Briefing

International review for November

Speed read

2020 will long be remembered for the covid-19 pandemic which has been a major disruptor to lives globally, changing the way we live and work, hitting the economy and influencing monetary and fiscal policy. The world has become increasingly digitalised as a result, underscoring the importance of the OECD's continued work on taxation of the digital economy which reached a significant milestone in October with the publication of its pillar one and pillar two blueprints. Meanwhile, Joe Biden is expected to be inaugurated as the next US president in January, and the Brexit deadline draws ever closer. Looking ahead, it will be interesting to see how governments approach economic recovery from covid-19 and how well they can balance growth with balancing the books. Tax will undoubtedly play a crucial role in this.

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In this article, my last of 2020, I'm looking back over the year to date and sharing some of my thoughts on the year ahead. Covid-19 has, of course, dominated headlines globally and as a result we have seen governments introduce a wealth of monetary and fiscal policies in an attempt to ensure that businesses and people can weather the crisis. Against this backdrop, the OECD has made strides in its work on solving the tax challenges of the digitalised economy. Looking forward into the next 12 months, I consider the tax implications of Brexit and the potential tax policies that a Biden-led US government may seek to bring in. Undoubtedly, covid-19 will continue to be at the forefront, particularly as we enter the recovery phase and governments start to consider how to raise tax revenues, whilst being mindful of a recovering economy.

Looking back

Covid-19 has been a feature of many of my articles this year, first appearing in my monthly update for February, when China's tax and finance authorities issued guidance setting out preferential measures to support businesses and citizens with the outbreak there. Since then, as the pandemic spread, a wealth of measures has been introduced around the world to help businesses and people survive in the face of restrictive lockdowns. Temporary tax reliefs were introduced by many governments and have included tax payment deferrals, suspension of formal tax audits as well as a host of non-tax measures, including loans to businesses and wage support schemes. Many of the tax reliefs introduced in the Spring are still effective, or have been extended, with countries now facing a second wave of the disease.

With restrictions placed on travel and the closing of borders, the impact of the pandemic on residency and permanent establishment was also uncertain. In response guidance was published by the OECD in April with several countries, such as Canada and the UK, issuing their own specific guidance. As we head towards the end of the year businesses will need to consider the impact of the pandemic on their expected outturn for 2020 and whether transfer pricing adjustments are required for 2020 and any adjustments to their policies for 2021.

Taxation of the digital economy has also generated considerable media attention this year with a number of countries including the UK, India, and Mexico announcing and/or implementing unilateral measures to tax the digital economy in the absence of global consensus. This has generated tension with the US which, in June, launched trade investigations into a number of these taxes, including the UK's DST, and in July announced tariffs in retaliation to France's DST.

Work on a global solution has nevertheless continued at pace. As I mentioned in my last update, October saw the public release of the OECD's 'blueprints' for pillar one and pillar two, an important step. A consultation has been launched inviting stakeholder comments on the 'blueprints' with a virtual hearing scheduled to take place in January 2021 and a view to reaching political agreement by mid-2021.

November updates

2020 has been a busy year for the world of tax with November showing no signs of slowing down.

Covid-19 measures

As a second wave of covid-19 grips much of Europe, countries are yet again extending measures put in place earlier in the pandemic or introducing additional measures. This month Belgium has again extended the filing deadline for corporate tax returns until 30 November 2020, the UK has extended its job retention scheme until March 2021 and Lithuania has introduced further tax measures relating to tax payments. Meanwhile, in Canada, the new Canada emergency rent subsidy has been introduced to allow businesses, eligible charities and non-profits that experience a revenue drop to claim a subsidy on eligible expenses, on a sliding scale up to a maximum of 65% of eligible expenses, including rent and interest on commercial mortgages, until June 2021.

Advance pricing arrangements (APAs)

The South African, tax authorities are considering whether to introduce APAs and have launched a consultation requesting input by 18 December 2020. APAs have not historically been available to taxpayers in South Africa, despite many other countries offering APAs in line with OECD guidance. Introducing an APA programme should help to increase certainty for investors and potentially help increase the attractiveness of South Africa as an investment location.

Separately, in China, the 2019 annual APA report notes that the number of agreed and signed APAs in China was at a record high. The majority of these were in the manufacturing sector with an increasing number in wholesale and retail.

Australian R&D measures

Following the federal budget, the Australian Government has announced it will invest heavily in developing the country's research, manufacturing and energy sectors, with the revised R&D tax incentive applying for years of income commencing on or after 1 July 2021. Under the revised incentive, companies with annual aggregated turnover of

less than AUD 20 million will be able to access a refundable offset pegged at 18.5 percentage points above the corporate tax rate, which from 1 July 2021 will be 25% providing a 43.5% refundable tax offset, with no cap on the refundable tax offset. Meanwhile, companies with an annual aggregated turnover of AUD 20m or more will have a two-tiered R&D intensity (R&D spend compared to total business expense) framework providing a premium intensity benefit of 8.5% above the corporate tax rate for R&D intensities up to 2%, and 16.5% above the corporate tax rate for R&D intensities above 2%.

