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Global Tax Insights

Editorial

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'BEPS' (base erosion and profit shifting) is the current buzz word: all around us, tax administrators are busy implementing the BEPS recommendations and tax professionals are busy advising clients of the challenges posed by the framework.
At the request of the G7 countries, the Organisation for Economic Co-operation and Development (OECD) has issued new model disclosure rules that require lawyers, accountants, financial advisers, banks and other service providers to inform the tax authorities of any schemes they put in place for their clients to avoid reporting under the OECD/G20 Common Reporting Standard (CRS) or prevent the identification of beneficial owners of entities and trusts. The model mandatory disclosure rules are based on the framework contained in the BEPS Action 12 Report. The framework has five key elements:

- A description of the arrangements that are required to be disclosed (i.e. the hallmarks of a disclosable scheme)
- A description of the persons required to disclose such arrangements (i.e. the intermediaries that are subject to reporting obligations under the rules)
- A trigger for the imposition of a disclosure obligation (i.e. when an obligation to disclose crystallises under the rules and any exceptions from reporting)
- A description of what information is required to be reported
- Appropriate penalties or other mechanisms to address non-compliance.

These guidelines target persons and their advisors, by introducing an obligation for intermediaries to disclose those schemes designed to circumvent CRS reporting to the tax authorities.

India has been at the forefront of implementing BEPS, and the Budget 2018 has proposed to introduce two more changes pursuant to BEPS recommendations. These changes are in respect of expanding the scope of Business Connection in India. The first is to align the scope of dependent agent stipulated in 'business connection' under the domestic tax law with the BEPS Action Plan 7 and Multilateral Instrument. The second is to include the 'significant economic presence' test for determining the trigger of 'business connection' for entities in digital business. These changes are described in detail on pp. 7-8 and 9-11.

I express my gratitude to all the member firms that have contributed to this edition of the newsletter.
I sincerely hope that the contents are useful to members and their clients. Feedback and suggestions on the contents are always welcome. You may email your suggestions at sachin.vasudeva@scvindia.com.

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Country Focus

AUSTRALIA

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Foreign investment in Australian property

The 2017–18 Budget changes affecting investors in Australian property

The 2017–18 Federal Budget introduced a number of changes and amendments affecting those looking to invest in the Australian property market. Some of the most significant impacts were aimed at transactions involving foreign investors. There have also been a number of stamp duty and land tax changes at the state level. Though similarities exist among each state and territory's tax regimes, specific advice should be sought based on individual circumstances. For the sake of illustration, we have outlined changes affecting property transactions in New South Wales (NSW), as NSW is the most populous state in Australia and Sydney has seen the fastest growth in property values of any Australian capital city over the last 5 years.

Federal Budget 2017–18: What changed?

A clear focus of this year's federal budget and NSW state budget was to tackle the Australian housing affordability issue. It saw a number of amendments and new initiatives introduced, seven of which are summarised below.

1. AMENDMENT – Deductions for property investors

From 1 July 2017, deductions for travel expenses related to inspecting, maintaining or collecting rent for a residential rental property are disallowed.

Plant and equipment depreciation deductions are also limited to outlays actually incurred by residential property investors. The changes to depreciation deductions apply on a prospective basis, with existing depreciating assets grandfathered. However, deductions for capital works (e.g. building write-offs) are not affected.

> *"From 1 July 2017, the foreign resident capital gains withholding tax rate increased from 10% to 12.5%"*

2. AMENDMENT – Foreign resident capital gains withholding tax

From 1 July 2017, the foreign resident capital gains withholding tax rate increased from 10% to 12.5%, and the threshold was reduced from A$2 million to A$750,000.

If purchasing property in Australia with a market value above A$750,000, the buyer must withhold 12.5% of the purchase price and remit that amount to the Federal Commissioner of Taxation as a non-final withholding tax unless the vendor provides a valid clearance certificate confirming that they are not a foreign resident. Conversely, all Australian resident vendors selling property valued above A$750,000 are required to obtain a clearance certificate from the Australian Taxation Office (ATO) to ensure there is no withholding tax retained by a purchaser on settlement.

3. CHANGE – CGT main residence exemption removed for foreign and temporary residents

A major change to capital gains tax (CGT) affects both foreign and temporary residents, who will no longer be able to access the main residence exemption for CGT purposes. Transitional measures are in place for existing properties until

30 June 2019. However, this change is likely to have a significant impact for property owner occupiers, particularly for Australian citizens and residents who have migrated overseas in recent years either temporarily or permanently.

4. NEW – GST withholding on residential property transactions

On 7 November 2017, Treasury released exposure draft legislation with respect to proposed changes to Goods and Services Tax (GST) on real property transactions previously announced in the 2017–18 Budget.

From 1 July 2018, purchasers of new residential premises or new subdivisions of potential residential land will be required to withhold and remit 1/11th of the total price of the supply of residential premises directly to the ATO at settlement. Once passed into law, the proposed changes will require that at settlement the purchaser must arrange for a cheque to be drawn in favour of the ATO and then remit the GST payment to the ATO on behalf of the developer. One of the potential challenges is that, historically, the GST paid on newly constructed residential property has been calculated by developers using something known as the 'margin scheme', usually without the involvement of the purchaser. From 1 July 2018, developers will need to change the way they report GST liabilities to the ATO and claim GST withholding credits and refunds on their business activity statements.

A strict obligation will also be imposed on vendors to notify purchasers of their GST withholding obligations. Failure to comply will be considered a strict liability offence that could result in significant penalties for the vendor.

5. NEW – Annual vacancy charge on foreign owners of underutilised residential property

On 9 May 2017, the Australian Government announced that it will introduce a charge on foreign owners of Australian residential property where the property is not occupied or genuinely available on the rental market for at least 6 months per year.

