PKF FRANCISCLARK

Chartered accountants & business advisers

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tax newsletter

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PKF Worldwide Tax Update

Welcome

In this first quarterly issue for 2019, the PKF Worldwide Tax Update newsletter again brings together notable tax changes and amendments from around the world, with each followed by a PKF commentary which provides further insight and information on the matters discussed. PKF is a global network with 400 offices, operating in over 150 countries across our 5 regions, and its tax experts specialise in providing high quality tax advisory services to international and domestic organisations in all our markets.

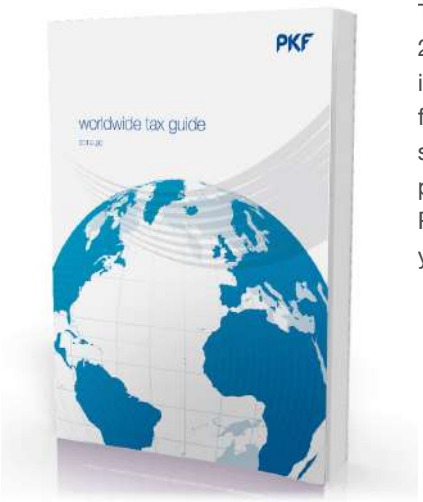
In this issue featured articles include discussions on:

- Key tax changes for 2019 in Costa Rica, Romania, Russia, Serbia and Uganda
- Transfer pricing developments in China, Peru and the USA
- Developments in the area of double tax treaties in Belgium, Cyprus and South Africa
- Digital services tax in Chile and the UK
- Controlled Foreign Companies (CFCs) in Austria, Ireland and the USA
- Tax incentives in Austria, China and Poland

We trust you find the PKF Worldwide Tax Update for the first quarter of 2019 both informative and interesting and please do contact the PKF tax expert directly (mentioned at the foot of the respective PKF commentary) should you wish to discuss any tax matter further or, alternatively, please contact any PKF firm (by country) at www.pkf.com/pkf-firms.

2019/20 Worldwide Tax Guide

Last year's PKF Worldwide Tax Guide featured 134 countries and was a resounding success with almost 1,500 distributed globally. We are extremely grateful to all those that provided country submissions, and of course, to each person who ordered a guide and supported this very marketable and impressive publication.



The production of the 2019/20 Worldwide Tax Guide is underway and we look forward to your continued support. An **Order Form** is provided at the end of this PKF newsletter. Thank you for your continuing support.

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Australia

Changes to company tax rate for small businesses

During the 2018 year, further changes were made to the eligibility requirements for the concessional company tax rate of 27.5% in respect to small businesses entities.

Eligibility for the lower company tax rate depends on whether you are classified as a base rate entity for Australian tax purposes. A base rate entity is a company that:

- Has an aggregated turnover less than AUD 25 million for the 2017–18 income year (previously this aggregated turnover threshold was less than AUD 10 million)
- 80% or less of their assessable income is passive income – this replaces the requirement to be "carrying on a business" which was the previous requirement for "small business entities"

Key points to note:

- Aggregated turnover includes the annual turnover of your company plus the annual turnover of all the entities that are connected or affiliated with your company. These connected or affiliated companies may be based in Australia or overseas.
- Passive income includes:
  - Corporate distributions and franking credits on these distributions
  - Royalties and rent
  - Interest income (some exceptions apply)
  - Gains on qualifying securities
  - A net capital gain
  - An amount included in the assessable income of a partner in a partnership or a beneficiary of a trust, to the extent it is traceable (either directly or indirectly) to an amount that is otherwise base rate entity passive income
- Future reductions to the corporate tax rate are legislated as follows:

- 27.5% for the 2019–20 income year (aggregated turnover threshold increased to AUD 50 million)
- 26% for the 2020–21 income year (aggregated turnover threshold AUD 50 million)
- 25% for the 2021–22 income year and for subsequent income years (aggregated turnover threshold AUD 50 million)

PKF Comment

*For corporate taxpayers that do not qualify as a base rate entity, the company tax rate of 30% continues to apply. These changes not only impact the rate at which small business entities are taxed but also the rate which eligible companies can use franking credits to frank dividends under Australia's imputation system. With that in mind, the tax rate for imputation purposes will reflect the rate of tax for that applicable year. For further information or advice with respect to Australian taxation, please contact Sara Crevillen at sara.crevillen@pkf.com.au or call **+61 7 3839 9733**.*

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ATO releases Practical Compliance Guideline "PCG" 2018/D4

The Australian Taxation Office released on 25 October 2018 the PCG 2018/7 which sets out the ATO's compliance approach in relation to the hybrid mismatch rules and related restructures. The PCG is designed to assist taxpayers to manage their compliance risk and outline restructuring that the Commissioner considers to be of "low risk".

This PCG follows the implementation of the hybrid mismatch legislation in Australia in May 2018 further to the Organisation for Economic Cooperation and Development (OECD)'s Base Erosion and Profit Shifting Action Plan on hybrid mismatches.

The hybrid mismatch rules aim to prevent multinational companies that are liable to tax in Australia from being able to avoid income taxation or obtain a double non-taxation benefit, by exploiting differences between the tax treatment of certain entities and instruments across different jurisdictions. Broadly, the rules target payments (e.g. interest, royalties, rent, dividends) that are deductible for the payer in one country but not assessable to the recipient in another country, as well as payments that give rise to a deduction in two jurisdictions. The rules also apply to receipts that are sheltered from tax directly or indirectly by hybrid outcomes elsewhere (e.g. as in a group of entities or chain of transactions). A targeted integrity rule may also apply in certain circumstances to deny Australian interest deductions. Broadly, this integrity rule applies where the Australian entity pays interest to a foreign interposed entity, the interest income is subject to tax at a rate of 10% or less (e.g. Singapore or Hong Kong), the foreign interposed entity, the Australian entity and the ultimate parent entity are all members of the same control group and there was a scheme entered into for a "principal purpose" (or for more than one principal purpose) that includes a purpose of obtaining an Australian deduction and enabling foreign tax to be imposed on the payment at a rate of 10% or less.

The rules will operate in Australia to neutralise hybrid mismatch outcomes by cancelling deductions or including amounts in assessable income. Subject to some exceptions, the rules apply to certain payments and income years commencing on or after 1 January 2019. There are no de minimis thresholds that apply in relation to these rules (unlike the provisions that apply to 'significant global entities').

As per the explanatory memorandum of the legislation, it is expected that many taxpayers will restructure out of hybrid or high-risk arrangements and enter into different arrangements. The PCG provides guidance and reassurance for taxpayers in order to restructure in a manner that qualifies as low risk. Examples of higher risk arrangements are also given in the PCG.

PKF Comment

Multinationals with international related party dealings involving Australia and hybrid arrangements (e.g. hybrid entities or instruments) should consider if the hybrid rules are potentially applicable. This will include determining how the entities involved are taxed in their respective jurisdictions. Although the PCG provides guidance on low risk restructures, it may not be possible to implement them commercially. In this case, taxpayers should ensure that the restructure does not attract the general anti-avoidance rules contained in Part IVA of the Australian legislation. There are also various other tax issues to be considered including transfer pricing, withholding taxes and foreign tax credits amongst others in the different jurisdictions involved. Given the timing is tight and issues can be complex, we recommend all inbound and outbound entities consider and plan for the application of these rules as a priority.

*For further information or advice concerning the Australian's legislation on hybrid mismatch rules or any advice with respect to Australian taxation, please contact Iain Spittal at ispittal@pkf.com.au or Emma Roulet at eroulet@pkf.com.au or call **+61 2 8346 6000**.* »BACK

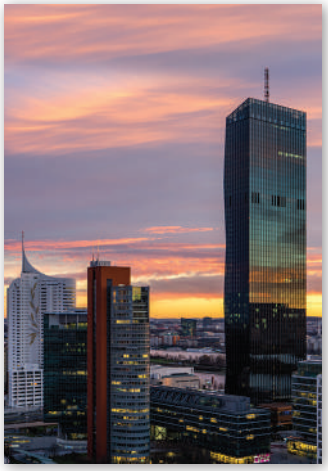
Austria

New CFC regime starting 2019

In accordance with BEPS and ATAD, Austria will introduce CFC taxation with effect from 1 January 2019. Passive income of foreign subsidiaries subject to low tax rates will be taxed at the level of the controlling parent company in Austria. The CFC rule applies to passive income subject to low or no taxation abroad, which is generated by a controlled foreign corporation (also including permanent establishments). The CFC income is added to the income of the Austrian parent company. The regulation applies for the first time to fiscal years that commence after 31 December 2018.

Passive income

Low-taxed passive income must amount to more than one third of the total income of the foreign company. Passive income includes interest, royalties, dividends and income from the sale of shares, income from finance leasing, income from banks and insurance companies (subject to exceptions) and other financial activities. Own personnel, equipment, assets and premises can serve as proof that a controlled foreign corporation carries out a "substantial economic activity". In such cases the CFC rule will not apply.



Low taxation

Low taxation means that the actual offshore tax burden does not exceed 12.5 %. The total income (passive and active) of the foreign corporation must be determined in accordance with Austrian tax rules. In order to calculate the average total tax burden, the tax actually paid offshore is then compared with the converted income of the foreign corporation.

Controlled corporation

A foreign company is considered controlled if the Austrian entity holds directly or indirectly, independently or together with other associated entities, more than 50 % of voting rights or stock, or has the right to receive more than 50 % of the profit. Should this result in the simultaneous allocation of passive income on various levels within the group, double taxation will be avoided by certain regulations.

PKF Comment

*The new CFC regime represents a significant change to Austrian corporate tax law. A (highly) tax-efficient retention of profits abroad is no longer possible. Some details and the specific procedures still have to be clarified and regulated by the Austrian tax authorities. If you believe the above measures may impact your business or require any advice with respect to Austria taxation, please contact Thomas Ausserlechner at thomas.ausserlechner@pkf.at or call **+43 1 512 87 80**.* »BACK

Belgium

Tax consolidation in Belgium

As of 2019, Belgium tax legislation is featured by tax consolidation legislation for corporate tax purposes following the transposition of the EU Anti-Tax Avoidance Directive into Belgium tax law. As a preliminary remark, it is merely optional to become part of a tax consolidation group or not. In addition, all Belgium companies and permanent establishments (PE) being part of a tax consolidation group need to keep on filing their own Belgium corporate tax return. The conditions to become part of a tax consolidation group are as follows: (i) only Belgium tax resident companies qualify if they have a parent–subsidiary relationship or are sister companies with a common EEA based parent company (ii) also a Belgium PE of one of the above-mentioned companies qualifies (iii) the companies at hand must have been having a minimum 90% shareholding link during the entire financial year at hand and for 5 full financial years in total (iv) all companies need to have the same year-end date, (v) all companies should be subject to "normal" taxation, and (vi) a company or a PE cannot have an asset on its balance sheet that is put at the disposal of a company director.