The year ahead

US election

Against the backdrop of covid-19, the heavily anticipated US election took place on 2 November 2020. After a nail-biting wait for the results, Joe Biden has been reported as the winner and is expected to be inaugurated as the next POTUS in January 2021. Looking forward over the next 12 months, it will certainly be interesting to see how a Biden-led US government will change the US tax landscape.

We have already had some clues from Biden's business tax proposals including an increase of the top statutory corporate income tax rate to 28%, doubling the tax rate on global intangible low-taxed income (GILTI) earned by foreign subsidiaries of US corporations (from 10.5% to 21%), and creating a new 15% corporate minimum tax on global book income of $100m or more.

However, at the time of writing, it appears likely that there will be a divided government, with the Republicans retaining control of the Senate and the Democrats the House of Representatives. As a result, major tax policy changes, such as an increase to the headline corporate income tax rate, may be difficult to get across the line. However, there are two seats in the Senate up for grabs in Georgia runoff elections in January which could change the political landscape if both were won by the Democrat candidates. Less controversial changes, such as introducing reliefs in response to the economic challenges of covid-19 or providing research and development incentives may gather bipartisan support.

It will also be interesting to see the Biden administration's approach to global tax initiatives such as BEPS 2.0.

Brexit

At the time of writing, and with the end of the Brexit transition period on 1 January 2021, just around the corner, negotiations on the UK's future trading relationship with the EU are still ongoing leaving little time for a deal to be concluded before the end of the year. With just weeks to go until 1 January 2021 businesses should be prepared for the worst-case eventuality of no deal being reached.

Whether or not a deal is reached, from a tax perspective this will be a very hard Brexit and technically little different from no-deal. It is anticipated that customs declarations will need to be filed, VAT rules and procedures will be different for transactions with the EU and there will be additional formalities and potentially licences required for the importing or exporting of certain types of goods. With this in mind, HMRC has been releasing new guidance over the past few months on the expected import and export procedures and they have written to all VAT registered businesses with advice on how to prepare. There remains significant confusion and uncertainty about the status of trade across the Northern Ireland sea border with knock-on implications for indirect tax compliance.

It is important to also remember that, upon expiration of the transition period, from a direct tax perspective, the UK will no longer be directly covered by EU directives including: the Parent-Subsidiary Directive; the Interest and Royalty Directive; the Merger Directive; the Directive on Administrative Cooperation (DAC); the Anti-Tax Avoidance Directive (ATAD); and the Directive on tax dispute resolution mechanisms in the EU.

As a result of this, the tax treatment of payments of interest, royalty and dividend payments from the EU to the UK will depend on domestic law of the source country and the relevant tax treaty between that country and the UK. Although the UK has an extensive treaty network, some treaties offer a less favourable outcome than has been the case under the EU directives. As a result, the UK may well seek to renegotiate some of its tax treaties with less favourable terms to try to bolster the attractiveness of the UK as a holding jurisdiction post-Brexit. In the short term, companies with undistributed earnings in EU subsidiaries which may be subject to irrecoverable dividend withholding tax post transition, should consider payment of dividends before the expiry of the transition period.

Covid-19 recovery and future tax trends

With promising news on vaccine development recently announced, we can hope that during the next 12 months we will start to see the beginning of the covid-19 recovery. As the world slowly moves back towards some form of normality, governments will undoubtedly be looking for ways to increase tax revenues, however they will also be weary of stifling economic recovery.

The most straightforward way to raise revenue is through increasing tax rates however there can be drawbacks to this simplistic kind of approach. For example, increasing a country's corporation tax rate could reduce the incentive to invest in that location while universal income tax rises will reduce households' disposable income potentially reducing discretionary spending. Alternative targeted taxes such as a surcharge on excess profits, or a windfall tax on sectors that have been profitable during the covid-19 pandemic may be attractive alternatives for governments.

We may also continue to see further tax incentives and targeted cuts employed as a means of stimulating growth, for example reducing VAT rates and enhanced relief for capital expenditure to encourage spending. Indeed, we have seen this already in the UK with the temporary cut to VAT for the hospitality industry, due to expire in January and the recently announced extension of the £1m annual investment allowance until 31 December 2021.

Winston Churchill once said, 'Never let a good crisis go to waste'. Covid-19 has presented a rare opportunity for wholesale reform of tax systems. It is possible, therefore, that we could see more radical changes. Governments may look to broaden their tax bases; for example, further consideration could be given to green taxes, such as on plastics and carbon emissions. This type of approach could be used to incentivise companies to be more considerate of the environment whilst also raising revenues. A less likely alternative could be expanding the scope of VAT. Wealth taxes, such as the net wealth tax already in place in Switzerland, are another possibility while an additional more novel idea which has generated attention recently is imposing a tax on home workers. Whatever happens, 2021 is certain to be another interesting and busy year for tax professionals. ■

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