Briefing

International review: looking back on 2019

Speed read

This year was characterised by developments in the taxation of the digitalised economy, including the proliferation of unilateral digital services taxes around the world, refinements to US tax reform, the EU mandatory disclosure rules coming into force, more high-profile EU state cases and an ever-increasing global focus on tax transparency. The pace of change is unlikely to relent in 2020.

Tim Sarson
KPMG
Tim Sarson is a tax partner at KPMG in the UK. He has worked in the international tax and transfer pricing field since 1998, in both practice and industry. Email: tim.sarson@kpmg.co.uk; tel: 020 7694 4831.

For my final article of 2019, I decided to recap on some of the interesting developments that unfolded over the past year. Tax has never been higher on the business and political agenda. The OECD's work on digital taxation has the potential to transform the international landscape but while those discussions continue, we have seen refinements to US tax reform, EU mandatory disclosure rules taking shape, more high-profile EU state aid cases, the continued fight against aggressive tax avoidance and supranational efforts to increase tax transparency. It has been another extremely busy year; if you had to ask me 12 months ago to predict the state of the international tax world a year ahead, I would not have predicted many of the developments we have seen.

This article discusses this progress under two lenses: the OECD and the EU. Although much has already been reported on taxing the digitalised economy, I could not start the article without summarising the key developments we have seen in this area over the last 12 months because of its global significance. I will then focus on some key developments in the EU and US. I end the article with a reflection on the type of tax world businesses may need to navigate in 2020.

Taxation of the digitalised economy

2019 was the year where unprecedented progress was made in the taxation of the digitalised economy. Initially identified as a main area of focus in the 2015 BEPS Action 1 report, the general feeling in a post-BEPS world was, however, that little progress was actually being made to adequately address the tax challenges of the digitalisation of the economy. Fast-forward to 2019. Early signs were that the subject was clearly going to be high up the OECD's priority list with 'digital' fast becoming the tax buzz word of the year. In fact, a policy note, public consultation and programme of work (to develop a consensus solution) later; we now have two OECD Secretariat proposals which focus on reviewing profit allocation and nexus (the pillar one 'unified approach') and the introduction of a globally-agreed minimum standard on direct tax matters that will ensure that all internationally operating businesses pay a minimum level of tax (the pillar two 'globe proposal'). If agreed to, these changes will fundamentally alter the international tax regime; the biggest change since the 1920s.

As at the date of writing, the OECD has just published the public comments received on its pillar one proposal. More than 300 submissions from a range of businesses and other stakeholders were made. This certainly reflects the potentially far-reaching implications of the OECD's proposed reforms. The OECD held the public consultation on pillar one on 21 and 22 November. A public consultation on pillar two will be held on 9 December. The OECD is working towards achieving a consensus-based solution in 2020. We await further developments in earnest.

Over the past year, we also witnessed a proliferation of unilateral digital services tax (DST) across the globe, with various countries unwilling to wait for action at OECD level. EU member states also failed to reach agreement on a watered-down version of the EC's DST proposal back in March with the Romanian presidency of the Council confirming that an EU-wide DST will be revisited if global consensus on a solution is not reached by the end of 2020. In the meantime, France enacted a 3% DST on the gross revenues derived from digital activities of which French users are deemed to play a major role in value creation. Austria will impose a 5% DST on the turnover from advertising services rendered by service providers in Austria. Czech Republic started the formal legislative process to introduce a 7% DST in July. Italy had planned to introduce a DST but this has been delayed. The UK has consulted on a 2% DST on revenues derived from British users' creation of value for digital services businesses. Turkey issued a legislative proposal for a 7.5% DST in November. The breadth of these taxes, as well as the applicable rates, vary considerably (bearing in mind they apply to a revenue measure rather than profit) and, absent an international consensus emerging through the OECD's pillar one, there is a real risk of double taxation arising.

The EU's BEPS response

ATAD

We started off 2019 with the immediate application of the EU's Anti-tax Avoidance Directive (ATAD) rules. This is somewhat of a turning point in EU direct taxation, as ATAD provides for five common minimum rules that member states have to implement – relating to interest limitation, exit taxation, general anti-abuse (GAAR), controlled foreign companies (CFC) and hybrid mismatches – with the intention of targeting tax avoidance practices in the EU. Various member states, such as the UK, already had robust anti-avoidance rules in place which in most cases met or exceeded the ATAD requirements. However, for some, ATAD meant making structural tax policy choices and amending substantive law to incorporate new layers of anti-abuse rules.

Only the interest limitation rule, GAAR and CFC rules had to be applied as of 1 January 2019. The date of application for exit taxation is 1 January 2020, while other rules may be applied at later dates.

The 1 January 2020 date is relevant for ATAD II, which extends the territorial scope of ATAD to third countries and brings within scope reverse hybrid mismatches, imported mismatches, hybrid permanent establishments and hybrid transfers. EU member states have to transpose ATAD II into domestic law by 31 December 2019 and apply most of the provisions from 1 January 2020.