If Belgium companies and Belgium PEs are part of a tax consolidation then the Belgium corporate tax ramifications are as follows: if a group member has current-year tax

losses, these can be fully or partially transferred to another group member of the tax consolidation. However, to compensate for the use of tax losses, the company or PE that actually offsets the tax loss against its taxable basis has to cash-wise pay a group contribution compensation to the group member that transferred the tax loss. The amount of the group contribution compensation equals the amount of tax losses received times the applicable corporate tax rate. The proof of payment should be enclosed with that group member's corporate tax return. At the level of the group member paying the group contribution compensation, the latter is a disallowed expense for corporate tax purposes. At the level of the group member receiving the group contribution compensation, the latter is tax-free.

For the sake of completeness, it is also possible to deduct 'final losses' of a foreign (EEA based) affiliated company for Belgium corporate tax consolidation purposes if the latter's business activities have not been taken over by another affiliate during the course of the 3 most recent years. However, if such a 'final loss' has been deducted from a Belgian group member's taxable basis and the activities of the foreign company concerned are subsequently restarted within a 3-year period, then there will be a 'recapture' of this foreign tax loss in Belgium.

As a formal condition to create a tax consolidation group, each financial year the various group members need to conclude a group contribution agreement in which all terms and conditions of the tax consolidation group are defined.

PKF Comment

*The Belgium tax consolidation rules give rise to attractive tax and cash-flow benefits for the various group members involved. However, particular attention should be paid to the formal conditions that need to be met annually in order to put in place a Belgium tax consolidation group. If you have more questions about Belgium tax consolidation, please contact Kurt De Haen at kurt.dehaen@pkf-vmb.be or call **+32 2 460 0960** for any further questions.*

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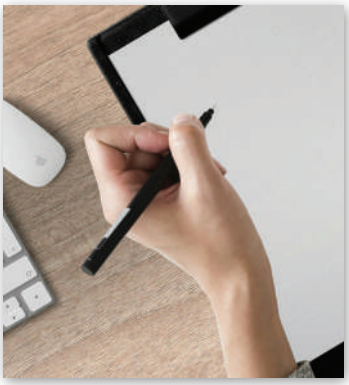
Circular Letter confirms subject-to-tax test in view of tax treaty relief

On 20 July 2018, the Belgium tax authorities have issued a Circular Letter regarding the subject-to-tax test which is laid down in (mostly article 23 of) applicable tax treaties in order to avoid or minimise double taxation. The Circular Letter focuses in particular on the subject-to-tax test of the Belgian-Dutch tax treaty. Actually, the Circular Letter in essence is a reaction of the Belgium tax authorities to a recent (and surprising) decision of the Belgium Supreme Court dated 25 January 2018. Summarised, in this decision, the Supreme Court seemed to say that when Belgium tax residents receive Dutch-source income which is not effectively taxed in The Netherlands, even though the latter have levying power pursuant to the tax treaty, Belgium should grant a tax exemption anyhow in order to minimise double taxation. Without entering into details, this case law was very surprising because the Belgian-Dutch tax treaty explicitly states that foreign-source income should be "taxed" to be eligible for tax relief in the other contracting state. According to the Belgium interpretation and as confirmed in earlier Circular Letters, the notion "taxed" means "effectively taxed" in view of benefitting from a tax exemption in Belgium. Hence, the notion "taxed" distinguishes itself from the notions "can (possibly) be taxed" or "is (theoretically) taxable" as laid down in other tax treaties concluded by Belgium. Specifically, in the Circular Letter of 20 July 2018 the Belgium tax authorities reiterate that a tax treaty rule should be interpreted in accordance with the objectives and intentions of both contracting states when negotiating and concluding the tax treaty at hand. As a result, there cannot be any doubt that the notion "taxed" means "effectively taxed" following the view of the Belgium tax authorities.



PKF Comment

The position taken by the Belgium tax authorities in their Circular Letter of 20 July 2018 did not come as a surprise. Moreover, it is good to note that the Belgium tax authorities reacted so promptly and instantly after the January 2018 case law of the Belgium Supreme Court, in particular in

*order to duly manage the taxpayer's expectations after this (stand-alone) court decision. Very likely, this administrative statement will minimise additional litigation with the Belgium tax authorities and additional court cases on this interpretative matter going forward. If you have further questions in this respect, please contact Kurt De Haen at kurt.dehaen@pkf-vmb.be or call **+32 2 460 0960** for any further questions.*

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Bulgaria

Interest limitation rule introduced in the Bulgarian Corporation Tax Act

The new interest limitation rule in the Bulgarian Corporate Income Tax Act comes into force as of 1 January 2019. If the threshold of EUR 3 million borrowing costs per year is reached, the excess interest costs will be deductible up to 30% of the taxpayer's EBITDA.

The definition of borrowing costs includes interest costs from all types of debt arrangements and all costs made in respect to obtaining capital, e.g. amounts paid under alternative funding mechanisms, currency losses that arose from debts or financial instruments, etc. If the borrowing costs are under EUR 3 million per year, then a modified version of the existing thin capitalisation regime will be applied in parallel with the new interest limitation rules where the latter's conditions are met. The existing 5-year limitation for carrying forward non-deductible interest expenses under the thin capitalisation rule has been abolished.

PKF Comment

*The tax consultancy team of PKF Bulgaria has substantial knowledge and expertise and is in the position to provide assistance at each stage of Bulgarian tax planning and compliance procedures to both foreign and local individuals. We have successfully consulted our PKF clients who operate in various fields of business on how to be compliant with the rapid changes of the tax legislation in the everchanging business environment. For further information or advice concerning Bulgarian tax planning, please contact Venzi Vassilev on venzi.vassilev@pkf.bg or call **+359 2439 4242**.*

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Chile

Tax on digital transactions

On 23 August 2018 the government presented a tax reform package to the Congress proposing, among other things, new regulations for the taxation of digital services rendered in Chile by non-resident companies.

The tax would have the following characteristics:

- It is a specific tax, indirect and substitutive of any other tax
- The tax affects digital services provided by persons or entities domiciled or resident abroad, when such services are used in Chile by individuals (irrespective of where servers may be located). It will be presumed that digital services are used by individuals in Chile, when the issuers of the electronic means of payment used are persons or entities with domicile or residence in the country, or agencies that such issuers have in Chile
- The tax rate is 10% and is applied to the total amount of the operation
- The tax must be withheld by the issuers of electronic means of payment, provided the service is paid through these means. However, when the payment is in cash, the tax obligation will be on the provider of the digital services
- Digital services subject to tax are the remunerated services of digital intermediation between providers of any kind of services and users thereof that allow carrying out the respective transactions by electronic means, whether the provision of the services object of the digital intermediation is performed by traditional or electronic means. The tax also affects digital content entertainment services (videos, music, games, etc.), advertising abroad and data storage services

PKF Comment

The Bill would affect foreign companies that provide the above services when they are used in Chile by individuals. Services that might be affected include e.g. digital intermediation (Uber and Airbnb), digital entertainment (Spotify, Netflix) and digital storage (either as cloud or software services).

It would be presumed that the service is consumed in Chile by individuals when using electronic means of payment the users of which have their domicile or residence in Chile or have agencies in Chile, i.e. a service that has been used abroad but was paid by means of a credit card issued in Chile will be considered subject to the tax. Regarding the possibility of proving that the service was used abroad and would therefore be exempt from the tax, as well as for other situations stated in the proposed regulations, we expect the Internal Revenue Service to issue appropriate instructions in due time.

If you believe the above measures may impact your business or require any advice with respect to Chile taxation, please contact Antonio Melys Alvarez at amelys@pkfchile.cl or call ***+56 22650 4332.***

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China

Research & Development cost super-deduction increased up to 75% in China

On July 23, 2018, Premier Li Ke Qiang proposed a plan in the State Council meeting for better financial policies to support domestic demand expansion and structural adjustment to promote real economic development. In the meeting it was decided that the pre-tax super deduction policies for research and development (R&D) expenses will be extended from technology-based small and medium enterprises to all enterprises.

Soon after, the State Administration of Taxation issued the corresponding documents. According to Cai Shui [2018] No. 99, with respect to research and development expenses effectively incurred by an enterprise from its R&D activities, an extra 75% of the actual amount of expenses is deductible before tax, in addition to other actual deductions, during the period from 1 January 2018 until 31 December 2020, provided however that the said expenses are not converted into the intangible asset. If the said expenses have been converted into the intangible asset, such expenses may be amortised at a rate of 175% of the intangible asset's costs before tax during the abovementioned period.

