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BDO will be hosting a webinar on top tax tips for expanding your business into the UK or US on Tuesday 6 December 2016. Read full details and register here.

UNITED KINGDOM

BREXIT – THE TAX IMPLICATIONS

On 23 June 2016 the UK voted to leave the European Union, sending shockwaves around the global economy.

For more background, and possible Brexit timing, read this overview.

This article summarises what we consider to be the key tax changes and other economic changes that may impact the tax position for UK businesses in order to help them plan for Brexit and maintain their competitive edge.

Introduction

Over the past 40 years the UK's tax laws have become entwined with the regulations within the EU, which look to ensure a level playing field for companies across the union and therefore support the four pillars of freedom for members.

As the UK Government works through the economic impacts of Brexit and how it might be able to cushion the downside and support the upside through fiscal incentives, it will also need to unwind the complex connections between domestic and EU laws.

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EDITOR'S LETTER

Welcome to this issue of *BDO World Wide Tax News*. This newsletter summarises recent tax developments of international interest across the world. If you would like more information on any of the items featured, or would like to discuss their implications for you or your business, please contact the person named under the item(s). The material discussed in this newsletter is meant to provide general information only and should not be acted upon without first obtaining professional advice tailored to your particular needs. *BDO World Wide Tax News* is published quarterly by Brussels Worldwide Services BVBA. If you have any comments or suggestions concerning *BDO World Wide Tax News*, please contact the Editor via the BDO Global Office by e-mail at mireille.derouane@bdo.global or by telephone on +32 2 778 0130.

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1. Customs duty

a) Current state of affairs

The UK is currently part of the EU Customs Union, consisting of all EU Member States plus the following territories:

- Channel Islands and Isle of Man
- Andorra
- Monaco
- San Marino
- Turkey.

The EU Customs Union gives the member states the following Customs landscape:

- There are no customs duties payable on goods moved between jurisdictions within the Customs Union;
- There is a common external customs duty tariff imposed on goods entering the customs union, regardless of which jurisdiction they first enter through;
- There are a number of special procedures available to companies, offering duty savings and cash flow advantages.

b) Likely changes due to Brexit

On a formal exit from the EU, following the completion of the Article 50 process, the UK will no longer be part of EU's Customs Union. As a result, the external EU customs duty tariff could be imposed on goods imported from the UK. As customs duties on imported goods and materials are an absolute cost, this is likely to make it less attractive for EU companies and consumers to source goods from suppliers in the UK.

Similarly, the UK Government may extend the current UK customs duty tariff to imports from countries within the EU Customs Union, adding costs for UK companies reliant on raw material and finished goods from EU suppliers.

Another related issue for UK businesses to be aware of is that an exit from the EU will mean that the UK no longer has access to the EU's 34 external trade agreements with countries and trading blocks around the world.

This could also lead to increased customs duties on goods imported into these 53 other jurisdictions – making UK goods potentially less competitive in those markets. This could also increase the cost of goods and materials imported from these countries, as well as the EU Customs Union members, for UK businesses and consumers.

Practical barriers would also arise as all goods would need to be customs cleared, adding time, complexity and cost to value chains.

Currently there are various customs reliefs available for companies importing goods into the UK, such as Customs Warehousing and Forward Processing Relief. As and when the UK Government considers independent UK tax legislation post Brexit, these may well be recreated in order to provide UK companies with the reliefs they need to remain competitive.

c) What should UK businesses be doing to prepare for these changes?

The potential for increases in costs for UK businesses importing and exporting goods and materials, means that UK businesses should start to consider the following as part of their Brexit readiness planning:

- Are sales within the EU large enough to justify moving manufacturing and operations to an EU site to avoid a customs duty hit on margins?
- For imports, how would total costs (including duties) compare from EU suppliers v potential non-EU suppliers?
- For current EU imports, can suppliers be changed easily? If not, do prices of goods need to be increased?
- For importing materials or unfinished goods in from outside the EU, is there a need for parallel inbound warehouses (one EU based and one UK based)?
- Is it economic to operate parallel sites in the EU and UK?
- Can prices be increased to absorb the additional duty cost and if so, by how much?

Finally, customs duties work both ways; it is likely that the UK will impose duties on EU imports if a comprehensive free trade arrangement with the EU cannot be maintained. Therefore, European businesses may be looking to acquire UK businesses to protect or expand their UK trade.

2. VAT

a) Current state of affairs

The current EU Value Added Tax (VAT) system is part of the fiscal union which operates across the 28 member states. Although each member state has its own national VAT legislation, the basic principles and operation of the VAT system has its roots in the EU Directives and the European Court of Justice is the ultimate legal arbiter in disputes.

VAT is a business sales (or consumption tax) which "cascades" through the supply chain and is intended to be ultimately borne by the end consumer. VAT is generally chargeable by a supplier of goods/services at the local rate in his member state on all domestic supplies and supplies to private consumers (persons not registered for VAT) in other member states. The system, however, taxes supplies between businesses in different member states under the "destination" principle which aims to tax the supply at its place of consumption in the EU. Such supplies are generally (with a few exceptions) subjected to the VAT charge in the customer's own country under the Self Charge (or Reverse Charge) mechanism and a complex compliance framework exists to monitor such transactions and ensure they are correctly accounted for in the member states – the EC Sales List and Intrastat Returns.

