Briefing

International review for April

Speed read

The tax agenda in recent weeks has been dominated by measures aimed at alleviating the economic and social impact of the Covid-19 pandemic, but other tax announcements are still being made. There has been further progress on the implementation of BEPS changes: the UK/Switzerland double tax treaty has been updated; the OECD has reported on progress made by members regarding action 6; and Luxembourg has increased its anti-avoidance measures by preventing deductibility of certain payments to tax havens. There has been further guidance on the UK's digital services tax and the French and Turkish counterparts. Hong Kong has issued temporary interim guidance on the taxation of the digital economy, and India has announced an amendment to their equalisation levy.

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The announcements of measures aimed at tackling the economic and social impact of Covid-19 from countries all over the world are coming in thick and fast. Governments round the world are quickly realising this situation requires significant intervention, in terms of support both for healthcare and the economy. In the United States, for instance, President Trump has announced the phase 3 response which includes an estimated $2.3 trillion in aid; a huge increase from the initial phase 1 aid commitment of $8.3bn. In the UK, the key pillars of the economic strategy are now in place, and the focus has shifted to implementation.

All businesses should research what reliefs, deferrals and other mitigation measures are available in any territory in which they operate, especially if the business is under severe financial distress because of the virus (for details of the main tax provisions implemented by key jurisdictions, see 'Covid-19: a cross-jurisdictional update', *Tax Journal*, 3 April 2020). This isn't as straightforward as it may sound as it involves, inter alia, navigating EU state aid rules (under the temporary framework a limit of €800,000 applies to certain types of state aid) and considering financial statement disclosure requirements for government grants and the wider reputational considerations that arise from claiming financial support from governments.

Businesses should also consider how restrictions on travel, which are likely to last for some time yet, affect the residence of companies, the permanent establishment (PE) position and payroll taxes.

However, developments in recent weeks haven't only been about the Covid-19 pandemic. Whilst many tax developments that aren't concerned with Covid-19 have stalled, some others have taken place, including developments on implementing BEPS and the taxation of the digital economy.

Protocol to the UK/Switzerland double tax treaty comes into force in the UK

The UK/Switzerland double tax treaty has been updated with new provisions to tackle tax base erosion and profit shifting. It has been in effect for Swiss taxes since 1 January 2020, and for taxes withheld at source for both countries from the same date. However, it has only had effect in the UK for income tax and capital gains tax purposes from 6 April 2020, and for corporate tax purposes from 1 April 2020.

In line with recommendations from the OECD, the revised treaty includes new provisions stating the treaty is not intended to enable taxpayers to inappropriately access tax benefits. It includes provisions to specifically prevent access to treaty benefits for arrangements where the principal purpose of that arrangement or transaction is to derive a tax benefit.

References to conduit arrangements within the treaty have been removed, and the wording in article 9 on transfer pricing adjustments has been modernised.

BEPS Action 6 against treaty shopping

As shown by the recent changes to the UK/Switzerland double tax treaty (discussed above), the large majority of members of the OECD/G20 Inclusive Framework on BEPS are translating their commitment on treaty shopping into actions and are modifying their treaties.

At the end of March, the OECD released the second peer review assessing countries' efforts to implement the Action 6 minimum standard as agreed under the OECD/G20 BEPS project.

The results of the peer review show that good progress has been made overall, and the multilateral instrument (MLI) has been the tool used by the vast majority of jurisdictions that have begun to implement the minimum standard. The MLI's impact is expected to increase quickly as jurisdictions ratify it and its coverage is also expected to increase as other jurisdictions with a large network of tax treaties are considering joining it.

Digital services tax (DST) guidance

On 29 March, HMRC published guidance on the new UK DST in its *Digital Services Tax Manual*. As readers will know, the DST is a 2% tax on the revenues derived from UK users of social media platforms, search engines and online marketplaces. This will apply to revenue earned from 1 April 2020. The guidance gives businesses practical advice on how to check if they need to register, registering the company's details, calculating the liability and how to submit a DST return and pay the liability. This should be welcome assistance with the practicalities of the DST and whilst this is unlikely to affect a significant number of companies it will be useful for companies caught by the rules and also to any close to the thresholds so they can monitor their position. Businesses must register online within 90 days of the end of the first accounting period that includes a liability for DST. Therefore, any businesses with year-end dates in the next few months should ensure that their deadline is not missed.

The French tax authorities also released draft guidance on its DST which applies to revenues earned after 1 January 2019. Previously only limited guidance on filing and payment formalities had been published, to allow taxpayers to make the first payment in November 2019. The recent publication is more comprehensive.