The charge will be levied annually and will be equivalent to the relevant foreign investment application fee imposed on the property at the time it was acquired by the foreign investor. The measure will apply to foreign persons who make investment applications for residential property on or after 9 May 2017.

6. AMENDMENT – NSW foreign investor surcharges increased

From 1 July 2017, the foreign investor transfer duty surcharge doubled from 4% to 8%. Similarly, the foreign investor land tax surcharge of 0.75% increased to 2% p.a. from the 2018 land tax year. When setting up a new discretionary trust to hold NSW land, consideration needs to be given to whether any foreign persons are potential beneficiaries of the trust. If so, the trust could be liable for the foreign investor surcharges if appropriate clauses are not incorporated into the trust deed. For any existing discretionary trusts, the trust deed can potentially be amended to exclude foreign persons.

We also note that many other states and territories around Australia, including Victoria and Queensland, have similar foreign investor surcharges on real property.

7. NEW – NSW first home buyers exemption from stamp duty

A number of changes also came into effect for first home buyers in NSW. From 1 July 2017, first home buyers:

- Are exempt from paying stamp duty on the purchase of property with a purchase price of up to A$650,000
- Receive a discount on their stamp duty for the purchase of property up to A$800,000
- Are eligible for a grant of A$10,000 towards buying a new home worth up to A$600,000.

Builders are also eligible to receive a grant of A$10,000 for building a new home worth up to A$750,000.

Country Focus

CANADA

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Canada Federal Budget updates

Introduction

Canada has seen considerable and far-reaching changes proposed in July of 2017. The proposals of July 2017 would have seen small business owners faced with significant increases in taxes for the management of owner wealth, taxable income, and for estate planning purposes. These proposals were largely struck off the table, and by 17 December had been whittled down to a few impactful changes.

The 2018 federal budget introduced on 27 February has now confirmed the implementation of the more modest 17 December proposals, with support in personal taxation for women and Aboriginal groups.

Overall, 2017 and 2018 have seen a great deal of change to Canada's tax law. The government has focused its measures on eliminating unintended consequences of previous legislation which were exploited by small business and by businesses with foreign affiliates. In addition, both budgets have focused on promoting clean energy, and providing support for issues specific to women and aboriginals. In the final tally, Canada maintains some of the lowest tax rates worldwide for business.

Changes to business taxation

Income sprinkling

With the new proposals, the federal government brings the treatment of dividend sprinkling much more in line with the treatment of employment income sprinkling. Previously, Canadian corporations could pay dividends to the adult children of controlling owners which would then be taxed at normal graduated rates in the hands of the recipients. With the implementation of the new Tax on Split Income (TOSI) income sprinkling rules, adult children with little to no labour or capital involvement in the company will see such dividends taxed at the highest marginal rate of approximately 50% depending on the province of residence. This reduces the availability of a previously significant tax-planning tool utilised by small-medium business owners. Some small opportunities remain for those with some contribution to the company but are very limited. These changes have taken effect from 1 January 2018.

Passive income inside of an operating corporation

Canada offers very low overall tax rates for small business on the first C$500,000 of income (10–15% for 2018, depending upon the province of activity). Where small business owners have accumulated investment capital in these corporations, the federal government made it one of their key objectives in July of 2017 to eliminate the ability for small business owners to apply small business rates to passive investment income. The 2018 federal budget has enacted these measures. Small businesses will now see a reduction in the income subject to low tax rates by C$5 for every C$1 of investment income earned in the corporation over C$50,000. Effective for tax years starting after 31 December 2018, a small business earning C$150,000 in investment income would therefore completely use up its C$500,000 limit of low tax rate income available. Grandfathering this measure is seen to satisfy the government's objective in this area and no further changes are expected.

Changes to the corporate refundable dividend tax (RDTOH) regime

The 2018 federal budget has largely removed the ability for corporations to receive a dividend refund for the payment of eligible dividends (low-tax dividends in the hands of recipients). Corporations will now obtain dividend refunds only when paying out ineligible dividends (higher-taxed dividends). This is expected to have a noticeable effect to the returns of many small businesses. This measure is effective for tax years starting after 31 December 2018.

Small business tax cut

In what has been seen as an effort to maintain a competitive advantage for Canadian-owned small businesses, the federal government has dropped the small business corporate tax rate from 10.5% to

10% with effect from 1 January 2018, and scheduled a further drop to 9% effective 1 January 2019. Similarly, the government of Ontario, Canada's most populous and business-centred province, dropped its small business corporate rate to 3.5% for 1 January 2018. This brings the total small business tax burden on the first C$500,000 of taxable income to about 9.5–15%, depending upon the province of activity, making Canada's small business environment extremely competitive worldwide.

Changes to business taxation: Energy specific

Classification of expenditures relating to drilling/completing a discovery well

Before 2017, the classification of expenditures relating to drilling or completing a discovery well qualified as Canadian exploration expenses (CEE). CEE was fully deductible to the extent of the company's income. The 2017 budget reclassified these expenses to Canadian development expenses (CDE), reducing their deductibility to 30% of the expense incurred. In certain special cases, such as drilling expenses incurred where the oil or gas well has either been abandoned or has not produced within 24 months, the full amount is still classified as CEE and is fully deductible.

Further to this measure, where expenses qualifying as CDE are incurred by an eligible small oil and gas corporation after 2018 and renounced to flow-through share investors, they can no longer be reclassified as CEE.

Tax support for clean energy

The 2017 budget expanded the depreciation allowable for tax purposes on geothermal energy equipment, electric charging equipment, and the allowable expenses for conservation activities. The specific changes are:

- The equipment classes 43.1 (30%) and 43.2 (50%) now include geothermal equipment used primarily for generating heat or electricity – this is significant for business and individuals
- The cost of related electricity transaction equipment is now deductible in all equipment classes
- The cost of making geothermal heat an eligible thermal energy source for use in a district energy system is deductible
- Deductible Canadian renewable and conservation expenses now include expenses incurred for the purposes of determining the extent and quality of a geothermal resource and the cost of all geothermal drilling.