Generally, a company shall follow the process below to claim R&D super-deduction:

1. The company shall decide to set up the research and development projects
2. The contracts signed by entrusting or cooperating R&D projects shall be registered with the science and technology department
3. Establish accounts ledger (R & D cost account and sub-accounts)
4. Establish the supplementary accounts of the R&D project expenses
5. Prepare accounting records for R&D expenditure
6. Prepare the R&D costs supplementary ledger according to relevant documents
7. Prepare a supplementary account summary table of R&D costs as the notes to financial statements submitted to the Tax Office
8. Prepare the computation table of R&D costs that can be deducted for R&D projects
9. Collecting and storing data for reference
10. Tax filing with the competent Tax Office
11. Declare annual corporate income tax filing and apply in order to benefit from preferential policies
12. Relevant materials in the above process should be kept for follow-up administration for the Tax Office

PKF Comment

It is estimated that the expansion of the R&D super-deduction policy will reduce corporate income tax payables by CNY 65 billion. Since 2008, the China tax authorities have promoted the R&D super-deduction policy to encourage enterprises to invest in R&D activities. In recent years the tax authorities have simplified the process to enjoy the R&D super-deduction. However,

*they are strengthening their follow-up administration. It is recommended that enterprises carry out a self-review of the R&D projects to ensure that the R&D super-deduction policy can be benefited from. If you believe the above measures may impact your business or require any advice with respect to China taxation, please contact Allan Jiang at allan.jiang@pkfchina.com or call **+86 21 6076 0876**.*

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Small Low-profit Enterprise Income Tax Incentive expanded in China

China's Ministry of Finance (MOF) and the State Administration of Taxation (SAT) together released the "Circular on Further Expanding the Coverage of the Favourite Tax Policy for Small Low-profit Enterprises" Cai Shui [2018] No. 77, based on which the policies on small enterprise income tax incentive administration are as follows:

1. From 1 January 2018 until 31 December 2020, small low-profit enterprises with an annual taxable income of CNY 1 million or less will be eligible to have their taxable income reduced by 50% and based on 20% of the Corporate Income Tax ("CIT") rate. A small low-profit enterprise is an enterprise engaged in an industry not restricted or prohibited by the State and shall meet the following conditions:
   - In the case of an industrial enterprise, it will be considered a small low-profit enterprise if its annual taxable income does not exceed CNY 1 million, the number of people employed is lower than 100 and total assets do not exceed CNY 30 million
   - In the case of other enterprises, they will be considered a small low-profit enterprise if their annual taxable income does not exceed CNY 1 million, the number of people employed is lower than 80 and total assets do not exceed CNY 10 million

   The number of people employed by the enterprise, as mentioned above, refers to the staff members having a labour relationship with the enterprise and the dispatched workers. The number of employees and total assets should be calculated based on the quarterly average number of a single year.

   When the enterprise prepays CIT in the first quarter of the year and fails to settle and pay previous year tax and is unable to determine whether the previous year conditions meet the requirements of a small low-profit enterprise, it can declare the annual CIT based on the tax prepayment of the fourth quarter of the previous year
2. Eligible enterprises can enjoy the favourite tax policy when prepaying CIT by filing taxes with relevant content
3. All qualified small low-profit enterprises have to declare CIT on a quarterly basis
4. The enterprise can enjoy the favourite tax policy as a result of the prepayment of annual CIT declaration in accordance with the following provisions:
   a) A small enterprise may enjoy the favourite tax policy, if current year taxable income based on net profit by year-end does not exceed CNY 1 million, or if the enterprise prepays the taxes on an average basis based on last year's taxable payables
   b) For the enterprise that is taxed on a deemed profit basis, when the enterprise enjoyed the favourite small profit enterprise policy and its actual gross revenue of the year does not exceed CNY 1 million
   c) For enterprises whose tax payables are deemed by the local tax authorities, the deemed tax payables may be adjusted by the governing tax authorities according to the latest favourite tax policy
   d) When an enterprise that did not meet the requirements to be considered a small low-profit enterprise last year but is expected to meet the requirements in the current year and if the taxable income of the year does not exceed CNY 1 million, it may benefit from the favourite tax policy
   e) A newly established enterprise in the current year that is expected to meet the requirements of a small low-profit enterprise may enjoy the favourite tax policy if the taxable income of the year does not exceed CNY 1 million

   Regarding an enterprise that has enjoyed the favourite tax policy, if during the annual CIT declaration the enterprise could not be qualified as a small low-profit enterprise, the enterprise should refund taxes according to Chinese tax laws and regulations.

   Several tax reduction measures were outlined and one of the measures was that starting from 1 January 2018 until 31 December 2020, small and low-profit

enterprises, whose taxable income in the previous year did not exceed CNY 1 million (previous upper limit was CNY 500,000), will be eligible for preferential Corporate Income Tax policies. In addition to preferential tax rates, eligible enterprises will also benefit from simplified tax filing procedures.

PKF Comment

*The new favourite tax policy has reduced the tax burden and cost for small low profit enterprises and aims to provide further support to innovation and entrepreneurship. If you believe the above measures may impact your business or require any advice with respect to China taxation, please contact Allan Jiang at allan.jiang@pkfchina.com or call **+86 21 6076 0876**.*

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China tax authority releases annual report on Advance Pricing Agreements

On 6 December 2018, the State Administration of Taxation (SAT) released its ninth APA annual report to describe the latest mechanisms, procedures and implementation of the APA program in China. The report is intended to provide guidance to enterprises interested in entering into APAs with the Chinese tax authority and to serve as a reference for competent authorities of other countries (regions) and the general public to better understand China's APA program.

The 2017 report contains data pertaining to the period from 1 January 2005 to 31 December 2017. By 31 December 2017, the cumulative total of APAs signed reached 147 (87 unilateral and 60 bilateral) during this 13-year period, accounting for 59.2% and 40.8% of the total number of signed APAs in China respectively. So far China has not signed any multilateral APA.

In 2017, a total of 3 unilateral APAs and 5 bilateral APAs were signed. Most of them were concluded within 2 years. Of the 5 bilateral APAs, 3 were signed with European countries and 2 were signed with Asian countries. Most of the APAs signed in 2017 still involved manufacturing industry but a further diversification in the types of industries covered can be seen.

It is expected that the APA request will arise against the backdrop of concern about uncertainty drawn out by the universal implementation of BEPS projects and the increased transfer pricing scrutiny by individual tax administrations. The SAT has therefore determined to prioritize certain APA requests, taking into account the following factors:

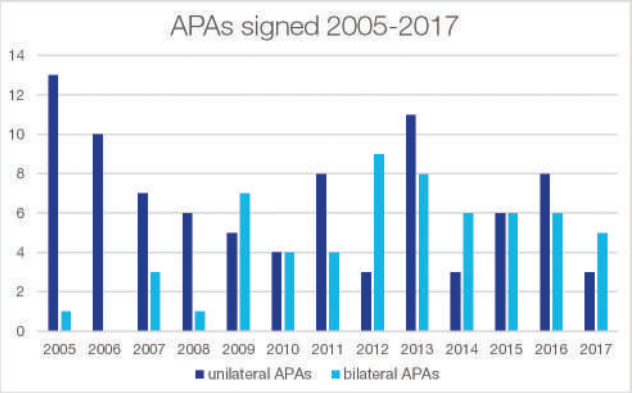
(i) Overall principle: first come, first served

(ii) The quality of the request submission, e.g. whether all required documents have been submitted, whether sufficient documentation clearly evidencing the transactions throughout the entire value chain or supply chain has been provided, whether the applied transfer pricing method is appropriate, and whether the calculation is correct. Applicants will be required to make additions or revisions to the submission when necessary

(iii) Whether the applicant is in a specific industry or located in a specific region that merits prioritised attention

(iv) For a BAPA request, whether the BAPA partner country (region) has the intention to accept the case and pursue the BAPA will also be an important factor for consideration. Among the four factors, the one the SAT values most is the quality of the submission. A submission that presents innovative application of TP methods or high quality quantitative analysis for intangibles, cost savings or market premiums will merit the SAT's prioritised attention

APAs signed by year



There is a clear preference for taxpayers requesting bilateral APAs over recent years as they can be concluded with less effort by the SAT. However, they do not provide the desired level of certainty and protection against double taxation.

Other APA statistics

- Transaction type: transfer of the right to use or ownership of tangible assets accounts for the largest portion of transactions covered by China's APA program. Of the concluded APAs, 65.1% involve transfer of the right to use or ownership of tangible assets, 15.9% involve transfer of the right to use or ownership of intangibles, and 19% involve services. As China's tertiary industry develops, an increasing number of service companies may decide to apply for APAs. Thus, more APAs may involve transactions related to transfer of the right to use or ownership of intangibles, services, financing and transfer of financial assets
- Bilateral APAs by region: From 2005 to 2017, China has signed 39 bilateral APAs with Asian countries (65% of total cases), 15 with European countries (25% of total cases) and 6 with North American countries (10% of total cases)
- Time taken to conclude APAs: for the entire time period 2005-2017, 56.3% of China's unilateral APAs were concluded within 1 year, 37.9% were concluded in 1 to 2 years while only 5.8% took more than 2 years. While bilateral APAs generally took more time, 50% were concluded within 1 year, 15% took 1 to 2 years, 15% took 2 to 3 years, and the remaining 20% were concluded in more than 3 years
- APAs by transfer pricing method: the transactional net margin method (TNMM) is the most commonly used transfer pricing method, being used 130 times and accounting for 77.9% of all the applied transfer pricing methods. The most commonly used profit level indicators are the EBIT operating margin (used in 57 APAs) and the Full Cost Mark-up (used in 71 APAs). The second most popular transfer pricing method is the cost plus method, being used in 19 of the concluded APAs. The other transfer pricing methods are applied less frequently. The comparable uncontrolled price (CUP) method is used in 6 cases, the resale price method in 1 case, the profit split method in 5 cases and other methods in the other 6 signed APAs
- Industries covered by signed APAs: There is a further diversification in the types of industries covered, yet 83.7% of the APAs signed from 2005 to 2017 still involve the manufacturing industry (123 out of 147 APAs). Other industries that were covered include leasing and commercial services (5); wholesale trade and retail (9); transportation, warehousing and postal services (4); scientific and technical services (2); information transmission, software and information technology services (2); electricity, thermo, gas and water generation and supply (1); and construction (1)

PKF Comment

*Companies seeking to conclude an APA to achieve a higher level of tax certainty in conducting business are recommended to turn to a China tax specialist to evaluate their operations and to formulate appropriate strategies. If you believe the above measures may impact your business or require any advice with respect to China taxation, please contact Allan Jiang at allan.jiang@pkfchina.com or call **+86 21 6076 0876**.*

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Costa Rica

Significant tax reform enacted

On 4 December 2018, Law No. 9.635 was gazetted, which is aimed at strengthening public finances by increasing revenue through the amendments of several tax laws, including the VAT law and Income Tax Law and the introduction of measures concerning public employment.

