Briefing

# International review for September

## Speed read

**Transfer pricing continues to be a focus of tax authorities worldwide: recently published guidance in Singapore suggests the tax authority may now take a stricter approach to non-compliance; while in China, the expedited process to obtain a unilateral APA has become effective. In the US, the pressure is on the Democrats to come to a consensus on the tax legislation to be included in the upcoming budget reconciliation bill. Meanwhile, support continues to build for BEPS 2.0, with Barbados and Togo now committing to the two-pillar plan. In the EU, there is disquiet amongst some MEPs that no decision has yet been made on an EU digital tax, potentially putting the 'NextGenerationEU' recovery plan at risk. Finally, tax reform bills in New Zealand and Brazil include notable changes.**

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### Transfer pricing

New transfer pricing guidelines published by the Inland Revenue Authority of Singapore (IRAS) consolidate four earlier tax guides. In addition, there are also some new important updates that those with operations in Singapore should take note of. Of particular note is the change from the previous transfer pricing 'consultation' process to a transfer pricing audit. The move from 'consultation' to audit suggests that IRAS may take a stricter approach to non-compliance going forward; something that groups should make sure they are well prepared for and ensure they have adequate defence files in place.

Also new is guidance on benchmarking interest rates on intercompany loans and further guidance on the levy of a surcharge where transfer pricing adjustments are made following a transfer pricing audit. According to the new guidance, a surcharge will be imposed in almost all cases where there is an adjustment made by IRAS resulting from a transfer pricing audit. The exception is in a small number of cases, where consequential upward adjustments are made.

The surcharge may be mitigated wholly, or in part, where the taxpayer is cooperative during the audit and has good compliance records. For this purpose, the taxpayer must:

- have been cooperative and provided responses and required documentation within the timeframe set;
- have maintained proper transfer pricing documentation; and
- have a good compliance record and have submitted tax returns and paid tax due on time for the current and two preceding years of assessment.

This further demonstrates the need for taxpayers to keep their affairs up to date and ensure that they are being proactive in responding to any questions from IRAS.

Staying with transfer pricing, in China the simplified application procedure for unilateral advance pricing arrangements (APAs) announced by China's State Tax Administration (STA) became effective as of 1 September. The fast-track process reduces the number of steps in the application process from six to just three (with the final step being the monitoring of the APA). It is hoped that the simplified process will bring down the unilateral APA timeframe from two years to one, thereby hopefully increasing the number of applications that can be dealt with by the STA.

Securing a unilateral APA is likely to be highly appealing to both domestic Chinese businesses as well as multinationals, especially given the limited number of bilateral APAs that have been agreed by the STA to date. Those who could benefit from the certainty that a unilateral APA provides should therefore strike while the iron is hot, as it is likely there will be a high volume of applications, as the route proves a popular risk management tool.

### US budget resolution

Leaving transfer pricing behind, tax reform in the US continues to take shape, following the House of Representatives' vote to advance the $3.5 trillion budget resolution passed by the Senate in August. Using the 'budget reconciliation' process should open the door for the Democrats to advance major tax changes, regardless of the level of Republican support. However, it may not all be plain sailing. Democrats now need to settle on the tax legislation to be included in the budget reconciliation bill, which is perhaps easier said than done. So what is the current state of play?

On 13 September, the House Ways and Means Committee released draft legislation and a summary of tax proposals which build on President Biden's 'Made in America' tax plan. The release followed the publication of draft tax legislation by Senate Finance Committee Chair Ron Wyden last month. Key measures include, increasing the corporate tax rate to 26.5% and reforms of the global intangible low-taxed income (GILTI), as well as the base erosion and anti-abuse tax (BEAT) rules. Broadly these two sets of rules aim to tackle base erosion and profit shifting, ensuring a minimum rate of tax is paid in the US.

Proposed changes to GILTI include allowing a qualified business asset investment (QBAI) return of 5%, rather than the existing 10% (remaining at 10% in US territories). In addition, a country by country application of the GILTI rules is proposed (rather than looking at a globally blended rate on income earned overseas).

The planned GILTI tax rate per the Ways and Means Committee's draft legislation is 16.5%. A 3 September Democrats' letter responding to Wyden's draft proposals had argued that the GILTI tax rate should either be equal to the domestic corporate tax rate (which is expected to be raised), or at least 21%. The 21% GILTI rate, suggested in the letter, is higher than the OECD's proposed minimum global level of taxation of at least 15%, agreed on by the majority of the OECD/G20 Inclusive Framework on BEPS. US businesses have also expressed concerns that a 21% rate for GILTI is too high and would put US businesses at a competitive disadvantage.

The draft changes to the BEAT propose increasing the BEAT rate from 10% to 12.5% in taxable years beginning after 31 December 2023 and before 1 January 2026, and then from 12.5% to 15% in any taxable year beginning after 31 December 2025, as well as taking tax credits into account when determining the base erosion minimum tax. The Biden administration's earlier proposal had been to replace BEAT with a new regime referred to as SHIELD (stopping harmful inversions and ending low-tax developments). SHIELD would deny corporate deductions by reference to payments to foreign

related persons that are subject to a low effective tax rate, unless the income is subject to an acceptable minimum tax regime. Although the draft legislation does not incorporate SHIELD, it does provide an exception for payments to foreign parties if the amount was subject to an effective rate of foreign tax not less than the applicable BEAT rate.