DAC 6

We also witnessed plenty of activity in the tax transparency and mandatory disclosure reporting space. The EU Directive on Administrative Cooperation in the field of taxation (DAC 6), which entered into force on 25 June 2018, introduced an obligation on intermediaries and relevant taxpayers to disclose information on certain reportable cross-border arrangements. Relevant arrangements implemented on or after 25 June 2018 must be reported by 31 August 2020. Arrangements where the trigger point for disclosure arises after 1 July 2020 must be reported within 30 days of the relevant trigger date. EU member states are required to transpose DAC 6 into their respective domestic law by 31 December 2019. This deadline, however, does not extend to the publishing of domestic administrative guidance.

Member states have been moving to implement DAC 6, albeit at different speeds. Poland and another six member states (Austria, France, Hungary, Lithuania, Slovakia and Slovenia) have finalised the internal legislative process for implementation. Poland is particular in its approach as it has implemented rules far wider than the directive. For example, it has already introduced 30 day reporting and also brought VAT and other domestic transactions into scope. Seventeen countries – Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the UK – have approved or published draft legislation for consultation or are discussing proposals within their finance ministries. (The UK issued draft UK regulations were issued on 22 July 2019, alongside a consultation document.) At the other end of the spectrum four member states (Greece, Latvia, Malta and Romania) are yet to make public the text of their respective DAC 6 implementing legislation. It remains to be seen whether the latter countries will meet the 31 December deadline.

The EU has chosen not to adopt a highly prescriptive approach to DAC 6, using broad definitions and various undefined terms. As time goes by, it is becoming increasingly evident that there will be – in some instances, significant – different approaches to interpretation across EU jurisdictions. This will probably lead to increased complexity in practice, with potentially different conclusions being drawn when assessing the same arrangement in different jurisdictions. Whilst the publication of interpretative guidance by several member states is a welcome development, more is expected in this space over the coming months. The landscape looks set to become more complicated over the coming year with third countries, such as South Africa, the Channel Islands, Norway and Mexico, also contemplating introducing mandatory disclosure rules.

State aid developments

Under EU Commissioner for Competition Margrethe Vestager's watch, tax law and EU competition law have never been closer. Article 107 of the TFEU on EU state aid is being used by the EC as a powerful tool to assess particular domestic tax regimes which are seen as providing selective uncompetitive advantages to certain companies over others. In fact, in 2019 we witnessed an arm wrestle between the UK and EU – away from the Brexit debate – with the state aid rules targeting the UK's regime for certain financing income of CFCs. In a 2 April ruling, the EC confirmed that the exemption was partially justified. It did not constitute state aid when it related to financing profits attributable only to capital investment from the UK but did constitute state aid in relation to financing profits attributable to UK activities ('significant people functions'). The latter part of the judgment is under appeal.

Various tax rulings provided by domestic tax authorities to multinationals have also come under attack. On 16 September, the EC launched separate in-depth investigations into 'excess profit' tax rulings granted by Belgium to 39 multinational companies. We also had the landmark decisions against the Netherlands and Luxembourg in relation to advance transfer pricing agreements granted to two different multinationals. Moreover, the high profile case concerning Ireland and Apple is still ongoing, where €13bn of alleged illegal state aid plus interest is in dispute.

US tax reform

It has been two years since the Tax Cuts and Jobs Act was signed in late 2017 triggering a sweeping overhaul of the US tax rules. The initial reaction of US multinationals to the base erosion and anti-abuse tax (BEAT) and the global intangible low-taxed income (GILTI) rules was cautious as the issue of key proposed regulations was delayed. However, in June 2019, the US Treasury and IRS issued regulations that included a new GILTI high-tax exception election which clarified and amended some of the potential issues that were noted for the previous proposals. For instance, 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%). Interestingly, Boris Johnson announced at the CBI annual conference on 18 November that the previously enacted 17% corporation tax rate which was due to come into effect from 1 April 2020, would be put on hold if the Conservative Party wins the general election. This could be beneficial in enabling the profits of UK subsidiaries of US multinationals to qualify for the GILTI high-tax exception.

It is expected that the final and proposed BEAT regulations will be released over the coming weeks, and the final GILTI regulations will be issued in 2020. It will be interesting to watch the US's role at the OECD over the coming months, particularly with respect to the pillar two GloBE proposal, which is widely understood to have been inspired by GILTI but which could adversely impact a number of large US multinationals.

Other notable developments

EU list of non-cooperative jurisdictions for tax purposes

Various amendments were made to the list in 2019. On 10 October, EU ministers agreed to remove Switzerland from the grey list of non-cooperative jurisdictions and into the fully cooperative category. This followed the highly-anticipated Swiss referendum earlier this year and confirmation that relevant legislation had come into force with an effective date of reform of 1 January 2020.