These measures apply to all property acquired for use on or after 22 March 2017.

The original measures allowed the application to all property acquired before 2020. The 2018 federal budget extends that application period to all property acquired before 2025.

Changes to business taxation: International

Foreign accrual property income (FAPI)

The FAPI rules are Canada's deeming rules attributing undistributed passive foreign earnings to the income of the Canadian parent. Prior to 2018, an opening existed for foreign corporations with different owners who did not by themselves qualify for the very low small business tax rates (9–15%) to pool their operations in order to meet the qualification. The 2018 federal budget addresses this practice by deeming that each taxpayer contributing assets and resources to an operation be tracked separately, along with the returns attributed to them. Their eligibility for the low small business rate is thereby tracked along with their income and assessed separately from the other contributors to the operation.

In addition to this provision, the measure in the 2018 budget expands the capital requirements for regulated foreign financial institutions earning FAPI to institutions trading or dealing in indebtedness. These activities were previously exempted.

This measure is effective for taxation years beginning after 27 February 2018.

Procedural measures

International information sharing on criminal matters

The 2018 Federal Budget introduced a significant extension of information sharing capability, allowing the Canada Revenue Agency to share information in cases of tax offenses under Canada's treaties with Canadian law enforcement, and where applicable, subsequently with international law enforcement. The information sharing will extend to legal cases of terrorism, organised crime, money laundering, and prohibited substances. This proposal could significantly extend access to law enforcement of private financial information of persons under investigation and for that reason there is a good deal of opposition to this measure. It will be seen whether this is removed in subsequent legislation.

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Country Focus

INDIA

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Maintenance and filing of master file and country-by-country report

The OECD's BEPS Action Plan 13 recommends a standardised approach for transfer pricing documentation and a template for country-by-country (CbC) reporting of income, earnings, taxes paid etc. As a member of the BEPS project, India amended its domestic law *vide* Finance Act 2016 to provide for a specific reporting regime in respect of CbC reporting and master file. Section 92D of the Income-tax Act, 1961 ('the Act') was amended to provide for maintenance and furnishing of a 'master file' of the international group and Section 286 of the Act was inserted for CbC reporting by either the parent company or alternate reporting entity. The detailed rules under the said sections had been awaited since the Budget 2016 was announced on 29 February 2016. The Rules have now been finally notified by the Central Board of Direct Taxes (CBDT) on 31 October 2017. The requirement for filing the master file and CbC report is applicable from financial year 2016–17; however, the due date for filing these has been extended by the CBDT from 30 November 2017 to 31 March 2018, in consideration of the complexities involved and preparation time required.

Master file (Rule 10DA read with Section 92D of the Act)

A master file is required to be filed in Form 3CEAA in the following cases:

1. Part A of master file is to be filed by all constituent entities of an international group, irrespective of value of international transactions or consolidated group turnover
2. Part B of master file is to be filed if the threshold given under the Rule 10DA is achieved, i.e.:

   a. if the consolidated group revenue of the international group, of which such person is a constituent entity, as reflected in the consolidated financial statement of the international group for the accounting year, exceeds Rs. 500 crore (INR 5 billion),

   and

   b. the aggregate value of international transactions:

      i. during the reporting year, as per the books of accounts, exceeds Rs. 50 crore (INR 500 million), *or*

      ii. in respect of purchase, sale, transfer, lease or use of intangible property during the reporting year, as per the books of accounts, exceeds Rs. 10 crores (INR 100 million).

Information that must be maintained and filed under the master file

- List of all entities of the international group, along with their name, address and legal status
- Descriptions of
  - all businesses of the international group, giving details of important drivers of profit
  - supply chain of five largest products or services in terms of revenue and of any other product or service which contributes more than 5% of the consolidated group revenue
  - important service arrangements between members of international group

- capabilities of main service providers within the group,
- transfer pricing policies for allocating service costs and determining prices to be paid for intra-group services

- List of major geographical markets, function asset and risk analysis of constituent entities that contribute at least 10% of the revenues or assets or profits of such group and description of important business restructuring transactions
- Description of the overall strategy of the international group for the development, ownership and exploitation of intangible property giving details of all constituent entities engaged in development and management of intangible property
- List of all intangible property owned by group, along with detail of entity that owns it
- List and brief description of important agreements among members of the international group related to intangible property, including cost contribution arrangements, principal research service agreements and license agreements, along with group transfer pricing policy in relation to this
- Description of important transfers of interest in intangible property among entities of the group along with detail of seller and buyer and the compensation
- Details of the financing arrangements of the group, including the names and addresses of the top 10 unrelated lenders
- Name, address of operations and of effective management of the group entities that provide central financing functions
- Transfer pricing policy related to financial arrangements among the group members
- Copy of annual consolidated financial statements of the group.

Country-by-country report (Rule 10DB read with Section 286 of the Act)

The country-by-country report (CbCR) is required to be filed in form 3CEAD by the parent entity or any alternate entity designated by the international group, if the consolidated group turnover of the group exceeded Rs. 5,500 crore (INR 55 billion) during the preceding accounting year.

The information to be furnished by country is:

1. Revenue from related and unrelated parties, profits (loss) before tax, income tax paid and accrued, capital, accumulated earnings, number of employees and tangible assets other than cash and cash equivalent. The information is to be given for each tax jurisdiction

1. Details of all constituent entities and business activities of each such entity.

The notified rules provide the procedure and content to be filed with regard to the master file and CbCR, which are more or less in line with OECD Action Plan except that the threshold for filing the master file remains low, resulting in a greater compliance burden in India. Many multinational corporations which are not required to prepare the master file in their home jurisdiction would be burdened with extra compliance for the Indian constituent entity. The disclosure requirements also include transparency of group financial arrangements, transfer pricing positions, and other information that was previously unavailable to the tax authorities and could open up new avenues for litigation.