The following are among the major changes:

- Transformation of the existing sales tax into a Value Added Tax (VAT) at the same 13% rate. However, reduced rates of 1%, 2%, and 4% are included
- Another significant change is that with the new VAT law, not only goods will be taxed, but services as well. Taxed services will be required to pay this new tax, unless exempted by law
- In terms of income tax, the Law provides that capital income (asset-related income) will be subject to a 15% tax, as well as capital gains (investment-related gains). It is important to highlight that both individuals and corporations that own property (such as houses, lots, stock, software, or licenses) will be subject to a 15% tax in the event of a sale thereof

- Thin capitalisation rules are introduced and are applicable to financing from shareholders or related parties. In such cases, interest would be deductible up to 20% of the earnings before tax, depreciation, and amortization (EBITDA). The difference may be deducted in the following years until the expense is amortized. Thin capitalisation rules would not apply to loans granted by local banks or non-domiciled financial entities supervised in their country of origin
- Global Income Taxation is created, which, in general, means that taxpayers are required to add together their various income, deduct any expenses, and pay income tax over the resulting difference. It is important to note that any such income may originate from different sources, e.g. salary, independent worker's income, interest on savings, stock dividends and leases, among others. (Note that before the Law came into effect each income was taxed separately and subject to different rates). For example, an individual who earns CRC 2,000,000 in one month as a result of his professional-related activities and receives CRC 100,000 of interest, will now pay CRC 15,000 tax on said interest. Thereafter, he will have to add the CRC 2,000,000 plus the CRC 100,000 and calculate his income tax over the basis of CRC 2,100,000. The CRC 15,000 tax already paid may be deducted from the corresponding income tax amount
- In terms of salaries, individuals reporting a salary in excess of CRC 2,103,000 million (approximately USD 3,700) will now pay a 20% salary tax instead of the former 15% if his salary is between CRC 2,103,000 million and CRC 4,205,000 million, and a 25% tax if his salary exceeds the latter threshold
- Provisions to fight tax avoidance are included (especially oriented towards transnational companies), adopting international parameters (recommendations such as OECD BEPS standards) that include a ban to deduct expenses from operations carried out in countries classified by the Tax Administration as non-cooperative jurisdictions or tax havens
- Non-domiciled individuals or legal entities that own real estate in Costa Rica will be subject to a 2.5% withholding tax when selling the asset
- A Tax Amnesty is further included for the remission of penalties and interest accrued by tax-debtors, provided they pay their tax debts
- Regarding the Free Trade Zones (FTZs), the VAT exemption for local-market purchases and, of course, exports, is expected to be upheld. Likewise, other benefits granted to FTZs remain in place

PKF Comment

*If you believe the above measures may impact your business or require any advice with respect to Costa Rica taxation, please contact Fernando Murillo at fernando@pkf.cr or call **+506 2253 0304**.*

»BACK

Cyprus

Cyprus and the United Kingdom have renegotiated an all-new Double Tax Treaty

The new treaty was signed by the two states on 22 March 2018 and was published in the Government Gazette on 2 April 2018. The old tax treaty between Cyprus and the UK had been in existence since 1975.

The new treaty is generally based on the OECD Model Tax Convention. The treaty applies to taxes on income as well as on gains from alienation of movable or immovable property. The key provisions of the treaty are the following.

Dividends, Interest and Royalties

No Withholding Tax (WHT) applies on dividends, interest and royalty payments if the recipient is the beneficial owner of the income.

There is an exception on dividends which provides for a 15% withholding in case they are paid out of income (including gains) derived directly or indirectly from immovable property by an investment vehicle which distributes most of this income annually and whose income from such immovable property is exempted from tax.

Capital Gains

Capital gains arising from the disposal of shares will be taxable only in the country of residency of the seller, unless more than 50% of the value of such shares is directly or indirectly derived from immovable property situated in the other country. In such case, the source country will have the right to tax the gain, unless the shares being disposed are substantially and regularly traded on a stock exchange.

Limitation of Benefits Provision
The treaty includes a Limitation of Benefits (LoB) clause which incorporates the OECD/G20 Base Erosion and Profit Shifting (BEPS) project Action 6 report 'Principal Purpose Test' (PPT). The benefits under the treaty shall not be granted, subject to conditions, if obtaining that benefit was one of the principal purposes of an arrangement or transaction.

This clause was included in order to tackle "treaty shopping" and emphasises that operations should be supported by appropriate substance and reflect a principal commercial rationale.

Entry into force and effective dates
The treaty will enter into force once both Cyprus and the UK ratification procedures are completed.
The provisions will have effect in Cyprus on or after 1 January following the date the treaty enters into force and in the UK:

- for withholding taxes for amounts paid or credited on or after 1 January of the next calendar year
- for income tax and capital gains tax from the next 6 April
- for corporation tax for any financial year beginning on or after the next 1 April

PKF Comment

*The treaty terms are quite favourable in that they entail no withholding tax on distributions to the beneficiaries. It also addresses BEPS concerns. For further information or advice on any Cyprus tax matter, please contact Nicholas Stavrinides at nicholas.s@pkf.com.cy or call **+357 258 68000**.*

»BACK

Czech Republic

Transposition of the Anti-Tax Avoidance Directive (ATAD) into Czech domestic tax law

On 21 December 2018, the lower chamber of the parliament approved a Bill which implements the EU Anti-Tax Avoidance Directive (ATAD), as well as introduces changes to other tax laws. If approved the draft law will be effective from 1 January 2019. The salient features are as follows:

Taxation of Controlled Foreign Corporation (CFC)
Revenues of a Controlled Foreign Corporation are taxed pursuant to Czech tax legislation if the controlled foreign company does not perform significant economic activities (using equipment, staff, assets and premises) and is subject to a tax liability that is less than 50% of the tax liability to which it would be subject in the Czech Republic.

Disclosure to the Tax Authority about payments to foreign residents
Corporations paying dividends, interest, royalties or other income that is subject to withholding tax under Czech domestic tax law but are exempt from tax e.g. under a DTT shall report these payments to the Tax Authority on a monthly basis if such income paid to one non-resident exceeds CZK 100,000 (approximately EUR 3,800) per month

Introduction of exit tax rules
Exit tax rules will apply in case of a transfer of property out of the Czech Republic in case:

- Property is transferred from the head office in the Czech Republic to a foreign permanent establishment (PE), but only in cases, where the Czech Republic would apply the exemption method in respect of such a PE
- Property transferred from the PE in the Czech Republic of a non-resident to another part of the enterprise abroad, but only in cases where the Czech Republic would not be able to exercise the taxing rights in respect of such a subsequent disposal of such property
- Transfer of tax residence status of the taxpayer, but only in respect of property, where the Czech Republic would not be able to exercise its taxing rights in respect of such subsequent disposal of such property

Interest limitation rules
Borrowing costs are excessive if they exceed 30% of earnings before interest, tax, depreciation and amortisation (EBITDA). A de minimis rule applies, which is set at CZK 80 million (approximately EUR 3 million), which means that the limitation rule will not apply if the borrowing costs do not exceed the foresaid limit.

The interest limitation rule applies to both interest payments in relation to transactions with related parties and/or third parties.

The existing thin capitalisation rules will remain applicable.

PKF Comment

*The intention of the Tax Authority is to prevent profit shifting and tax evasion. If you believe the above measures may impact your business or require any advice with respect to Czech taxation, please contact Jaroslava Hanková at hankova@apogeo.cz or call **+420 267 997 721**.*

»BACK

Ecuador

Formal requirement to disclose foreign cash transactions eliminated

The Internal Revenue Service decided to eliminate the existing formal requirement for individuals and companies to disclose current or average balances and/or annual movements in monetary assets within any foreign financial institution equal to or exceeding USD 100,000. Also, the existing formal requirement for local financial institutions to disclose monthly information regarding transfers made by their clients from/to tax havens and/or from/to those countries which have concluded double tax treaties agreements with Ecuador was eliminated.

PKF Comment

*These changes aim to facilitate the flow of economic resources within the local economy. Also, the first change makes sense since that information is already embedded in the information that should be disclosed by individuals and companies in the "Annex of foreign assets and liabilities". For further information or advice concerning Ecuador tax, please contact Manuel García at mgarcia@pkfecuador.com or call **+593 4 236 7833**.*

»BACK

Hungary

Introduction of group taxation for CIT purposes

Pursuant to the newly adopted regulations, group corporate taxation will be available for resident taxpayers (at least two Hungarian companies, including Hungarian branches of foreign companies) as of 1 January 2019. In order to qualify for this scheme certain conditions must be met (e.g. the group members shall be under 75% ultimate common control by the same person, the same balance sheet date and currency shall be applied by the group members, etc.).

One of the potential advantages of group taxation is that the loss incurred by group members during their membership can be deducted from the group's tax base, the latter being the total amount of positive tax base of the group members reduced by the accrued group loss.

A further significant advantage of group taxation is that transactions between members are not subject to transfer pricing rules, which means in practice that group members will not be obliged to modify their CIT base in case of a deviation from the arm's length price and to document the transactions between the group members.

For establishing a group as of 1 January 2019, a joint written application of the members shall be submitted to the Hungarian State Tax Authority between 1 and 15 January 2019.

PKF Comment

*The new group taxation regime, combined with a corporate income tax rate of only 9%, as well as the availability of participation exemption rules and a general lack of withholding taxes, gives Hungarian companies a distinct advantage which is still unique in the CEE region. When making the final decision other tax aspects (e.g. limitation of interest deduction, using losses incurred before membership, remaining transfer pricing liabilities for other tax purposes, etc.) should also be considered. For further information or advice concerning Hungarian group taxation or any advice with respect to Hungarian taxation, please contact Krisztián Vadkerti at vadkerti.krisztian@pkf.hu or call **+36 1 391 4220**.*

»BACK

Ireland

Introduction of new Controlled Foreign Company rules

In Budget 2019, the Minister for Finance announced the introduction of new Controlled Foreign Company ("CFC") rules, in line with the Anti-Tax Avoidance Directive

("ATAD"), for accounting periods beginning on or after 1 January 2019. The CFC rules are an anti-abuse measure, designed to prevent the artificial diversion of profits from controlling companies in Ireland to offshore subsidiaries, located in low or no tax jurisdictions. The CFC rules operate by attributing certain undistributed income of a CFC, arising from non-genuine arrangements put in place for the essential purpose of securing a tax advantage, to the controlling company in Ireland for immediate taxation, where that parent company has "relevant Irish activities" (i.e. significant people functions (SPFs) in Ireland).

A company is considered to have control of a subsidiary for CFC purposes, if it has direct or indirect ownership of or entitled to acquire more than 50% of the share capital, voting power or distributions. The terms 'participator', 'associate', 'director' and 'loan creditor' under CFC rules are given the same meaning as they have under Irish close company provisions. The CFC charge that can be imposed on an Irish controlling company will depend on the extent to which the CFC holds the assets or bears the risks that it does, were it not for the controlling company undertaking SPFs in Ireland, relating to those assets and risks. SPFs are defined for Irish CFC purposes, by reference to the use of the term in the 2010 OECD Report on the Attribution of Profits to Permanent Establishments.

