application of transfer pricing rules to determine the market value of chargeable assets for capital gains tax purposes and to capital transactions (i.e. for capital allowance and balancing event purposes) when the transaction value/capital expenditure exceeds €25m.

Poland: new anti-hybrid rules

On 23 August 2019, new legislation was published by the Polish government to address tax optimisation via the use of hybrid structures. The legislation, which concerns the implementation of the EU's ATAD, introduces new rules concerning discrepancies in the classification of economic entities and payments by various tax jurisdictions to prevent different treatments of revenues and costs by taxpayers.

The rules are introduced via a new chapter in Polish corporate income tax law. The key purpose of the new chapter is to address situations involving the double tax deduction of costs or deduction without recognition of corresponding revenues. The changes also address issues including dual-resident mismatches and disregarded permanent establishments.

Any multinationals with Polish activities should carefully consider whether these new rules may affect their structures. However, most groups will be looking at this more widely, as all EU territories are required to implement the anti-hybrid element of the ATAD.

Apple EU state aid case hearing

It is over three years ago now since the European Commission ordered Apply to pay €13bn plus interest to the Irish government in relation to illegal state aid during the period 2004 to 2014. This was the largest corporate tax fine in history, and Apple paid €14.3bn into an escrow fund in September 2018 pending its appeal and that of the Irish government against the decision. On 17 and 18 September, appeal hearings took place in the Court of Justice in Luxembourg. The appeal hearing saw all parties flesh out arguments that have been heard previously. Focus was placed on the interpretation of Irish tax law, as well as the allocation of assets and functions to the two Apple subsidiaries which were incorporated in Ireland, but were not tax resident there. This resulted in the accusation that Apple and the Irish state had created an 'artificial' profit arrangement enabling Apple to pay a tax rate of less than 1%.

The Commission argued that with the companies having no employees and no record of boards of directors outside Ireland, the profits should therefore be attributed to Ireland. It's safe to say that Apple does not agree, having previously accused Brussels of 'legal mumbo jumbo' and the Commission of 'rewriting' Irish tax law in relation to the original decision. Apple argues that the subsidiaries were in no way involved in creating or managing IP rights and were merely performing routine functions in Ireland. A ruling is expected by the end of 2020. However, regardless of the outcome, the losing party is likely to appeal to the CJEU, meaning that I expect we won't hear the end of this case for a while to come yet.

MAP statistics for 2018 released

As mentioned above, the first 'OECD tax certainty day' saw the detailed MAP statistics for 2018 published, covering 89 jurisdictions and almost all MAP cases worldwide. The report shows that the number of new cases is continuing to increase. New transfer pricing cases are up 20% on the previous year statistics, and there is a 10% rise in other cases. On a positive note, the aggregate global inventory has reduced, largely owing to the number of transfer pricing and PE profit attribution cases closed exceeding the number of new cases opened.

The report revealed that the average time taken to close transfer pricing cases increased to 33 months from 30 months in 2017. In contrast, the average duration of other cases has fallen from 17 months in 2017, to 14 months in 2018. It's worth noting that average times for case resolution vary drastically by jurisdiction, ranging from two to 66 months. It will not come as a surprise to readers to hear that Italy is amongst the slowest countries to resolve cases.

In terms of outcomes, close to 75% of transfer pricing cases closed were resolved with an agreement fully or partially resolving taxation not in accordance with tax treaty, with 5% being granted a unilateral relief and another 5% resolved via a domestic remedy. It's reported that only 2% of MAP cases were closed without a mutual agreement being reached between the competent authorities.

This is the first time that the OECD has compared the reporting jurisdictions' performance to key indicators such as time taken to close MAP cases within the report. This jurisdiction specific reporting is expected to allow for greater transparency as well as improved focus.

Looking at the individual country statistics reveals a mixed picture. A number of countries have made significant progress in reducing their transfer pricing caseload, most notably Germany, the United States, Canada and Japan. Germany closed 227 transfer pricing cases in 2018, which was 46 more than the next highest total by the US. By contrast, the caseload for France, Italy, Spain and India increased significantly. 66% of the transfer pricing cases closed in 2018 were opened prior to the later of 1 January 2016 and the date the country joined the BEPS Inclusive Framework. The statistics suggest that a number of countries are taking steps to reduce their inventory of old cases which should create more capacity to help them meet the dispute resolution minimum standards established by BEPS Action 14. ■

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