Country Focus

INDIA

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Scope of business connection widened

India has been at the forefront in implementing the BEPS recommendations and vide Finance Act, 2016 had introduced a 6% equalisation levy on certain categories of income – including online or digital advertising space or any other facility/service for the purpose of online advertisement. The Finance Bill, 2018 proposes two further changes pursuant to BEPS recommendations in order to expand the scope of 'business connection' in India. The first is to align the scope of 'dependent agent' stipulated in business connection under the domestic tax law with the BEPS Action Plan 7 and Multilateral Instrument. The second is to include the 'significant economic presence' test for determining the trigger of 'business connection' for entities in digital business. Here, we examine both changes and their impact.

Aligning the scope of business connection with modified permanent establishment (PE) rule as per multilateral instrument

The domestic tax laws deem certain income to accrue or arise in India if it is through or from a business connection in India. In simple terms, this can be equated with business presence. Under the existing provisions of the domestic law, 'business connection' includes business activities carried on by a non-resident through dependent agents. The scope of 'business connection' under the Act is similar to the provisions relating to 'dependent agent permanent establishment' (DAPE) in India's double taxation avoidance agreements (DTAAs). In terms of the DAPE rules in tax treaties, if any person acting for the non-resident is habitually authorised to conclude contracts on their behalf, then such agent would constitute a permanent establishment (PE) in the source country. However, at present, in many cases, with a view to avoid establishing a PE under Article 5(5) of the DTAA, the person acting on the behalf of the non-resident negotiates the contract but does not conclude it.

The OECD under BEPS Action Plan 7 reviewed the definition of PE with a view to prevent avoidance of payment of tax by circumventing the existing PE definition by way of commissionaire arrangements or fragmentation of business activities. In order to tackle such tax avoidance scheme, Action Plan 7 recommended modifications to paragraph 5 of Article 5 to provide that an agent would include not only a person who habitually concludes contracts on behalf of the non-resident, but also any person who habitually plays a principal role leading to the conclusion of contracts. Further, with a view to prevent BEPS, the recommendations under Action Plan 7 have now been included in Article 12 of the Multilateral Convention to Implement Tax Treaty Related Measures ('MLI'), to which India is also a signatory. Consequently, these provisions will automatically modify India's bilateral tax treaties covered by MLI, where a treaty partner has also opted for Article 12. However, for those countries that have not signed up for Article 12 of the MLI, the earlier tax treaty would hold good. In effect, the relevant provisions in the DTAAs, as modified by MLI, are wider in scope than the existing domestic law of India. However, the provisions of the domestic law would prevail over corresponding provisions in the DTAAs, to the extent they are beneficial. Since, in the instant situations, the provisions of the domestic law being narrower in scope are more beneficial than the provisions in the DTAAs, as modified

"Nowadays, taxing principles based on physical presence are obsolete. Taxation of business profits on the basis of economic allegiance has always been the underlying basis of existing international taxation rules"

by MLI, such wider provisions in the DTAAs are ineffective.

In view of the above, the Finance Bill, 2018 has proposed a change in the existing definition of business connection in the Indian Income-tax law according to which 'business connection' shall also include any business activities carried through a person who, acting on behalf of the non-resident, habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by the non-resident. Further, for the said provisions to be attracted, the contracts should be (a) in the name of the non-resident or (b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that the non-resident has the right to use or (c) for the provision of services by that non-resident. This change would align the provisions of the domestic law with the provisions of DAPE in the DTAA as modified by MLI in order to make the provisions in the treaty effective.

Business connection to include significant economic presence

Nowadays, taxing principles based on physical presence are obsolete. Taxation of business profits on the basis of economic allegiance has always been the underlying basis of existing international taxation rules. Economists gave primacy to the economic allegiance rather than physical location and made it clear that physical presence was important only to the extent that it represented the economic location. Ordinarily, as per the allocation of taxing rules under Article 7 of the DTAA, the business profit of an enterprise is taxable in the country in which the taxpayer is a resident. If an enterprise carries on its business in another country through a PE situated therein, such other country may also tax the business profits attributable to the PE. For this purpose, PE means a 'fixed place of business' through which the business of an enterprise is wholly or partly carried out, provided that such business activities are not preparatory or auxiliary in nature and are not carried out by a dependent agent.

For a long time, a nexus based on physical presence was used as a proxy to regular economic allegiance of a non-resident. However, with recent advances in information and communication technology, new business models operating remotely through digital media have emerged. Under these new business models, the non-resident enterprises interact with customers in another country without having any physical presence in that country, resulting in avoidance of taxation in the source country. Therefore, the existing nexus rule based on physical presence no longer holds good for taxation of business profits in the source country. As a result, the source country's right to tax business profits derived from its economy is unfairly and unreasonably eroded.

Under its BEPS Action Plan 1, the OECD proposed several options to tackle the direct tax challenges arising in digital businesses. One option is a new nexus rule based on 'significant economic presence', according to which a non-resident enterprise would create a taxable presence in a country if it has a significant economic presence in that country on the basis of factors that have a purposeful and sustained interaction with the economy by the aid of technology and other automated tools. It further recommended that revenue factor be used in combination with these factors to determine 'significance economic presence'.

The scope of existing provisions of the domestic law is restrictive, as it essentially provides for a physical presence-based nexus rule for taxation of business income of the non-resident in India. The term 'business connection' is also narrow in its scope, since it limits the taxability of certain activities or transactions of a non-resident to those carried out through a dependent agent. Therefore, emerging business models such as digitised businesses, which do not require the physical presence of itself or any agent in India, are not covered within the scope of business connection. Hence, another vital measure proposed by the Finance Bill, 2018 is the incorporation of 'significant economic presence' as a test of business connection under the domestic law.
Significant economic presence is defined to cover transactions like sale of goods, services or property in India, including provision of data download or software in India; or systematic and continuous soliciting of business activities, interacting with a certain number of users in India through digital means. These provisions shall be applicable regardless of whether the non-resident has a residence or place of business in India or renders services in India.