Irish legislation provides for the following exemptions from a CFC charge:

- Effective tax rate exemption: where the CFC pays a comparatively higher amount of tax in its resident territory than it would have paid in Ireland
- Low profit margin exemption: where the accounting profits of a CFC are less than 10% of its relevant operating costs
- Low accounting profit exemption: where the accounting profits of a CFC are less than EUR 750,000 and the amount of those profits representing non-trading income is less than EUR 75,000 or the accounting profits are less than EUR 75,000
- Exempt period exemption: a one-year grace period is given for newly acquired CFCs, where certain conditions are met

The legislation provides that the CFC rules will not apply in circumstances where the arrangements, under which the relevant SPFs are performed, are entered on an arm's length basis or are subject to the Irish transfer pricing regime.

PKF Comment

Like other jurisdictions, Ireland will welcome this choice as it's also the option endorsed by the OECD. Ireland has adopted elements of optionality within ATAD, such as the small profits and low-profit margin exemptions, as well as the use of white, grey or black lists of third countries and provision of a "grace period" in respect of newly acquired CFCs which would allow multi-national companies time to ensure their structures are compliant.

*For further information or advice on the above, please contact Shane O'Donovan at s.odonovan@pkf.ie, Eoin Kenny at e.kenny@pkf.ie or Louise Doyle at l.doyle@pkf.ie or call **+3531 4961444**.*

»BACK

Italy

Supreme court rules on tax deductibility of intercompany management fees

Management fees incurred by a holding company for managing the overall group and for providing intercompany services (marketing plans, R&D, personnel training, IT etc.) are allocated to the single group entity. The Supreme Court (Corte di Cassazione) recently ruled (case number 20113/2018; see also before rulings 16480/2014 and 23164/2017) that it is the subsidiary's responsibility to prove the inherence (i.e. the relationship between the cost and the enterprise) and the coherence of the management fees charged on it. Generally, only large and well-structured corporate groups have an efficient cost accounting system to control details of the specific intercompany service provided.

For this reason it is quite easy for the Tax Authority to reject the cost deduction of the aforementioned expenses because they are not properly documented. The subsidiary should therefore implement an internal control system to collect and analyse the entire information flow related to the single service received. The subsidiary needs to prove not

only the actual service provision, but also whether it serves the corporate purpose.

The Supreme Court confirmed that, as far as intragroup costs are concerned, proof of the company's benefits, related to the service received, must be correctly identified. It is no longer sufficient to satisfy the inherence requirement by only submitting the contract with the parent company and the related invoices, but it is also necessary to submit further supporting documents such as the number of hours worked. If not, it will not be possible to correctly determine the costs and the parent company will not be allowed to deduct them.

In case of statements provided by the subsidiary and certified by an independent international audit firm, the Tax Authority will not be able to reject the cost assessment without a valid reason.

Summarised, the Supreme Court is changing the compliance rules and thereby increasing the information burden on corporate groups. In order to be prepared for a possible Tax Authority audit it is recommended to carefully document the intercompany management fees submitted and, if and when necessary, the related analytical supporting information.

PKF Comment

*For further information on this matter or any advice on Italian taxation, please contact Stefano Quaglia at stefano.quaglia@tclsquare.com or call **+39 010 8183250**.* »BACK

Jersey

Introduction of an economic substance requirement to companies in Jersey

As a response to the EU Code of Conduct Group the Government of Jersey has introduced an economic substance requirement to companies in Jersey.

Jersey made a commitment to address economic substance concerns in December 2017 by December 2018. The draft Taxation (Companies – Economic Substance) (Jersey) Law was lodged in October 2018. In November 2018, Jersey, Guernsey and Isle of Man published the key aspects document on substance requirements.

The next step is to publish a comprehensive guidance of this new law and for the legislation to be passed.

The principles align with international standards, they are broad in scope to include all Jersey tax resident companies including foreign-incorporated companies.

There are 3 key steps in the legislation;

- To identify the relevant activities
- To impose substance requirements
- To ensure there are enforcement provisions in place

Companies are required to have "real economic activity" and "substantial economic presence".

The EU Code of Conduct Group also required commitments from Jersey in two further areas:

- Mandatory disclosure rules
- Beneficial ownership

PKF Comment

The Jersey model is based on substance and real presence. The principles are sector-specific as not one size fits all and they are broad in scope as commented on above. Guernsey is also introducing a similar law/requirement and has been working alongside Jersey. The law was debated in Jersey on 4 December 2018 and should be in place during 2019.

*For further information or advice concerning the new economic substance law in Jersey or any advice with respect to Jersey taxation, please contact Rob Behan at robb@pkfbba.com or call **+44 153 485 8490**.* »BACK

Nepal

Reformation of organisational structure of Tax Authority

As a part of its tax administration reform plan, the Government of Nepal has introduced a new organisational structure significantly increasing the main customs offices and Inland Revenue Offices. Five small customs offices have been upgraded to customs offices. Now, the number

of main customs offices has reached 28 and small customs offices 138. Meanwhile, the government decided to transform 13 taxpayer service offices into Inland Revenue Offices. Likewise, three existing Inland Revenue Offices have been upgraded to Middle Level Taxpayer Offices.

PKF Comment

*The government has made this reform to achieve its revenue collection target for the FY 2018-19. This is also aimed at making smooth service delivery and putting large taxpayers under special focus. This restructuring will lower the burden of Large Taxpayers Office and with the introduction of new Inland Revenue Offices service delivery to small taxpayers it will also be more efficient and effective. For further information or advice on Nepal tax laws or if you have any specific query about your particular tax situation, please contact Shashi Satyal at shashi.satyal@pkf.com.np or call **+977 1 4410927**.*

»BACK

Introduction of Electronic Tax Payment System

Electronic tax payment has been made possible through the introduction of a system of Connect-IPS introduced by Nepal Clearing House Limited, an institution promoted by the Government of Nepal, Nepal Rastra Bank (Central Bank) and other banking institutions. The Government of Nepal has taken the initiative for a fully integrated and automated e-payment of transactions related to payouts and revenue collection. With the introduction of a system of Connect-IPS, sending/receiving funds is possible directly from/to the bank accounts, without the need to move the funds to any of the intermediary accounts.

PKF Comment

The existing system of tax collection is expected to be drastically changed with the introduction of a system of Connect-IPS. Easy collection and refund of taxes, lesser documentation and an increase in cashless transactions would benefit both the revenue department and taxpayers. Also, this initiative by the Government of Nepal will improve operational efficiency, reduce cost, better public services and increase financial transparency. This new initiative is a welcome sign but taxpayers should be prepared for a delay in implementation and teething issues while using this application during the initial period of implementation.

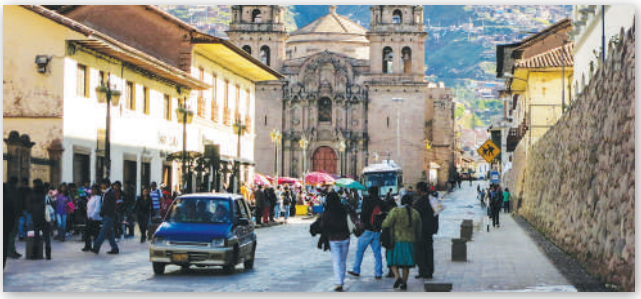
*For further information or advice on Nepal tax laws or if you have any specific query about your particular tax situation, please contact Shashi Satyal at shashi.satyal@pkf.com.np or call **+977 01 4410927**.*

»BACK

Peru

Benefit test for intragroup services

Article 4 of Legislative Decree No. 1312 (published on 31 December 2016 and introduced in Income Tax Law) stipulates that the taxpayer must comply with the benefit test and provide the requested documentation and information as necessary conditions for the deduction of an intragroup cost or expense, according to what is expressly indicated. Relevant Regulations were published in February 2018 so in practice the obligation came into force in June 2018.



The purpose of the Test is to justify the real need, the nature and the effective provision of an intragroup service, as well as the cost and its assignment criteria.
In this sense, transactions for services between related parties, in addition to requiring being reliable and complying with the principle of causality, must necessarily also meet the conditions of the so-called “Benefit Test”, otherwise the expense will not be accepted for purposes of income tax determination.

It is understood that the benefit test is met when the service provides economic or commercial value for the recipient of the service, improving or maintaining its commercial position, which occurs if independent parties have satisfied the need for the service by executing it themselves or through a third party.

These services are distinguished between having high and low added value. In the case of services with low added value, the margin cannot exceed 5% of the costs and expenses incurred by the service provider.

Low value added services are considerd to meet the following characteristics: (i) they are of an auxiliary or supportive nature (ii) they do not constitute principal activities of the taxpayer or the multinational group, as applicable (iii) they do not require the use of unique and valuable intangibles nor do they lead to the creation of unique and valuable intangibles and (iv) they do not involve assuming or controlling a high or significant level of risk nor do they generate a significant level of risk to the service provider.

Further to this, on 30 December 2018, Supreme Decree 337-2018-EF was issued, which establishes the requirements for the benefit test and the supporting documentation, as well as the procedure to calculate the profit margin. It also establishes which services do not qualify as low-value added services.

PKF Comment

The incorporation of the benefit test into Peruvian tax legislation has generated an impact on MNEs whose effective income tax rate ultimately ends up being higher in the case of services received with low added value.

Another area of impact is that the effective provision of these services must be scrutinised from every angle, being part of a business group often quite complicates its measurement, and even more so when it comes to digital services.

*In this regard, it is extremely important to plan and reorient these types of transactions in order to avoid possible full or partial expense adjustments and thus a higher tax payment. For any further information on transfer pricing legislation or assistance with respect to any other Peruvian taxation issues, please contact Renato Vila at rvila@pkfperu.com or call **+51 142 16 250**.*

»BACK

Poland

Innovation Box – New tax incentive supporting innovation

On 14 November 2018, the President of Poland signed a bill amending income tax acts, which among others introduces a new tax incentive – the Innovation Box. The new mechanism introduces a preferential 5% tax rate applicable to 'qualified income' derived from intellectual property rights and it will enter into force as from 1 January 2019 for both Personal and Corporate Income Tax purposes.

