Briefing

International review for March

Speed read

Progress appears to have been made on the EU's 'public' country by country reporting proposals with long-standing disagreements on their legal basis being overcome by a 'compromise text'. The Council and the European Parliament have since approved mandates for their respective negotiating positions in anticipation of the start of inter-institutional negotiations on the proposals. Across Europe, tax authorities are focusing on tackling fraud; and Germany introduces tougher transfer pricing documentation requirements for cross-border transactions between related parties. Governments around the world continue to extend assistance for businesses amongst the pandemic, but tax rises are on the horizon with wealth taxes being considered across Latin America and an increase to its corporation tax rate announced in the UK. There is a renewed sense of optimism that the OECD may reach agreement on taxation of the digital economy by mid-2021 following news that the new US administration has dropped its 'safe harbour' request. In India, the Supreme Court held payments to foreign software manufacturers for resale or use is not a royalty payment and therefore not subject to withholding tax.

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Is public country by country reporting on the horizon?

The 'public' country by country reporting (CbCR) proposal that was initially put forward by the European Commission in April 2016, would require multinational groups headquartered in the EU with total consolidated group revenue of at least €750m to publicly disclose income taxes paid in each member state as well as other tax-related information. It is also intended to be applied to non-EU headquartered companies exceeding the threshold above where their EU presence includes either medium-sized or large subsidiaries (as defined in Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings), or branches that meet certain criteria in terms of net turnover.

The proposal builds on the current CbCR under Action 13 of the BEPS action plan which only requires filing to the parent country tax authority. The proposal has thus far been deadlocked due to disagreements on its legal basis however there is now renewed impetus.

Portugal, who hold the Council presidency for the first semester of 2021, issued a new compromise text and brought up the proposal for discussion during a meeting between member states on 25 February 2021. The compromise text includes amendments meant to clarify the aim of the initial proposal to improve transparency and reporting related to companies. During the meeting, 16 member states broadly expressed their support for the compromise text, although not all agreed with the legal basis but were willing to compromise to break the stalemate. Other member states that expressed their views either noted their support for transparency initiatives but noted reservations on the choice of legal basis or expressed concerns regarding the impact the proposal may have on the competitiveness of EU MNEs compared to those based in countries that do not impose such requirements.

Following this meeting, the Council and the European Parliament approved, on 3 and 4 March 2021 respectively, mandates for their respective negotiating positions in anticipation of the start of interinstitutional negotiations (so-called 'trilogue') on the public CbCR proposal.

Whilst there are differences between the European Parliament's and the Council's negotiating positions, official statements made by the representatives of each of the two institutions suggest that both parties are committed to starting the trilogue process with the aim of reaching an agreement in the first half of 2021. This is a significant breakthrough given the stalemate to date. If an agreement is reached, this would bring a new level of public attention and scrutiny to the tax affairs of EU-based multinationals and could inspire other jurisdictions to implement similar requirements.

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Tax authority audit trends

Staying in the EU, in recent months a number of countries have been investing in their tax authorities and strengthening their tax audit processes in order to protect their tax bases. France and the UK are focusing their efforts on tackling tax fraud while new guidance in Germany has broadened the scope of transfer pricing documentation requests and enhanced the possibility of the tax authorities making estimations.

The UK government, for example, announced in the small print of the March Budget that it is planning to invest a further £180m in 2021/22 in additional resources and new technology for HMRC to help tackle tax fraud. Among the areas of focus will be fraudulent claims under the coronavirus job retention scheme (CJRS), which is a notoriously complex area for employers.

The French tax authorities, meanwhile, have taken a more novel approach to focusing their resources on tax fraud. Back in January, a new tax audit process was introduced whereby all companies are able to obtain a tax audit conducted by the private sector including chartered accountants, statutory auditors and tax lawyers who will be required to issue a compliance report following conclusion of the audit which is required to be e-filed with the tax authorities. These audits consider items such as tax deductibility of certain exceptional charges, amortisation rules, corporate tax and VAT regimes; however, complex transactions such as corporate restructurings, interest deducibility or review of transfer pricing policies are excluded. The French tax authorities may still conduct

further audits or checks following this, however it is hoped that this new process will allow taxpayers an opportunity to address and correct mistakes freeing up the tax authorities to improve the efficiency of their tax audits and allow them to focus more on addressing tax fraud. This is certainly a fresh approach and it will be interesting to whether other countries decide to follow suit once the French system has been fully tried and tested.