This change in the domestic law will enable India to negotiate for inclusion of the new nexus rule in the form of 'significant economic presence' in the DTAAs. However, unless the corresponding amendments are made to the DTAA, cross-border business profits will continue to be taxed under the existing DTAA provisions and this new domestic regime will not be effective. Existing tax treaties will be unaffected by this new concept of significant economic presence; however, the intention of this change is to enable the government to negotiate treaties to include the new nexus rules in the form of significant economic presence. Further, while it appears that the main intention is to target digital services and provision of digital goods, it would seem that the language is broad enough to cover other activities as well. For instance, if a non-resident service provider provides services to an Indian customer above a specified value (in aggregate), then even if it is a non-digital service it could still form a business connection. However, the government has fairly conceded that unless tax treaties are modified to allow the imposition of tax pursuant to the formation of a business connection, the beneficial provisions under the tax treaty shall prevail and such transactions shall remain non-taxable.

In principle, one may say that both these measures are a step forward in codifying 'substance' over 'form'. With such legislation adapting to keep pace with changing business models and technological advancements, the enterprise will have to undertake a detailed study of their fact pattern and business model to assess their position vis-à-vis the proposed domestic law.

Country Focus

THE NETHERLANDS

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Terms of employment posted EU workers in the Netherlands

On 18 June 2016, the Terms of Employment Posted Workers in the European Union Act (WagwEU) became effective in the Netherlands. At the same time, the Terms of Employment Cross-Border Work Act (Waga) was withdrawn. The WagwEU is the Dutch implementation of the EU Posting of workers Directive (96/71/EC) and the EU Enforcement Directive (2014/67/EU). Employers from other EU countries who temporarily come to the Netherlands to perform a job (posting) are subject to the WagwEU.

Categories of posting

There are three categories of posting:

- Posting based on a contract between the service provider and the service recipient, the service provider not being a temporary work agency. This means that a service provider from a different member state comes to the Netherlands to perform a job with personnel under the management and supervision and at the expense of the service provider; e.g., a German company comes to build a bridge on the orders of a Dutch service recipient.
- Posting within multinational groups. Posting can also take place by seconding an employee of a branch of a group in another member state to a branch of the same group in the Netherlands.
- Temporary agency work. Making temporary agency workers available in the Netherlands, while the temporary employment agency has its registered office in another member state. The management and supervision with temporary agency work is not the responsibility of the service provider (the temporary employment agency), but of the hirer (the service recipient). However, the temporary employment agency remains responsible for the terms of employment of the temporary agency worker.

'Hard core' of employment terms

Employers are obliged to assign certain minimum terms of employment to personnel coming to the Netherlands to work temporarily. The so-called 'hard core' of the terms of employment always consists of the following Dutch labour laws: the Minimum Wage and Minimum Holiday Allowance Act, the Working Hours Act, the Working Conditions Act, the Placement of Personnel by Intermediaries Act (Waadi) and the Equal Treatment Act. Moreover, it is also important that when a foreign employer comes to work in a sector in which a universally binding collective agreement applies, the hard core of the terms of employment from this collective agreement also apply. The posted workers are entitled to the provisions of the universally binding collective agreement, which deal with:

- Maximum working hours and minimum rest hours
- Minimum number of day's holiday, during which the obligation of the employer exists to pay a wage, and extra holiday allowances
- Minimum wage, whereby this always includes the following:
  - — The applicable periodic wage on the pay scale
  - — The applicable reduction in working hours per week/ month/year/period
  - — Surcharges for overtime, shifted hours, irregular hours, including public holiday allowance and shift allowance
  - — Interim pay rise
  - — Expense allowance: travel expenses and travel time allowance, board and lodging costs and other costs involved in performing the work
  - — Increments
  - — End-of-year bonuses
  - — Extra holiday allowances, and whereby the following is not included in this minimum wage: entitlements to additional occupational pension schemes and entitlements to social security

"Failure to comply with the first three obligations will be regarded as a violation as from 18 June 2016, and may therefore be punished with an administrative fine"

exceeding the statutory minimum and fees above the wage for expenses to be incurred by employees in connection with the posting for travelling, housing or food

- Conditions for making employees available
- Health, security and hygiene at work
- Protective measures regarding the terms of employment and working conditions of children, youths, pregnant employees or employees who recently gave birth to a child
- Equal treatment of men and women, as well as other provisions regarding non-discrimination.

Whether a universally binding collective agreement applies can be checked at http://cao.minszw.nl/. If these hard-core provisions are not observed, employees and/or social partners may institute an action against the employer. When obligations in the labour laws are not observed, the Inspectorate Social Affairs and Employment (SZW) may impose a fine.

Enforcement

The WagwEU includes several measures to ensure that the hard core of the terms of employment can be enforced more adequately. For example, inspection services from the member states can exchange information with each other and imposed fines can be collected across the border. In addition, there are a number of administrative statutory obligations for companies that are going to perform temporary work in the Netherlands. These are now required to:

- Provide information, if requested, to the Inspectorate SZW which is required to enforce the WagwEU
- Have certain documents, such as payslips and summaries of working hours available at the workplace (or digitally available immediately upon request)
- Appoint a contact person who functions as a point of contact and who can be contacted by the Inspectorate SZW
- Foreign service providers must report in advance about where and when and with which employees work will be performed in the Netherlands. The service recipient in the Netherlands must check whether the report has been made and whether it is correct.

Failure to comply with the first three obligations will be regarded as a violation as from 18 June 2016, and may therefore be punished with an administrative fine. The duty to report will become effective at a later date (most likely from 1 January 2019) when a digital system is ready to submit the report. This means that at this moment, no reports have to be submitted by the service provider and verified by the service recipient. A more limited duty to report for self-employed persons will also apply in future (again, most likely to be from 1 January 2019). In order to tackle bogus self-employment, self-employed persons must also comply with the obligation to provide information and a more limited obligation to have a number of documents available at the workplace (in hard-copy or digital format).