The 5% preferential tax rate applies to qualified income from IP rights listed in the exhaustive catalogue consisting of:

1. Patents
2. Protection rights for utility models
3. Rights from registration of industrial designs
4. Rights from registration of topographies of integrated circuits
5. Extensions of patent protection for medicinal products and plant protection products
6. Rights for medical products or authorised veterinary products or plant and animal varieties
7. Protected rights to computer programs (software)

The above rights must be subject to legal protection under the provisions of separate acts or ratified international agreements to which Poland is a party or other international agreements to which the European Union is a party.

The income/loss from the qualified IP rights will include the income/loss from:

- The fees or charges under licence agreement of qualified intellectual property rights
- The sale of qualified intellectual property rights
- The qualified intellectual property rights included in the sales price of products or services
- The compensation for infringement of qualified intellectual property rights obtained as a result of litigation proceedings, including court proceedings or arbitration

The tax base subject to the preferential tax rate will be calculated using a proper formula – based on the OECD recommendations (nexus approach) – included in the amending act. This formula will reward taxpayers who create or develop qualifying IP rights, on their own or with the help of unrelated entities. The more Research & Development activity the taxpayer undertakes by himself (or in cooperation with an unrelated party), the higher the amount of the relief the taxpayer will be entitled to claim under the Innovation Box regime.

Benefiting from the IP box regime is voluntary, not mandatory. However, the legislator has obliged taxpayers

willing to apply the tax preference to separate the IP income in their accounting records in order to distinguish each qualifying IP right and to determine the revenue, costs, and income or loss attributable to each of the qualifying IP rights.

PKF Comment

*The Polish government continues to implement tax incentives designed to encourage taxpayers to start and develop innovative activities. Along with Research & Development tax relief, the Innovation box – as an R&D extension – is going to be an important factor in reducing the tax liability burden for both domestic and foreign enterprises, making polish tax regulations more attractive in running innovative business. A very competitive 5% tax rate, whilst taking into account the OECD guidelines (BEPS, Action 5), will surely attract and boost investments in high-end technology. Should you need more detailed information regarding the Innovation box regulations or require advice on any Polish tax matter, please contact Agnieszka Chamera at agnieszka.chamera@pkfpolska.pl or call **+48 609 331 330**.*

»BACK

Romania

Recent key tax changes

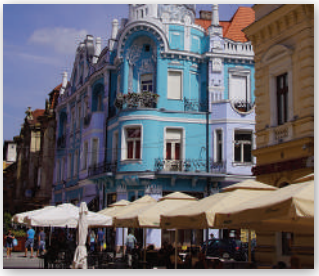
5% VAT rate for certain services

According to Ordinance 89/2018 published on 9 October 2018, a 5% VAT rate will enter into force as from 1 November 2018, for the following categories:

- Accommodation provided by hotels and similar facilities, including the letting of camping sites (taxable at 9% before 1 November)
- Restaurant and catering services, with the exception of alcoholic beverages (other than beer) (taxable at 9% before 1 November)
- The right to use sporting facilities (activities classified under NACE 9311 and 9313), for the purpose of performing sports and physical education (other than those already exempted)
- Services consisting in allowing access to fairs, amusement and recreational parks (activities classified under NACE codes 9321 and 9329)

PKF Comment

A case by case analysis should be performed by taxpayers to assure the extent to which the supply of food and/or beverages is accompanied by a sufficient number of



related services to qualify the operation as a supply of restaurant/catering services, subject to the 5% VAT rate, or as a mere supply of food and/or beverages, subject to the 9% VAT rate.

Companies can opt to distribute dividends on a quarterly basis

Starting 15 July 2018, Romanian legislation optionally allows for the distribution of dividends for the current and quarterly year, not just annually as it was foreseen before.

Dividends distributed to affiliates or shareholders on a quarterly basis, as well as those distributed annually, will be distributed proportionally to the participation quota to the paid-up share capital.

Changes in the distribution of dividends were made through Law No. 163/2018 amending and completing Accounting Law No. 82/1991, Companies Law No. 31/1990, as well as Law No. 1/2005 regarding the organisation and functioning of the co-operation.

The quarterly distribution of dividends will be made within the net quarterly profit margin, plus any retained earnings and withdrawn amounts of reserves available for that purpose.

On the other hand, all losses carried forward from previous years, if any, and the amounts deposited in reserves will be deducted from the amount allowed for distribution.

It is mandatory to first cover the accounting losses and only then to make the distribution of dividends if the losses are lower than the profit of the current year and of the previous years.

Because any distribution of dividends is made only after approval of the annual financial statements, if the distribution of quarterly dividends is decided, there is an obligation to prepare and submit interim financial statements. These will be audited only if those entities have statutory audits of the annual financial statements or opt to audit these.

Regularisation of possible differences resulting from the distribution of dividends during the year will have to be made through the annual financial statements and the payment of any possible adjustment differences will have to be made within 60 days from the date of approval of the

annual financial statements for the financial year ended. Failure to meet this deadline results in interest penalties being due.

PKF Comment

*If you believe the above measures may impact your business or require any advice with respect to Romanian taxation, please contact Narcisa Chirila at narcisa.chirila@pkffinconta.ro or call **+40 21 317 31 96.***

»BACK

Russian Federation

2019 changes to the Tax Code

Federal Law No. 424-FZ of 27 November 2018 has made a number of important amendments to the Tax Code. Some of the salient features are as follows:

- Liquidation proceeds, i.e. income in excess of what a shareholder actually paid for shares, will be taxed as dividends for both personal income tax and corporate income tax purposes. The differences derived from liquidation or exit are calculated at the market value of the assets less costs incurred by shareholders in acquiring those assets

PKF Comment

Before the amendments, there were some risks of applying the general tax rate to such proceeds. So this change mainly impacts corporate income tax as it potentially allows for the application of a 0% rate for Russian recipients and a basic rate of 15% (rather than the general 20% corporate income tax rate) for foreign recipients, subject to the application of a double tax treaty.

- Regarding asset contributions, shareholders are not liable for tax (including withholding tax) in the event of a return of their asset contributions

PKF Comment

This includes payments made not as a contribution to capital (as authorised/share capital) but made as a contribution to assets and it only impacts money contributions. Earlier returns of such payments were generally taxable.

- Tax-free sales of participations (interests) in Russian companies will no longer be limited by the date of acquisition of those participations. Before the amendment, it was stipulated that the benefit only applies to participations (interests) acquired after 1 January 2011. This provision applies to sales as from 27 November 2018

PKF Comment

Generally a 0% tax rate applies if shares of Russian companies are sold not earlier than 5 years from the date of acquisition. This rate was earlier only applicable to participations acquired after 2010. For sales as from 27 November 2018, participations acquired before 2011 could now also be sold applying the 0% tax rate.

*If you believe the above measures may impact your business or require any advice with respect to Russian taxation, please contact Yulia Ponomarenko at y.ponomarenko@mef-consult.ru or call **+7 495 988 15 15**.*

»BACK

Serbia

Changes to corporate income tax law

On 6 November 2018 a draft Bill was issued containing significant amendments to the corporate income tax law. Once approved it will come effective as from 1 January 2019. The salient features are as follows:

- The depreciation of fixed assets will be calculated for tax purposes by using the proportional method on the purchase value for each asset separately (instead of the degressive method which is used under the existing law), while for assets acquired during the fiscal period, the proportional method is implemented in proportion with the period between the acquisition period and the end of the fiscal period
- The limit for advertisement expenses (10% of total revenue under the existing law) will be cancelled
- R&D expenses can be deducted twice in the balance sheet. However, this does not apply to research and development costs incurred in the search for and development of oil, gas or mineral resources
- The purpose of the new regulations is to facilitate access to capital for newly founded enterprises, which can not be older than three years, that perform innovative business activities and to make other corporations invest in innovative enterprises more

easily. The proposed modifications contain a tax credit right at a rate of 30% of invested funds, with a limit of RDS 100 million (approximately EUR 850,000) of credit for a taxpayer investing in the capital of a newly founded enterprise that performs innovative business activities

PKF Comment

*If you believe the above measures may impact your business or require any advice with respect to Serbia taxation, please contact Mićun Žugić at micun.zugic@pkf.rs or call **+381 11 30 18 445**.*

»BACK

South Africa

Binding Private Ruling: taxability of interest where DTT between South Africa and Brazil applies

A Binding Private Ruling (BPR) 307 was issued by the South African Revenue Service on 4 July 2018 which deals with the application of double tax treaty (DTT) relief in respect of the double taxation of interest.

To summarise the facts of the ruling, the following is noted:

- The applicant, a South African resident company, wished to trade in government bonds purchased from the Brazilian government
- These bonds would be purchased from and sold to counterparties at an agreed date and price (effectively including an element of interest)
- Bonds would also be purchased in the market without any resell arrangements being entered into
- The applicant would earn interest on these bonds from the Brazilian Government for the period that it held such bonds
- The interest would not be subject to tax in Brazil

In terms of the DTT between South Africa and Brazil it is noted that:

- Interest arising in the source country can be taxable in both the source country and the country of residence. However, the source country cannot impose a tax exceeding 15%
- An exception to this rule is where the security, debenture or bond from which the interest arises is wholly owned by the Government in which case it is only taxable in that country

Based on the above DTT the ruling from SARS confirms that as the interest will arise as a result of bonds wholly owned by the Brazilian government, Brazil has exclusive taxing rights to such interest, therefore such interest is not taxable in South Africa. This ruling does, however, also state that it does not cover the application or interpretation of any general or specific anti-avoidance provisions nor does it pronounce on the deductibility of any expenditure incurred by the applicant in relation to the transactions.

PKF Comment

*For further information or advice concerning South African taxation please contact Kubashni Moodley at kubashni.moodley@pkf.co.za or call **+27 31 573 5000**.*

»BACK

Uganda

Tax updates 2018/19

In June 2018 the government of Uganda passed the following amendments to the domestic tax laws:

Allowable interest

The amount of deductible interest for a year of income in respect of all debts to a taxpayer who is a member of a group is limited to 30% of the tax earnings before interest, tax, depreciation and amortisation. The excess interest may be carried forward for not more than three years.

This amendment repealed the thin capitalisation provisions.