In recent years, there has been a global trend towards tax authorities focusing on cross-border transactions. An example of this is Germany, which recently introduced new guidelines on transfer pricing documentation. The German tax authorities may now request emails, text messages and other electronic media in addition to the usual documentation. Notably, under the new guidance, transfer pricing documentation is considered as 'unusable' in the event of differences between the actual facts and the presentation made in the transfer pricing documentation, for example if the submitted third-party data does not match the functional and risk profile whereas previously documentation was considered 'unusable' to the extent the taxpayer failed to submit items.

In addition to the increased scope and timing of documentation requests, penalties are become more punitive, being assessed for each transaction and separately for each individual assessment year, so taking the late-filing penalty as an example the maximum penalty could be increased from €1m to several times that amount due to the number of transaction groups and tax audit years.

Covid measures

As the pandemic continues, we are seeing a mixture of tax measures designed to stimulate growth and protect employment as well as inevitable tax rises as governments seek to balance their books.

In the US, on 10 March 2021, the US House of Representatives approved several measures aimed at supporting employment including an extension and expansion of the employee retention credit through to 31 December 2021 and an extension and expansion of paid sick leave.

In Latin America, meanwhile, wealth taxes are being looked at by various governments as a way to pay for the pandemic. Argentina has recently implemented a one-off tax applying to wealth over ARS 200m owned by resident and non-resident individuals, as of 18 December 2020. Brazil, Mexico and Chile and Peru are also exploring wealth taxes. There is precedent from Colombia and Venezuela, which have both applied a wealth tax of some form for many years.

Tax rates and global competitiveness

Speaking of paying for the pandemic, among the notable measures announced in the UK Budget this month was an increase in the headline rate of corporation tax to 25% with effect from 1 April 2023 – the first increase since the 1970s. With continued speculation that President Biden will increase the US corporate tax rate to 28%, it is perhaps only a matter of time before other governments follow suit, making the UK a tax trendsetter.

The chancellor was eager to point out that even after the increase the UK will still have the lowest headline rate of the G7 countries but how competitive really is the UK's tax regime? Perhaps surprisingly given the UK currently has one of the lowest corporation tax rates in the OECD, it ranked just 22nd (17th for corporate tax) out of 36 in the Tax Foundation's international tax competitiveness index for 2020. This is because tax incentives and the broadness of the tax net also have a part to play.

In the wake of Brexit and covid-19, the UK government arguably has a greater need than ever to protect its tax base, and maintaining tax competitiveness will no doubt be on its agenda. Notable giveaways already announced include enhanced tax reliefs for designated tax sites within freeports, as well as the temporary capital allowances super-deduction (although the latter is due to be withdrawn ahead of the corporation tax increase).

Two years is a very long time in politics and tax. New incentives mitigating the headline rate increase will be expected to pay their way in terms of stimulating economic growth. Potential measures could include enhancements to, or a broadening of, research and development relief particularly for growth sectors such as technology, clean energy and logistics.

Other countries too will no doubt be looking at tax incentives as a way of stimulating economic growth and it will be interesting to see how different governments balance tax carrots and sticks as the global economy recovers. The OECD's long-awaited global solution to taxation of the economy is also likely to have a transformative impact on tax bases.

Taxation of the digital economy: a breakthrough?

This month saw a renewed sense of optimism that the OECD may reach agreement on taxation of the digital economy by mid-2021. At the February 2021 meeting between the Finance Ministers of the G20, it was reported that the new US Administration would drop its demand that the proposed rules for taxing profits of MNEs apply only as a 'safe harbour', which has to date been a major stumbling block to reaching an agreement. With the removal of this obstacle, it is anticipated that there will be a consensus-based solution by the next meeting in July. It will be interesting to see the OECD's final proposals and how these differ to the latest blueprints published back in December 2020.

India: payment to foreign software manufacturers for resale or use not a royalty

Finally, in the significant judgment of *Engineering Analysis Centre of Excellence Private Ltd v CIT* (Civil Appeal No. 8733-8734 of 2018), the Supreme Court of India held that under various income tax treaties, amounts paid by resident Indian end-users or distributors to non-resident computer software manufacturers and suppliers, as consideration for the resale or use of the computer software through an end-user licensing agreement and distribution agreement, was not a payment of a royalty for the right to use the copyright of the computer software. Thus, the payments should not be subject to tax withholding at source under provisions of the Income-tax Act 1961. This will be of particular interest for suppliers or manufacturers of software to India. ■

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