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Country Focus

UK

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The UK tightens the tax net on UK immovable property

Historically, non-resident individuals and corporate entities have been able to realise gains from UK land and property ('immovable property') without being subject to UK tax. In contrast, UK residents have been subject to capital gains tax (CGT; for individuals) or corporation tax (CT; for corporate entities).

The disparity in treatment between UK residents and those based offshore is quite unusual compared with tax regimes in other countries, and in response to significant political and press pressure regarding offshore ownership of UK immovable property the UK government has taken a number of recent measures such as the introduction of occupation taxes on high-value residential property owned by overseas companies and the introduction of CGT for non-residents on the disposal of residential property (NRCGT) in April 2015. Furthermore, from 5 July 2016, offshore-based developers of land and immovable property situated in the UK were brought into the charge to UK tax on their profits.

Continuing the theme above, in the Autumn Budget 2017, the UK government published a consultation document; effectively a statement of intent, articulating that from 6 April 2019 (individuals) and 1 April 2019 (corporates) non-residents will be subject to UK tax on gains arising from the direct and indirect disposal of *all* UK real estate. This now also brings the disposal of commercial property by non-residents within the UK tax regime. Although the term 'consultation' has been used, it is more a consultation of how exactly the new rules will apply rather than whether they should or not!

The new provisions also detail proposed changes regarding the harmonisation of the annual tax on enveloped dwellings (ATED), NRCGT and non-resident gains on immovable property. However, these changes are not within the scope of this article.

It is expected that gains arising from April 2019 onwards will be taxed on individuals at the relevant CGT rate being 18% or 28% for residential properties and 10% or 20% for commercial properties and for corporate entitles at the prevailing CT rate – currently 19%, reducing to 17% in 2020 for all properties.

Given the extent of foreign ownership of commercial real estate in the UK (particularly in London), these new measures are expected to have a significant impact on the market. This article provides a brief summary of how the intended provisions will operate from a tax perspective.

Direct disposals by non-residents

Direct disposals are whereby a non-resident disposes of their interest in UK immovable property, regardless of the nature of the property or the residence of the disposing entity. Any gain from a direct disposal will be subject to tax at the rates discussed above.

Indirect disposals by non-residents

Indirect disposals are where a non-resident disposes of an interest in an entity that holds UK immovable property. The UK tax authorities argue that the 'economic effect of disposing of such a company may be the same as a direct disposal of the property', therefore not including indirect disposals within the scope to tax may create an inconsistency in the tax treatment of two economically very similar transactions.

"This approach represents a significant departure from previous and long-standing law and practice. Non-residents holding UK commercial real estate need to consider their existing structures as a matter of urgency"

As a result, the entire gain on the disposal of shares will fall within the charge to tax if the following conditions are met:

- The entity is considered 'property rich'; and
- Broadly speaking, the non-resident owner holds or has held at least a 25% interest in that entity at some point within the 5 years prior to the sale of the entity.

A 'property-rich' entity is one where, at the time of disposal, 75% or more of the gross asset value (hence excluding liabilities) is directly or indirectly derived from UK immovable property.

In instances where there are groups of companies, shares disposed of in a holding company that, viewed in isolation, is not property rich may be caught under these proposals where the group on the whole is property rich.

Rebasing

The UK government is seeking to tax only the gains arising on or after April 2019; therefore, the base cost of properties for the purposes of direct disposals will be rebased for April 2019 values. However, the taxpayer will be able to elect to use the original cost of the property instead in cases where the April 2019 valuation is less than the original cost of the property.

For indirect disposals such election is not available, so the property will be rebased to April 2019 – meaning that the change in value from that date onwards will be subject to UK taxation.

Interaction with tax treaties

With particular reference to indirect disposals, there are treaties between the UK and some overseas jurisdictions where disposals of shares in 'property rich' companies will not be subject to UK tax and will in fact be taxable in the state of residence of the person disposing of the shares. This will be of benefit to investors located in certain jurisdictions, particularly those with low rates of tax on gains. This might lead to arrangements known as 'treaty shopping' whereby an entity structures or restructures their investments to exploit treaties to ensure that their gains cannot be taxed in the UK. In an attempt to counter 'treaty shopping', anti-forestalling provisions have been effective from 22 November 2017 and seek to deny relief where the main purpose of the arrangement is to avoid the imposition of the indirect charge.

Conclusion

It has been argued that the proposed new rules could make the UK less desirable in terms of property investment from non-resident investors. This may be true; but in an environment with measures such as BEPS and the global drive to crack down on perceived tax avoidance using offshore structures, there is unlikely to be any relaxation of these plans.

This approach represents a significant departure from previous and long-standing law and practice. Non-residents holding UK commercial real estate need to consider their existing structures as a matter of urgency.

Country Focus

USA

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Changes in San Francisco gross receipts tax: What to expect for tax season

Overview

The Gross Receipts Tax and Business Registration Fees Ordinance (or simply 'Ordinance') was approved by San Francisco voters on 6 November 2012. The Ordinance replaces the existing payroll expense tax on the privilege of doing business in San Francisco over the period of 5 years with a tax that is based on gross receipts from business conducted within the city. Beginning tax year 2014, for 5 years, the San Francisco payroll expense tax rate had been incrementally reduced, and the gross receipts tax rate was correspondingly increased to allow time to adjust to the gross receipts tax. Tax year 2018 will be the last year of the payroll expense tax. Starting in 2019, businesses will pay only the gross receipts tax.

Who is subject to San Francisco gross receipts tax?