Turkey has also released proposed guidance on its DST, as enacted in December 2019. Turkey's DST is imposed

at a rate of 7.5% on Turkish revenues related to digital advertising, sales of digital content and social media platforms earned by large companies beginning in March 2020.

Hong Kong: taxation of the digital economy

Hong Kong is taking a slightly different and more relaxed approach to the challenges of taxing the digital economy. On 27 March 2020, the Hong Kong Inland Revenue Department (IRD) published a revised version of its *Profits tax digital economy, electronic commerce and digital assets* practice note (revised DIPN 39). The revised note provides practical guidance on the IRD's views, but it is of necessity a temporary measure pending the conclusion of global discussion on BEPS 2.0. Key practical points include:

- The IRD has set out what it considers to be the key value creators of an e-commerce business, having confirmed the view that data generated and gathered (such as customers' personal data) is understood to be key.
- The IRD has also confirmed that, in the absence of any specific provisions in the Inland Revenue Ordinance (IRO) that deal with the taxation of e-commerce, the tax consequences of e-commerce transactions are to be determined in accordance with section 14 of the IRO.
- The IRD has provided some guidance on how to determine the locality of profits in the context of e-commerce transactions. The IRD appears to take the view that the proper approach is to focus on the core operations that have implemented the digital transaction to earn the profits in question and the place where those operations have been carried out, rather than on what has been done electronically, i.e. location of core operations as a test of source.
- The IRD has reiterated that the authorised OECD approach will be adopted in attributing profit from non-resident to its HK PE, where applicable. This requires a two-step analysis, namely (i) considering the HK PE as a functionally separate entity and attributing assets and risks to the PE; and (ii) applying the arm's length principle to the transaction of the hypothetical entity (i.e. the PE).
- On the question of whether a non-Hong Kong resident company has a PE in Hong Kong, the IRD takes the view that, in the context of digital sales, the decisive criterion may be whether the activities of a fixed place of business (which could be a computer system or server) form an essential and significant part of the e-commerce business as a whole or whether those go beyond preparatory or auxiliary activities.
- The IRD also provided some relevant comments regarding the taxation of digital assets, namely in respect of digital tokens. The IRD's view is that, subject to any specific exemptions provided, profits arising in or derived from Hong Kong from an initial coin offering (ICO) can be charged to profits tax in accordance with the general principles in their tax law. However, profits arising from the sale of digital assets bought for long-term investment purposes would not be chargeable to profits tax (that is, profits from sale of capital assets).

The updated guidance is welcome. However, it perhaps struggles to reconcile a source-based approach to taxation with the realities of digital business. In our view, it is far from clear that the core operations and drivers of value creation set out by the IRD are the appropriate basis for determining source, or that the locations in which profits are sourced and business is carried on need necessarily coincide in the context of e-commerce.

The IRD will review its approach next year once the OECD has finalised its proposals on the taxation of the digital economy.

India: amendment to equalisation levy

Broadly, the equalisation levy is India's version of the DST, brought in response to BEPS Action 1. The levy previously applied to payments made to non-residents in respect of online advertising and certain related services. However, from 1 April 2020, the levy shall apply more widely to income received by an 'e-commerce operator' for e-commerce supplies or services. It is applicable only where the operator has turnover arising from these services over INR 20m (approximately £210k).

This widens the scope of the levy significantly and it is likely to impact businesses undertaking various types of transactions, such as online sales, online services and digital sales with customers located in India.

Luxembourg: anti-avoidance

On 25 March, the Luxembourg Government Council approved a draft law to limit the tax deductibility of interest and royalties paid or due to related entities or associated enterprises located in a country listed on the EU list of non-cooperative countries and territories (the 'EU blacklist').

The Bill follows conclusions of the Economic and Financial Affairs Council of the EU (ECOFIN), issued on 5 December 2019, which stressed the need for member states to agree to take coordinated defensive measures against blacklisted jurisdictions. It was agreed in the framework of the EU Code of Conduct Group that member states should apply at least one of the following defensive legislative measures against non-cooperative jurisdictions: non-deductibility of costs, controlled foreign company (CFC) rules, withholding tax measures or limitation of participation exemption on profit distribution.

The Luxembourg government has chosen the first option and applied limitations to the deductibility of some costs. Interest or royalties, due or paid, should not be deductible for tax purposes, provided that the following conditions are met:

- the beneficiary of the interest or royalties is a tax opaque entity;
- the recipient is an associated enterprise of the person owing the interest or royalties;
  Luxembourg tax law states that two undertakings are associated enterprises where one of them participates directly or indirectly in the management, control or capital of the other, or where the same persons participate directly or indirectly in the management, control or capital of both undertakings; and
- the recipient of the interest or royalties is established in a country included on the blacklist.
  This will apply to payments made from 1 January 2021. ■

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