The UAE, having improved its economic substance rules, was also added to the white-list. Other jurisdictions removed in 2019 were Aruba, Barbados, Bermuda, Dominica and the Marshall Islands. A decision was taken as recently as 8 November 2019 to remove Belize from the EU blacklist due to the introduction of four legislative acts, including a reform of its International Business Companies Regime and a commitment to amend or abolish the features that are considered harmful in its foreign source income

exemption regime. Belize will remain on the grey list until the promised reforms have been implemented. The blacklist now includes eight jurisdictions: American Samoa, Fiji, Guam, Oman, Samoa, Trinidad and Tobago, the US Virgin Islands, and Vanuatu.

In addition, a decision was made to remove the Republic of North Macedonia from the EU grey list following the submission of instruments of ratification for the OECD Multilateral Convention on Mutual Administrative Assistance to the Council of Europe on 30 September 2019. There are now 32 jurisdictions remaining on the EU grey list.

India

The Indian courts have again been busy with various cases on the determination of permanent establishments (PE) of foreign companies in India. In the *Gemelogical Institute of America* case, the Mumbai Bench of the Income-tax Appellate Tribunal held that an Indian subsidiary of a US tax group that rendered grading services and management services (in the stones/ diamond industry) to its US parent was not a PE in India under the India/United States income tax treaty. On service PE, the court found that the salary cost of the graders was borne by the Indian subsidiary and they were working under its control and supervision. The tribunal also found that the taxpayer was not a 'fixed place' PE nor was it an agency PE.

The year ahead

2020 will certainly see more developments in the OECD's work on taxing the digitalised economy. The OECD is seeking the consensus of all 134 members of the Inclusive Framework; this will be no easy task especially as the OECD is working towards tight deadlines. Where agreement on the OECD proposals cannot be reached, the EU has indicated that it will reintroduce proposals for an EU DST in 2020. The direction of travel should become clearer in the months ahead, however, it remains to be seen whether the recent progress at OECD level will be sufficient to curtail new unilateral DSTs from being enacted. There is also the eagerly awaited output from the OECD's project looking at transfer pricing of financial transactions.

DAC 6 deadlines means intermediaries and taxpayers should be closely monitoring the implementation of the Directive and begin readying themselves to make disclosures. Given apparent uncertainties in interpreting DAC 6, intermediaries and taxpayers may take a more cautious approach to reporting. This may mean more reporting and it remains to be seen how tax authorities will deal with the volume. From 2020 onwards, updates to the blacklist will be made no more than twice a year to allow sufficient time for member states to amend defensive measures against non-cooperative jurisdictions in their domestic law so it may be a quieter year (or at the very least, less sporadic updates will be published) ahead on this front. There could also be more developments in the EU state aid sphere given the EC's recent track-record.

The UK and the EU may find themselves at loggerheads going forward and, depending on the Brexit outcome (and post-general election), we expect to see the UK government looking to improve its existing tax treaties as well as negotiating new ones, although the process for negotiating treaties means these efforts may not bear fruit in 2020.

The war on tax rates is also starting to show signs of abating; according to OECD statistics published this year the average statutory tax rate for covered jurisdictions was 21.4% in 2018, narrowly down from 21.7% in 2017, when compared to the 28.6% rate in 2000. However, we can still expect to see competition for inbound investment through the various tax reliefs and incentives on offer, as well as strong barriers to tax-driven relocations.

One thing is for certain. With the digital debate, EU state aid and various other developments, including Brexit, multinationals will continue to have their hands full keeping abreast of changes to the global tax agenda. 2020 will be another year where they will have to navigate a fast-changing landscape with ever increasing complexities, but there will also be genuine opportunities to achieve improvements in efficiency and consistency thanks to the growing number of technology solutions on offer. ■

For related reading visit www.taxjournal.com

- Going GloBal: the OECD's consultation on pillar two (Brin Rajathurai & Murray Clayson, 18.11.19)
- Unify and conquer: the OECD's 'unified approach' to pillar one (Brin Rajathurai & Murray Clayson, 16.10.19)
- Examining the revised EC Anti-Tax Avoidance Directive (Zoe Wyatt & Tom Wesel, 7.7.16)
- ATAD II: the revised EU rules on hybrid mismatches (Kitty Swanson & Sandy Bhogal, 5.4.17)
- The UK's emerging response to the EU's ATAD (James Taylor, 26.7.18)
- The state aid ruling on UK's CFC regime: an EU compromise (Paul Davison, 3.4.19)
- State aid and the Belgium excess profits case (George Peretz QC, 21.2.19)
- US tax reform: examining the Tax Cuts and Jobs Act of 2017 (Donald L. Korb & Andrew Solomon, 11.1.18)
- US tax reform: the GILTI and FDII provisions (Mark Saunderson & Miles Humphrey, 26.7.18)
- The UK implementation of DAC 6: examining the draft regs (Matthew Hodkin & Susie Brain, 2.9.19)