Briefing

International review for February

Speed read

It has been another eventful month in the international tax world, with BEPS 2.0 continuing to dominate developments. The UAE has introduced a new federal corporate tax regime with a tiered system of rates, and MNEs within the scope of pillar two will be subject to different rates in line with OECD rules. In the first of a series of public consultations on pillar one, the OECD released draft model rules for nexus and revenue sourcing in relation to Amount A. The Indian government presented its Union Budget for 2022/23 with measures to continue its impressive economic growth, but interestingly it remained silent on the implementation of BEPS 2.0 in the region. The OECD has published a consolidating version of its transfer pricing guidelines to reflect developments since the last version of the guidance published in 2017.The Canadian government has issued a sweeping package of new draft tax legislation for public consultation. Finally, a VAT regime in Qatar is expected to be effective during 2022.

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UAE announces new corporate income tax regime

On 31 January 2022, the United Arab Emirates (UAE) announced a new federal corporate income tax (CIT), effective for financial years commencing on or after 1 June 2023.

The UAE has been through a series of tax reforms in the last few years to align itself with international markets and diversify its revenue, beginning with the implementation of a VAT regime in January 2018, followed by the introduction of economic substance rules and country by country (CbC) reporting regulations in April 2019.

Scope of the CIT

The CIT proposals introduce a new three-tier tax rate system of 0% or 9% for most businesses, whilst multinational enterprises (MNEs) in the scope of BEPS 2.0 pillar two will be subject to additional rates in line with OECD rules.

The 9% rate will only apply to eligible businesses with taxable profits above AED 375,000 ($102,000) to support small businesses and start-ups. Taxable profits are accounting profits subject to certain adjustments.

The new federal tax system is applicable to all businesses and commercial activities operating in the seven emirates, with exceptions for:

- businesses operating in the extraction of natural resources;
- individuals earning income in their personal capacity (i.e. salary and investment income) as long as the income generating activity does not require a commercial licence; and
- businesses registered in free trade zones, provided they comply with all the regulatory requirements, and that they do not conduct business with mainland UAE.

Note that the foreign banking sector, which has until now paid tax under the Emirate level bank tax decree, will now be subject to the federal tax law. This will be a significant shift for both branches of foreign banks and for local banks.

Other provisions

Businesses will have to wait until mid-2022 for further guidance on the new federal tax laws; however, in the meantime the UAE Ministry of Finance has confirmed the following points.

- There will be no UAE withholding tax on any type of domestic and cross-border payments.
- OECD transfer pricing rules will now be applicable in the UAE and may apply to domestic transactions. All companies will have to comply with the transfer pricing rules and documentation requirements. This is a game changer for companies doing business in the region, who will need to evaluate their current arrangements and assess the impact of these new requirements.
- Excess tax losses may be carried forward and used against taxable income in future years or used to offset taxable income of another group company, provided certain conditions are met. A UAE group of companies can elect to form a tax group and be treated as a single taxable person, filing a single tax return for the group, provided certain conditions are met.
- Foreign corporation tax paid on UAE taxable income will be allowed as a tax credit against the UAE CIT liability.

The introduction of a corporate tax regime in the UAE comes as more jurisdictions announce steps to implement the BEPS 2.0 pillar two rules. Ireland, Spain, Cyprus and Switzerland have all announced the intention to change their tax regimes in response to pillar two. I expect to see many more countries following suit in the coming months.

Pillar one public consultation

On 4 February 2022, the OECD launched a public consultation on the draft model rules ('the rules') for nexus and revenue sourcing in relation to amount A of pillar one. Responses to the consultation are due by 18 February 2022.

Pillar one deals with the reallocation of certain profits from in-scope multinational enterprises (MNEs) to market jurisdictions. The revenue-sourcing rules are an important building block of pillar one because they determine whether an in-scope MNE has sufficient nexus to a participating jurisdiction for that jurisdiction to be entitled to any amount A allocation and, if so, its share of amount A.

The rules are a 'working version,' and do not yet reflect the Inclusive Framework's (IFs) consensus on their substance. The responses to the consultation will assist the IF members in further refining and finalising them.

This is the first in a series of draft model rules that the OECD is expected to release in the coming months for comment, as part of a 'rolling consultation.' This approach (rather than waiting for a comprehensive document to be ready) will allow work to continue in parallel to keep within the ambitious pillar one timetable.

A comprehensive analysis of the rules is beyond the remit of this article; however, the key points to note are below.

- The nexus provisions reflect previous IF agreement that an MNE has sufficient nexus to a market jurisdiction if it derives at least €1m in revenue (or for a jurisdiction with annual GDP less than €40bn, at least €250,000). The revenue threshold must be satisfied for a period, adjusted proportionally for periods not equal to 12 months.