PKF Comment

The interest in excess of 30% of tax earnings before interest, tax, depreciation and amortisation is non-deductible irrespective of whether the loan is sourced locally or cross-border, from a financial institution or related party. This is a punitive legislation to taxpayers requiring huge financial resources for operations, expansion and investing in capital intensive ventures and consequently will stiff local investment and growth of the financial sector.

Income tax exemptions
Tax exemption on the income of a developer of an industrial park or free zone whose investment capital is at least USD 100 million for a period of 5 years from the date of commencement of construction.

Tax exemption on the income of an operator in an industrial park or free zone or other business outside the industrial park or free zone whose investment capital is at least USD 15 million for a foreigner or USD 5 million for Ugandan citizens for 5 years from the date of commencing business.

PKF Comment

The income tax exemption is in addition to the already existing tax incentives aimed at attracting foreign direct investments, export promotion, industrialisation and economic diversification which are vital for economic growth and development.

Interest on mortgage now allowed for individuals
The June 2018 tax amendments allow deductibility of interest on a mortgage from a financial institution as expenditure incurred by an individual to acquire or construct premises that generate rental income.

PKF Comment

The amendment is aimed at promoting the real estate sector which is steadily growing and still promising a lot of potential.

Excise duty

- Excise duty of 0.5% of the transaction value was introduced on mobile money withdrawal transactions

PKF Comment

The levy may hinder financial services accessibility at affordable costs to all individuals and businesses, in particular the rural dwellers and poor communities.

- Excise duty of UGX 200 (USD 0.05) per day introduced to facilitate access to Over-The-Top ("OTT") telephone data services which enable access to social media sites like Facebook, WhatsApp, Twitter, YouTube, Instagram, WeChat, Viber among others

PKF Comment

The duty will limit the right and ability to access information which is prerequisite in this digital era.

Sourcing of income from a (in)direct change of ownership of 50%
An indirect as well as a direct change of ownership of an entity located in Uganda - other than an individual, a government, and a listed institution located in Uganda - would now give rise to income sourced in Uganda.

PKF Comment

*The amendment is aiming at capital gains in respect of direct or indirect transfer of an interest or right bestowed in a property, resource or asset located in Uganda. For any further information or advice on Uganda tax matters, please contact Charles Oguttu at coguttu@ug.pkfea.com.tw or call **+256 312 305800**.*

»BACK

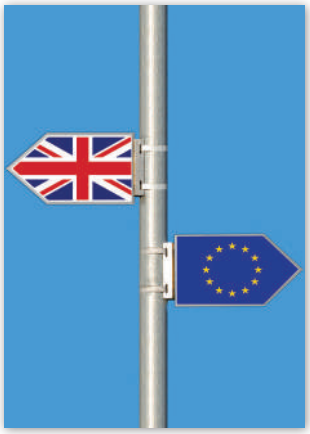
United Kingdom

UK government release no-deal Brexit plan for VAT

HM Revenue & Customs ("HMRC") has published a briefing note summarising the VAT implications if the UK leaves the EU on 29 March 2019 without a deal.

The government will introduce postponed accounting for import VAT on goods brought into the UK. This means that UK VAT registered businesses importing goods to the UK will be able to account for import VAT on their VAT return, rather than paying import VAT on or soon after the time that the goods arrive at the UK border. This will apply both to imports from the current EU and non-EU countries.

For UK businesses exporting goods to EU consumers, distance selling arrangements will no longer apply and UK businesses will be able to zero rate sales of goods to EU consumers. Current EU rules would mean that EU member states will treat goods entering the EU from the UK in the same way as goods entering from other non-EU countries, with associated import VAT and customs duties due when the goods arrive into the EU.



In terms of UK businesses selling their own goods in an EU member state to customers in that country, UK businesses will be able to continue to sell goods they have stored in an EU member state to customers in the EU in line with current Rest of World rules. Current EU rules would mean that UK businesses will continue to be required to register for VAT in the EU member states where sales are made in order to account for the VAT due on supplies made in those countries. In some countries it may be necessary to appoint a Fiscal Representative.

The low value consignment relief will be abolished for all parcels arriving in the UK. This will result in all goods entering the UK as parcels from overseas businesses being liable to UK VAT (unless relieved for VAT under domestic law). Overseas sellers will be liable to pay import VAT on postal packets valued at less than GBP 135 (in line with Customs values). Such suppliers will be required to register electronically with HMRC before the dispatch of the first parcel to the UK and will be issued with a unique identification number which must be displayed on all packages sent by post to the UK. The new provision will apply to both B2B and B2C supplies, and the supplier will be required to submit and settle quarterly returns electronically. Advance registration will be permitted in early 2019 and will be mandatory to all non-UK established suppliers of postal packets (valued less than GBP 135) dispatched from outside the UK, even if already registered for VAT in the UK.

The main VAT 'place of supply' for services rules will remain the same for UK businesses. The current 'place of supply' rules determine the country in which you need to charge and account for VAT. These rules are in line with international standards set out by the Organisation for Economic Co-operation and Development (OECD).

For UK businesses supplying insurance and financial services, input VAT deduction rules for financial services supplied to the EU may be changed, with more information on this expected to be released in due course. If the government decided to allow input tax recovery in relation to financial services transactions with EU counterparties, this could significantly reduce irrecoverable VAT for these businesses.

PKF Comment

*As we get nearer to March 2019, it is important that businesses consider how a 'no deal' scenario could affect them and begin to take steps to mitigate against such a risk. Whether these no-deal measures will need to be implemented remains to be seen, but with just a few weeks to go, businesses need to ensure that they are prepared for that eventuality. If you would like further information or advice on how Brexit may affect your business, please contact Luigi Lungarella at luigi.lungarella@pkf.com or call **+44 20 7516 2200**.*

»BACK

Non-resident Capital Gains Tax on disposal of UK property

As highlighted in a previous newsletter, changes are due to come into effect which broaden the scope of UK Capital Gains Tax (CGT). Currently non-resident CGT only applies to the disposal of UK residential property. From 6 April 2019, non-resident CGT will be extended to all UK property and will be payable by the vast majority of offshore property owners, e.g. individuals, trusts, companies and other certain investment vehicles.

The extended CGT will also apply to the disposal of property rich entities. Broadly, these are companies whereby at least 75% or more of its gross asset value is derived from UK land. An exemption applies for investors who hold less than a 25% interest (must have been below 25% during the two years prior to disposal).

There are few exclusions from the extension. One key exclusion is for trade related property such as care homes, hotels and restaurants. If the property rich entity is trading before and after the disposal and the land is being used in the trade, then the disposal of the entity may benefit from the exemption. The rules need to be carefully considered if the property and trade are operated by separate companies.

The extension of the charge will apply to all disposals from 6 April 2019 and onwards. The gain will be calculated by reference to either the original acquisition cost or the market value at 6 April 2019. The taxpayer will be able to choose which method to use and will invariably elect for the option resulting in the least tax.

PKF Comment

*The UK tax rules in respect of UK property have been altered significantly over recent years with increased territorial scope. It is important for non-UK resident taxpayers to consider the impact of the rules on their existing portfolio and future investment strategy. We would be happy to assist with a review of your client's position and if you have any questions please contact either Karen Bowen at karen.bowen@pkf-francisclark.co.uk or Adam Kefford at adam.kefford@pkf-francisclark.co.uk or call **+44 1392 667000**.*

»BACK

UK public register of overseas ownership

Draft legislation has been issued which results in a requirement for foreign companies owning, or attempting to buy, properties situated in the UK to reveal their ultimate owners. This forms part of the UK government's ongoing anti-money laundering strategy.

Under the proposed legislation, in order to register title to land, an overseas entity will have to be registered with UK Companies House and to have complied with the updating duty. Failing to register with Companies House will result in the overseas entity being unable to register as the owner of the land – this is necessary for obtaining full legal title to the land.

In practice, failure to register and comply with the updating duty will affect the ability of the entity to either sell or lease the land. It will also inhibit the ability to create a charge over the land, necessary if borrowing funds from a third party lender to fund acquisition.

The register is intended to be operational in 2021 and will apply to all existing overseas entity owners. There is a proposed transitional period of 18 months for such existing owners to register, starting from the date of commencement.

PKF Comment

*There may be very good reasons why UK property is held through an offshore entity. The move towards greater transparency needs to be considered by offshore persons using such structures for property ownership. Although changes are not tax-driven, it will provide the UK tax authorities with further information on the ultimate ownership of UK property thus as always it is important that taxpayers ensure their affairs are fully up-to-date. For further information on the proposed public register please contact either Karen Bowen at karen.bowen@pkf-francisclark.co.uk or Adam Kefford at adam.kefford@pkf-francisclark.co.uk or call **+44 1392 667000**.*

»BACK

Digital services tax

The recent UK budget in October 2018 announced a new Digital Services Tax (DST) to take effect from April 2020, which seeks to ensure that digital businesses pay sufficient tax on any value they derive from UK users.

The new 2% tax will focus on the location of the end user rather than the business itself, and will apply to search engines, social media platforms and online marketplaces. It's important to note that the tax will not be levied on the online sale of goods – only revenues earnt from facilitating these sales.

Small businesses will not be affected by the new tax, as rules have been put in place to ensure the tax is narrowly targeted. These are:

- **Double threshold** – only groups with over GBP 500 million global revenue will be subject to DST, with the first GBP 25 million of UK revenue exempt from the tax altogether via an annual allowance
- **Safe harbour** – companies with very low profit margins can elect to calculate their DST liability on an alternative basis. Where companies make a loss under this calculation, no DST will be due, and where a low profit margin is made, a reduced rate of DST will be levied

It is important to note that DST is expected to be a temporary measure until the UK government, along with the EU, G20 and OECD, reach a consensus regarding the reform of the international corporate tax framework in relation to Digital Businesses. A formal review of DST is scheduled for 2025, however if an agreement is reached before this date it will be dis-applied before then.

PKF Comment

*Although DST will not be implemented until 2020, it is important for businesses to consider whether they will be subject to the new tax as early as possible. There is currently a consultation open until 28 February 2019, seeking views of detail, design, implementation and administration of the tax. If you believe the above measures may impact your business or require any advice with respect to UK taxation, please contact Suki Kaur at sukik@pkfcooperparry.com or Sam Saxton at samanthas@pkfcooperparry.com or call **+44 1332 411163**.*

»BACK

Permanent establishment definition

Following the publication of the base erosion and profit shifting ('BEPS') Article 7 report in October 2015 and the ratification of the MLI, the UK government announced in the recent budget that the definition of a permanent establishment (PE) would be changing in the UK domestic legislation with effect from 1 January 2019.