In addition, the proposed draft legislation would increase the effective rate of tax on foreign derived intangible income (FDII) to 20.7%.

The draft legislation will undoubtedly require compromises that all Democrat senators can agree on and it will be interesting to see how it develops in the coming months.

### Support for BEPS 2.0 continues to grow

We continue to await the detailed implementation plan for the BEPS 2.0 project's global tax reforms, following July's OECD Inclusive Framework (IF) statement. In the meantime, the number of IF member jurisdictions who have not endorsed the July statement has decreased, with Barbados giving its endorsement in August, and recent IF joiner Togo following a few weeks later. This brings the total number of jurisdictions participating in the agreement to 134, at the time of writing. However, this still leaves six Inclusive Framework members, including Ireland, yet to endorse the 1 July 2021 Inclusive Framework statement on the two-pillar solution (pillar one reallocates taxing rights, and pillar two being a global minimum tax rate).

For the 22 African countries, including Togo, participating in the BEPS 2.0 negotiation process offers the opportunity to ensure that the specific challenges facing African countries, as a result of the digitisation of the economy, are addressed. Under current international tax rules, it is difficult for African countries to establish taxing rights over profits made by multinationals through business activities carried on in Africa. This is because digitalisation has enabled multinationals to operate with very little or no physical presence in the relevant African jurisdiction.

Pillar one should help by reallocating some of these profits back to the African market jurisdictions. A percentage of residual profit in excess of 10% of revenue (amount A) will be allocated to the market jurisdiction. However, the question is whether this is enough to fully address the current imbalance in taxing rights between source and residence jurisdictions.

When it comes to pillar two, whether or not the proposed minimum global level of taxation of at least 15% is enough to stop profits being shifted out of Africa, is another question. Indeed, many African jurisdictions, have corporate tax rates in the mid-high twenties and thirties, including new IF member Togo with a 27% rate. Furthermore, under the income inclusion, any 'top up' tax is imposed on the parent entity, rather than being allocated to other subsidiaries in higher tax jurisdictions. This could limit the benefits that are realised by developing countries as a result of pillar two. Nevertheless, that more countries are joining the talks, shows that clearly some value is seen in the two-pillar proposal by these jurisdictions.

### EU digital tax: staying alive?

In 2020, the European Commission committed to putting forward proposals for a digital services tax by June 2021, however this was later postponed to allow focus on the global-level solution through pillar one of BEPS 2.0, which is expected to be finalised next month. This postponement has recently been causing disquiet among MEPs who argue that the failure to propose the digital services tax puts the EU budget at stake and runs the risk of there being insufficient funds to pay for the 'NextGenerationEU' recovery plan. The EU Budget Commissioner Johannes Hahn nevertheless defended the decision to delay the proposal in a meeting with EU lawmakers, not wanting to put international negotiations at risk.

The OECD Inclusive Framework's July statement made a commitment to remove unilateral digital services taxes and other similar measures if pillar one is enforced. Therefore, even if a new EU digital tax were agreed on before pillar one is put in place, it could prove short-lived.

### New Zealand: a 'liquorice allsorts' bill

On 8 September, the government of New Zealand tabled the Taxation (Annual Rates for 2021-22, GST and Remedial Matters) Bill. Containing over one hundred policy and remedial amendments, this 'liquorice allsorts' bill has something for everyone!

Notable points for businesses include confirmation that cryptocurrency assets are (generally) not financial arrangements for tax purposes, and their removal in large part from being subject to GST. There were also amendments which deal with the capital gain, and dividend, consequences of share-for-share transactions which will affect mergers and internal restructurings. Extensive changes to modernise and update the GST tax invoice and related record-keeping requirements are also proposed which aim to better reflect modern systems and practice. These changes are quite detailed but, in general, they remove most of the prescriptive requirements and allow for much greater flexibility.

It is expected more will be added to this Bill in due course including the design of interest limitation rules for residential property and a 'new build' exemption which were recently consulted on by the Government. With draft legislation and especially a bill of this size, the devil will be in the detail, and therefore New Zealand taxpayers should monitor this carefully.

### Brazilian tax reform

Finally, the Brazilian House of Deputies has approved a bill which, if enacted, would see the corporate income tax rate reduced from 34% to 27% (or potentially even 26%), as well as the imposition of a 15% withholding tax on dividends and the elimination of tax deductible interest on net equity payments. Dividends have been withholding tax exempt in Brazil under domestic law since 1996 and the introduction of a 15% withholding tax rate would be a major change taking into account Brazil's limited treaty network and the fact treaty rates of withholding tax have not tended to vary from domestic rates.

Brazil is the most notable gap in the UK's tax treaty network. Previous attempts to negotiate a treaty have stalled. For UK groups with investments in Brazilian companies the combined effect of the reduced corporate income tax rate with the proposed introduction of a 15% dividend withholding tax is likely to lead to an increase in the effective tax rate on income earned in Brazil and repatriated to the UK.

This Bill could potentially be applicable from the next calendar year if it is approved by the Senate and the president this year. The bill is one of several tax reform bills being considered by Congress, so it will be interesting to see what further tax changes, if any, are passed before next year's election. ■

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- BEPS 2.0: the two-pillar approach (I Zeider & L Hodgson, 16.9.21)
- The Biden administration's international tax proposals: will they fly? (J VanderWolk, M Cutts, L Pfatteicher & R O'Hare, 21.5.21)