- These special nexus rules would apply only for the purposes of amount A, and not for the purposes of any other legislation.
- The rules on revenue sourcing retain many of the features of the 2020 pillar one blueprint and expand the guidance to address categories of transactions not previously in scope.
- The rules provide a sourcing principle for each type of revenue and a list of specific indicators to apply the principle to identify the jurisdiction of source. However, unlike the 2020 blueprint, the rules: do not impose a hierarchy among the indicators; allow MNEs to use other indicators not specifically listed; and introduce new allocation keys that may be used under certain conditions.

The introduction to the rules states that they have been designed to balance the need for accuracy with the need to limit compliance costs. However, the sourcing rules remain complex for businesses to administer: an in-scope MNE must gather information on all revenue, generally on a transaction-by-transaction basis, according to the category of revenue earned from the transaction. The adjustments required to systems to facilitate this could be significant, something I expect many businesses will feed back in the consultation response.

In the meantime, the Biden administration is still struggling to pass the Build Back Better Act (BBBA) which includes proposals to change the GILTI regime to be more aligned with pillar two. With this backdrop, the ability of the US to implement pillar one is looking uncertain: without US implementation the future of pillar one must be in some doubt, which could raise the possibility of more unilateral digital services taxes (DSTs), which would not be without controversy.

India: Union Budget 2022/23

The Indian government presented its Union Budget for 2022/23 on 1 February 2022. The Budget aims to build upon the momentum that has made India the fastest-growing large economy with a GDP growth rate of 9.2% for the year, which is a significant achievement given the detrimental impact of covid-19 on the country in recent years.

The Budget presents a roadmap for the economy for the next 25 years, leading up to the 100-year anniversary of India's independence, which includes plans around productivity enhancement, energy transition and climate action. Interestingly, widely expected clarifications relating to the equalisation levy and a framework for overseas listings by Indian corporates did not feature in the announcement. Similarly, the Budget did not mention a roadmap towards implementation of the BEPS 2.0 proposals.

In terms of direct tax announcements:

- There are no proposals to change the basic income tax exemption limit, income brackets ('slabs') and tax rates.
- The surcharge rate on income tax relating to all long-term capital assets has been capped at 15%.
- Taxpayers can file amended tax returns within two years from the end of the year of the assessment year, subject to the payment of additional taxes and fulfilment of certain conditions.
- The period of incorporation of eligible start-ups to claim certain tax incentives is being extended by an additional year to 31 March 2023.
- Newly incorporated domestic manufacturing entities will also be allowed an additional year's extension to 31 March 2024 to claim a concessional tax rate of 15%.
- Income from the transfer of virtual assets will be taxed at a rate of 30%.
- The concessional rate of 15% on foreign dividends will be repealed.

Special economic zone (SEZ) reforms will include changes to the customs administration of a SEZ. Customs duty exemption of capital goods will gradually be phased out.

OECD transfer pricing guidelines

On 20 January 2022, the OECD released its *Transfer pricing guidelines for multinational enterprises and tax administrations 2022*. This is a consolidating edition, incorporating the revised guidance on the transactional profit split method and guidance on hard to value intangibles published in 2018. It also includes the OECD's financial transactions transfer pricing guidance published in 2020. The new guidelines bring together these developments in a single volume.

According to the OECD, the 2022 edition provides guidance on the application of the arm's length principle, which represents the 'international consensus' on the valuation, for income tax purposes, of cross-border transactions between associated enterprises. The approach of tax authorities to newly published versions of the guidelines varies, but in practice many tax authorities, including HMRC, have applied these principles for some time. To the extent that they have not already done so, local tax authorities may use the 2022 guidelines as a framework to revisit local legislation and guidelines therefore businesses should monitor developments in the jurisdictions in which they operate.

Canadian draft tax legislation

On 4 February 2022, the Canadian government issued a sweeping package of new draft tax legislation, covering corporate, personal and trust tax changes, including measures to introduce limitations on deductible interest, expand existing mandatory disclosure requirements, introduce enhanced trust reporting requirements, and provide temporary immediate expensing for certain eligible assets. Draft legislation has been released for public consultation on each measure.

Taxpayers, including corporations, partnerships, trusts, individuals and non-residents should review the new package of draft legislation to determine how they may be affected.

Although this release includes draft legislation for many long-anticipated tax measures, there are still certain outstanding legislative proposals that have not yet been released, including measures to introduce a new luxury tax, hybrid mismatch rules, changes to modernize the general anti-avoidance rule and other amendments affecting certain intergenerational share transfers.

Qatar VAT regime

Finally, a VAT regime in Qatar is expected to be effective during 2022, with VAT being broadly imposed at a rate of 5%. VAT is expected to affect all businesses in Qatar – either directly or indirectly – and will have implications for most sales of goods and services in Qatar (with limited exceptions such as financial services and insurance). VAT-registered businesses would be able to claim a credit for the amount of VAT paid on expenditures relating to their taxable business activities. Groups doing business in the region should closely monitor the development of the regime and law and regulations to be published in due course. ■

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- Profit recognition under GloBE and domestic rules: it's all in the timing (B Salehy, 20.1.22)
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