Effectively, the new definition requires the group UK activities to be considered as a whole rather than in isolation. If together the activities are not preparatory or auxiliary, the new definition will remove the exemption.

This change in definition is targeted at foreign groups that artificially separate their business activities in order to fall within the preparatory/auxiliary activities exemption. Non-resident manufacturing and distribution businesses are likely to be the most affected by this change in definition, particularly where they have split their activities across different locations and various group companies within the UK.

PKF Comment

*Although the UK has adopted this anti-fragmentation rule in the 2018 Budget, the BEPS multilateral instruction contains many further amendments to the definition of a PE which the UK has chosen not to implement at this time. If you believe the above measures may impact your business or require any advice with respect to UK taxation, please contact Suki Kaur at sukik@pkfcooperparry.com or Sam Saxton at samanthas@pkfcooperparry.com or call **+44 1332 411163**.*

»BACK

UK property income

In a measure to deliver more equal tax treatment for property income arising to UK and non-UK resident companies, the taxation of non-resident companies will be chargeable to Corporation Tax rather than Income Tax.

Following the initial publication of legislation on 6 July 2018 and the technical consultation ending on 31 August 2018, the change is set to come into force from 6 April 2020.

The proposed revisions will amend the UK legislation in order to bring any UK property income arising to a non-UK resident company within the scope of Corporation Tax, while excluding the income to Income Tax.

As a result of these changes, provisions will be put in place within the legislation to ensure the following:

- There will be no disposal for a non-resident company for the purpose of capital allowances upon transition to the new regime
- All relevant property income and corresponding expenditure will only be brought into the scope of tax once
- A non-resident company will not need to notify HMRC of its chargeability to Corporation Tax, unless it has any additional sources of UK income

A number of provisions have been put in place to clarify the position for non-UK resident companies during the transition.

PKF Comment

*These rules indicate a fundamental shift in the taxing of UK property income for non-resident companies. Non-residents should also be aware of the change in the taxation of capital gains relating to UK property, as detailed in our article included last quarter. If you believe the above measures may impact your business or require any advice with respect to UK taxation, please contact Suki Kaur at sukik@pkfcooperparry.com or Sam Saxton at samanthas@pkfcooperparry.com or call **+44 1332 411163**.*

»BACK

United States

IRS proposed regulations: new interest limitation rules and Controlled Foreign Corporations

The interest expense limitation rules were modified by the Tax Cuts and Jobs Act (TCJA) in December 2017. On 26 November 2018, the Internal Revenue Service (IRS) released proposed regulations and related guidance.

For multinational companies, it is important to know that the proposed regulations clarify that the changes to the interest expense limitation rules apply to controlled foreign corporations (CFCs) in the same manner they apply to a domestic C corporation. For instance, the new interest limitation rules have to be used when computing subpart F income to be included in the taxable income of the parent company. However, the proposed regulations allude to certain cases where the application of the new interest limitation rules can be modified.

The Treasury Department and the IRS continue to study whether additional modifications to the application should be provided. This could include situations where a CFC is exempt from the application of the new interest limitation rules.

Taxpayers should look out for the publication of the Treasury decision adopting the proposed regulations as final in the Federal Register as the regulations are applicable to tax years ending after the date of the publication. However, taxpayers and their related parties may apply the proposed regulations to tax years ending after 31 December 2017 under certain conditions. Consequently, the proposed regulations would not be retroactive to the date that the TCJA was enacted.

PKF Comment

*If you believe the above measures may impact your business or require any advice with respect to US taxation, please contact Ralf Ruedenburg at rruedenburg@pkfod.com or call **+1 646 965 7778**.*

»BACK

IRS releases proposed foreign tax credit regulations

The TCJA made changes to the foreign tax credit rules and related provisions for allocating and apportioning expenses for purposes of determining the foreign tax credit limitation. On 28 November 2018, the IRS issued proposed regulations with guidance on how to determine the foreign tax credit under the new rules. They were published in the Federal Register on 7 December 2018 and comments can be submitted until 5 February 2019.

Among other matters, the following topics are covered by the proposed regulations:

- the allocation and apportionment of deductions
- adjustments to the foreign tax credit limitation
- carryover and carryback of unused foreign taxes
- the treatment of subsequent reductions in tax

It has to be noted that there are different applicability dates for portions of the proposed regulations. TCJA related ones apply to tax years beginning after 22 December 2017. Proposed regulations that do not apply to TCJA changes are applicable to tax years ending on or after 4 December 2018. Others have applicability dates dependent on certain circumstances.

PKF Comment

*If you believe the above measures may impact your business or require any advice with respect to US taxation, please contact Ralf Ruedenburg at rruedenburg@pkfod.com or call **+1 646 965 7778**.*

»BACK

Changes to Moving Expense Deduction

The new Moving Expense Deduction Rules will affect many taxpayers. Prior to the Tax Cuts and Jobs Act (TCJA) of 2017, a taxpayer would generally qualify for moving expense deduction if the new work location meets the distance test from the former home, and the taxpayer works a certain amount of time during the first one or two years in the new location.

However, the TCJA changed the rules. TCJA suspends the Moving Expense Deduction for tax years after 31 December 2017 and before 1 January 2026. One point to note is that if the taxpayer moved in 2017 and the employer reimbursed in 2018, the taxpayer will not be taxed on the reimbursement in 2018.

The only exception set forth by TCJA is for certain members of the Armed Forces. If the taxpayer is a member of the Armed Forces on active duty and the move is because of a permanent change of station, they may qualify for the Moving Expense Deduction.

Companies that plan to send their employees on global assignments may need to take this into consideration when negotiating the assignment package with their employees.

PKF Comment

*If you believe the above measures may impact your business or require any advice with respect to US taxation, please contact Marco Chong at mchong@pkfod.com or call **+1 646 699 2859**.*

»BACK

New voluntary disclosure procedures for Post 9-28-2018 Offshore and Domestic Disclosures

On 29 November 2018, the IRS released a memorandum with new procedures for all voluntary disclosures following the end of the Offshore Voluntary Disclosure Program (OVDP) on 28 September 2018. The new Voluntary Disclosure Program (VCP) will now apply to all voluntary disclosures, both domestic and offshore, submitted after 28 September 2018. In addition, the IRS may apply the VCP guidelines to unresolved domestic voluntary disclosures submitted on or before that date.

The new procedures continue to provide taxpayers an ability to come into tax compliance and generally eliminate the risk of criminal prosecution, but there are many changes from the prior OVDP. Some of the changes are logistical changes, such as the timing of submission of the required tax returns and additional documents. Other changes are more substantive including changes to the disclosure period and the penalties imposed.

The VCP covers a six-year disclosure period (shorter than the eight-year OVDP period) but allows a taxpayer to expand the disclosure period if desired. A new feature is that those who cannot reach an agreement on taxes and penalties have the right to appeal the results of the examination with the IRS Office of Appeals. The VCP penalty regime differs from both the OVDP and the longstanding Voluntary Disclosure Program and, although the penalty regime is more uncertain and in most cases potentially more severe than in the OVDP, the IRS makes clear that the VCP is geared toward taxpayers with possible criminal exposure and, for many in that category, that is its primary benefit.

Noncompliant U.S. taxpayers should consult with their tax advisors to calculate their maximum tax, interest, and penalty exposure under the new procedures and determine whether filing a voluntary disclosure is appropriate or other options should be considered.

PKF Comment

*If you believe the above measures may impact your business or require any advice with respect to US taxation, please contact Peter Baum at pbaum@pkfod.com or call **+1 914 341 7088**.*

»BACK

Tariffs and the impact on transfer pricing results

Major new tariffs enacted by the United States and any tit-for-tat tariffs enacted by other countries threaten to have an immediate, material impact on the transfer pricing results of multinational companies. Because of a lack of recent experience with strong and escalating trade disputes involving significantly high tariffs, few companies are prepared to deal successfully with the transfer pricing implications.

General background

A tariff, also referred to as a customs duty, is a tax on a certain class of imported goods. In the U.S., tariffs are levied at the time of import and are paid by the importer of record. The tariff rate varies depending on the product classification, pursuant to the Harmonised Tariff System of the United States and by its country of origin. Companies will typically account for the tariff costs as part of the imported product's cost in its cost of goods sold (COGS).

Impact on transfer pricing: which related party bears the tariff?

Based on the tariff rules, the importer of record bears initial responsibility for the tariff, and tariff costs would

ultimately become part of the COGS of the importer. Unlike anti-dumping rules, no rule prevents the parties from contractually allocating the tariff costs in whole or in part among the parties to the transaction. However, if the parties are related, then the resulting arrangement must be at arm's length.

Effect on comparability

Depending on the tested party and transfer pricing methodology, tariff treatment could raise comparability issues. For example, if the affiliated U.S. distribution company - the "tested party" for transfer pricing purposes - is exposed to the new tariffs and the comparables are not, some adjustment to the arm's length range may be appropriate. Such potential adjustments, however, are often difficult to quantify as detailed financial and transactional information on the comparables (e.g. home country of products purchased for resale) is simply not available.

Next steps for multinational companies

The major new tariffs may trigger an immediate, material impact on the transfer pricing results of multinational companies. Many companies may not be prepared to deal effectively with the potentially substantial transfer pricing implications. The solutions to issues created by these tariffs are likely to require both customs and transfer pricing input.

PKF Comment

*If you believe the above measures may impact your business or require any advice with respect to US taxation, please contact David Slemmer at dslemmer@pkfod.com or call **+1 646 965 7781**.*

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Daniel is a corporate and business tax specialist with extensive experience of complex tax structuring and risk management. He advises individual and corporate clients on a broad range of tax issues, with a particular focus on property investment and development, technology, and business restructuring. His tax specialisms include R&D incentives, debt and equity structuring, and cross-border taxation.

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Adam has a particular interest in international business tax matters. This is an area which is becoming increasing relevant for businesses of all sizes, including SME's, and he enjoys assisting clients who are looking to gain an understanding of the tax implications of expanding their business into new territories. In particular he recognises that it is important for businesses to understand the cost base to operating overseas which includes overseas tax and ensuring compliance with local tax laws.

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