Any person engaging in business within San Francisco is subject to the gross receipts tax. A person is considered 'engaging in business' if that person (or any employee, representative, or agent of that person) conducts any of the following activities:

- Maintaining a fixed place of business in San Francisco
- Owning, renting, or leasing real or personal property in San Francisco for a business purpose
- Maintaining tangible personal property for sale in San Francisco in the ordinary course of business
- Employing or loaning capital on property located in San Francisco for a business purpose
- Performing work, solicitation or services in San Francisco, including operating motor vehicles on San Francisco streets in a business activity, for any part of ≥7 days in the year
- Exercising corporate or franchise powers in San Francisco
- Liquidating a business when the liquidator holds itself to the public as conducting a San Francisco business.

There are exemptions for entities with limited activities within San Francisco, including:

- Contracting with or acting through the San Francisco services of an unrelated investment advisor
- Maintaining formation, incorporation or registration documents in San Francisco
- Owning an interest in a pass-through entity doing business in San Francisco
- Having trustees or directors that meet or reside in San Francisco.

Small business enterprise thresholds

Small businesses are exempt from payment of the gross receipts or payroll expense tax if their payroll expenses or gross receipts in the city are within the 'small business enterprise thresholds'. However, small businesses may still be required to file an annual return with the city. Every business with gross receipts of $500,000 or more, or payroll expense of $150,000 or more is subject to filing the annual return.

With respect to the tax year 2017, the small business enterprise thresholds are:

- $1,090,000 for gross receipts tax
- $300,000 for payroll expense tax.

A lessor of residential real estate is considered a 'small business enterprise' if and only if the lessor leases fewer than four units in any individual building.

Gross receipts tax rates

The gross receipts tax rates vary depending on the type of business and the annual gross receipts from business activity in the city. For tax year 2017, the gross receipts tax rates range from 0.05625% to 0.4875%. There are seven different tax rates, based on different business activity categories:

- Retail and wholesale (Code Sec 953.1)
- Manufacturing, transportation and warehousing, information, biotechnology, clean technology and food services (Code Sec 953.2)
- Accommodations, utilities, arts, entertainment and recreation (Code Sec 953.3)
- Private education and health services, administrative and support services (Code Sec 953.4)
- Construction (Code Sec 953.5)
- Financial services, insurance, professional, scientific and technical services (Code Sec 953.6)
- Real estate and rental and leasing services (Code Sec 953.7).

Businesses deriving receipts from activity both within and outside of San Francisco

Depending on the business activity, businesses must use one of these three methods to determine the portion of gross receipts that are within San Francisco:

- Allocation: allocate receipts based on rules that assign receipts to a particular location
- Apportionment: apportion receipts among multiple locations based on payroll
- A combination of the above two methods.

Payroll expense tax rate (applicable until tax year 2017)

The payroll expense tax rate for tax year 2017 is 0.711%, down from 0.829% for tax year 2016.

Due dates for filing annual return

The 2017 gross receipts tax and payroll expense tax return is due 28 February 2018. An extension can be filed by 28 February 2018 to extend the filing due date to 1 May 2018 under the condition that the person made payments of at least 90% of their tax liability for that period. Failure to file the return or the extension by the due date may result in penalties and interest.

Quarterly estimated tax payments

Beginning 2017, businesses are required to make quarterly estimated payments for payroll expense taxes and gross receipts taxes. Businesses may apply refunds of the business registration fee, the payroll expense tax and the gross receipts tax to subsequent tax periods.

The required quarterly estimated payments are each 25% of the prior year or current year tax liabilities, whichever is less.

The first, second and third quarterly instalments will be due and payable on 30 April, 31 July and 31 October, respectively, of the tax year. All quarterly estimated tax can be paid at one time or individually by their respective due dates. The fourth quarter payment is due by February 28 of the following year.

Failure to pay these quarterly amounts results in a penalty of 5% of the underpayment, with no interest. Payments may be made online at https://etaxstatement.sfgov.org/onlinepayment/.

Country Focus

USA

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Tax reform could mean big savings for craft beverage industry

The Craft Beverage Modernization and Tax Reform Act has brought some bright news for producers of craft beer, wine and spirits. Beginning in tax year 2018, excise taxes will be substantially reduced, resulting in some fairly hefty tax savings for many of America's beverage producers.

What is excise tax?

An excise tax is an indirect tax that is charged upon the sale of a specific good, such as a barrel of beer. Different from sales tax, which applies to all products, excise tax only applies to certain goods. The tax is often baked into the final cost of the good. A few of the goods subject to excise tax include, tobacco, alcohol, gasoline and gambling.

The reduced excise tax rates are effective as of 1 January 2018 and will apply to products removed in calendar years 2018 and 2019, regardless of when the products were produced. However, this reduction is set to expire after 2 years.

Craft brewers

For brewers producing less than 2 million barrels of beer a year, the bill reduces the federal excise tax from $7 to $3.50 a barrel for the first 60,000 barrels. For all other brewers and beer importers, the tax will be reduced from $18 to $16 a barrel on the first 6 million barrels. However, for barrelage over 6 million, the bill maintains the $18 a barrel rate.

The bill will also encourage collaboration between brewers by allowing the transfer of beer between bonded facilities without tax liability. This means that brewers will have more freedom to collaborate on new beers and share bottling and storage facilities without the tax burden.

The bill also expands the list of ingredients that can be automatically added to a beer without the approval of the Alcohol and Tobacco Tax and Trade Bureau (TTB). The list of exempt ingredients has been expanded to include wholesome fruits, vegetables and spices.

This reduction is expected to produce more than $140 million in annual savings, allowing considerably more capital to be invested within the business. Brewers can look forward to having more savings for research and development, expanding operations, hiring more workers and stimulating their local economy.

Wineries

The expansion of the excise credit will also apply to all wineries, regardless of production size. For 2018 and 2019, wines will be taxed by volume and by alcohol percentage. This will range from $0.535 to $1 per gallon based on the amount produced – $1 per gallon for the first 30,000 gallons, $0.90 per gallon on the next 100,000 gallons, and $0.535 on the next 620,000 gallons.

Wine with 14% to 16% alcohol content will see taxes reduced from $1.57 to $1.07 per gallon, while wines with higher alcohol content will incrementally increase. For the first time, sparkling wine producers will see their rates decrease to be in line with the rates of still wine.

Distilleries

The bill also proposes to reduce federal excise tax reduction to $2.70 per gallon for the first 100,000 gallons of the craft alcohol produced or imported. In addition, the new law will exempt the spirits ageing process from interest expense capitalisation rules, enabling distilleries to reinvest a significant portion back into their business.

Craft beverage producers who overpay their 2018 taxes based on 2017 tax rates are eligible to seek a refund or credit with the TTB.

Country Focus

USA

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International tax provisions in the US tax reform bill

In a move to a territorial tax regime, the new US tax reform bill that was passed into law late last year makes significant changes to the taxation of foreign income. All shareholders of foreign corporations – both US and non-US individuals – should take careful note of the new provisions that affect their income, tax deductions and accounting procedures.

Participation exemption

The Tax Cuts and Jobs Act ('HR 1') establishes a participation exemption tax system for foreign income. 'Specified 10%-owned foreign corporations' can elect a 100% dividends received deduction (DRD) for the foreign-source portion of dividends received by a US corporation, effective for distributions made after 31 December 2017.

A minimum 366-day holding period is required for the DRD to qualify. Certain 'hybrid dividends' are exempt from DRD, and hybrid dividends received by one controlled foreign corporation (CFC) from another CFC are treated as subpart F income.

One-time transition tax

When transitioning into this new tax system, a one-time tax will be assessed on shareholders who own 10% or more of a foreign corporation. Their post-1986 untaxed earnings will be taxed at 15.5% on cash and cash-equivalent assets, and 8% on non-cash assets. An election can be made to spread the tax pickup over 8 years.

Individuals, partnerships, estates and trusts are all subject to the transition tax, while there is a deferral for S corporations and special rules for real estate investment trusts (REITs). The tax is effective for the last tax year of a foreign corporation that begins before 1 January 2018. For US shareholders, it is effective for the tax years in which or with which such tax years of foreign corporations end. For calendar-year foreign corporations and US shareholders, the tax liability starts immediately in the 2017 tax year.

Active trade or business exception

Certain outbound transfers of property used in an 'active trade of business' are no longer eligible for an exception from the general non-recognition override provision. HR 1 repeals this exception for transactions occurring after 31 December 2017. As a result, the incorporation of a foreign branch or the establishment of a foreign company is now taxable.

In addition, certain loss recapture rules may apply to corporations that later incorporate a foreign branch for losses incurred after 31 December 2017.

New categories of income

The new tax system established two new categories of income associated with foreign corporations:

- **Foreign-derived intangible income (FDII) –** This is income derived from sales or other dispositions of property to a foreign person for a foreign use; a license of intellectual property to a foreign person for a foreign use; and services provided to a person located outside of the US.
  - Effective for tax years beginning after 31 December 2017, domestic C corporations are allowed a deduction of 37.5% (21.875% for tax years beginning after 2025) of FDII,

> *"This new tax regime creates a whole new tax landscape for foreign corporations, as well as major opportunities for the tax professionals who advise them"*

subject to a taxable income limitation.

- **Global intangible low-taxed income (GILTI)** – Generally speaking, GILTI is the income earned by foreign corporations in which a US person directly or indirectly owns 10%. The new tax regime requires US shareholders to include their share of GILTI in their gross income, eliminating the deferral of taxes on a significant portion of foreign earnings.
  - However, HR 1 also includes a partial deduction on GILTI for C corporations. Corporate US shareholders (other than regulated investment companies, REITs and S corporations) are allowed a deduction of 50% of the GILTI inclusion, effective in the foreign corporation's tax years beginning after 31 December 2017 (37.5% for taxable years beginning after 2025) and for tax years of US shareholders in which or with which such tax years of the foreign corporation end.
  - Like the FDII deduction, the GILTI deduction is limited by taxable income. A foreign tax credit for corporate US shareholders is also allowed as a deemed payment of 80% of the 'inclusion percentage'.

Base erosion and anti-abuse tax

HR 1 also imposes a base erosion and anti-abuse (BEAT) tax equal to the base erosion minimum tax amount (BEMTA) of a foreign corporation, effective in tax years beginning after 31 December 2017. This tax affects corporations that are applicable taxpayers, defined as a corporation with a base erosion percentage of at least 3% and average gross receipts of $500 million or more for the last 3 years. S-corporations and REITs are exempt from this definition.

The corporation is required to pay the greater of its regular tax liability or its BEAT tax liability. Payments included in cost of goods sold are not subject to the BEAT tax. Qualified derivative payments are also excluded, as are amounts charged at cost under the service cost method if tax is imposed and withheld under Sections 1441 or 1442.

Intangible property transfers

The new tax bill amends the definition of intangible property (IP) to include workforce in place, goodwill, and going concern value. It further provides statutory authority for the Internal Revenue Service to value IP on an aggregate basis if doing so would achieve a more reliable result than an asset-by-asset approach. This change effectively limits the amount of income shifting that can be done through intangible property transfers by making these transfers subject to Sections 367(d) or 482.

Other provisions

HR 1 contains a myriad of other changes affecting foreign corporations doing business in the United States, such as new anti-hybrid provisions, changes to subpart F income rules, and modified foreign tax credits. And clearly, these corporations are also impacted by the corporate tax law changes that affect all US businesses – such as the corporate rate reduction, new interest expense limitation, and changes to state and local tax deductions.

Altogether, this new tax regime creates a whole new tax landscape for foreign corporations, as well as major opportunities for the tax professionals who advise them.

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The Next Step

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