All EU, and most non-EU, businesses incurring costs in the EU are generally able to reclaim VAT across all member states using the 8th Directive Refund Mechanisms providing they make supplies which are subject to VAT in the EU or make supplies elsewhere which would be subject to VAT if made in the EU.

The current system is therefore designed to make VAT accounting across borders within the EU as easy as possible for businesses.

Most goods and services "exported" to businesses/consumers located outside the EU will be VAT free but these may be taxed under the local sales/consumption tax.

b) Likely changes due to Brexit

Various forms of VAT have been introduced in a wide range of jurisdictions across the world and these generate considerable revenues for governments, as does VAT for the UK exchequer. We would therefore not expect to see material changes to the domestic VAT rules after Brexit, but the international picture could change dramatically in terms of both VAT treatments of international trade and the associated compliance rules. We would certainly see the end of the EC Sales list and the Intrastat Return for UK companies, as imports and exports would be captured through customs documentation.

UK businesses may no longer be able to use the current EU acquisition and dispatch system for sales of goods to and from the UK, whereby input and output VAT is simply accounted for on their domestic VAT returns. Instead they would become imports and exports which would need to clear customs (as discussed in our section on changes to Customs Duties) and for imports incur import VAT charges. This will mean a cash flow disadvantage for UK importers caused by the delay between paying customs VAT charges and the entitlement to recover the input VAT on a subsequent VAT return. Companies currently mitigate this cashflow disadvantage for goods imported from outside the EU by using deferment and customs warehousing arrangements.

The UK Government would need to consider if the retention of such arrangements for all imports following Brexit is appropriate for the UK economy and for supporting UK business.

UK exporters will be required to keep evidence of export in order to zero rate supplies to the EU, as they do for non-EU exports at present.

UK businesses that are required to register for VAT in some EU member states – for reasons such as they hold stock there or making supplies to consumers in excess of the registration limits – will have to appoint a fiscal representative locally to deal with their returns.

We would expect that businesses supplying electronic services to individuals in EU Member States will need to register for VAT in an EU member state under the Non-Union Mini One Stop Shop (MOSS) scheme (in addition to their UK VAT registration).

Businesses supplying travel services in the EU will no longer have automatic access to the Tour Operators Margin Scheme (TOMS) post Brexit and therefore will either need a VAT registration somewhere in the EU in order to access TOMS or they will need to register and account for VAT in each country where travel services are supplied.

It is expected that it should still be possible to make claims for VAT refunds under the 8th Directive following Brexit. As non-EU members, these claims may need to be submitted on paper (supported by all of the original invoices) and the resolution of these will take a long time.

c) What should UK businesses be doing to prepare for these changes?

Businesses should ask themselves:

- How much more working capital will be needed to finance the VAT cashflow costs of imports and exports?
- How will multiple VAT registrations and their administration (as well as associated additional costs) be managed across the EU?
- If goods are currently distributed across the EU from a UK base, can you identify a suitable new location for post-Brexit EU sales?
- If you are involved in a VAT dispute based on EU legislation, can this be progressed ahead of an eventual Brexit?

3. Corporation tax

a) The general corporation tax landscape

Although direct taxes are a matter of UK and not EU law, they must be consistent with EU law, the principal of fiscal neutrality and the fundamental freedoms set out in the EU Treaty.

Currently we are seeing a number of changes in UK corporation tax rules which are being driven mainly through the OECD BEPS programme, designed to reduce the opportunities for multinational corporations to avoid taxation and create further transparency. The UK has been a leading jurisdiction in the drive for change, but this may slow down if the UK Government consider this to be putting the UK at a competitive disadvantage following Brexit.

We have already heard that the Chancellor may look to reduce the UK corporation tax rate (already the lowest in both the G7 and G20) still further in order to stimulate greater inward investment post-Brexit, although a number of commentators appear to get their maths wrong with regard to the cost of this measure. This would be a welcome addition to the UK's investment-friendly corporate income tax regime, which includes tax free disposals of subsidiaries, tax free receipt of foreign dividends, not taxing foreign branch profits and the widest double tax treaty network of any country.

Without the UK as a blocker, the EU may accelerate its plans for a Common Consolidated tax Base (i.e. EU-wide harmonisation of corporation tax). Corporation tax rates range from 12.5% in Ireland to between 30 and 33% in Germany (when the regional taxes and solidarity levy are taken into account), so this could prove a challenge.

It is now unlikely that the UK will implement any elements of the EU anti-avoidance package that deviate from the OECD BEPS programme.

b) Profit repatriation

Currently, the parent-subsidiary directive allows subsidiary companies to pay dividends up to UK parent companies without the need to account for withholding tax. Similarly, companies often rely on the interest and royalties directive to make interest or royalty payments free from either UK or local withholding taxes.

If the benefit of these directives is withdrawn, companies would be relying on existing bilateral double taxation agreements in order to reduce or eliminate withholding tax rates.

Although the UK has double tax treaties with all of the other 27 EU Member States, 10 of these allow the tax authorities in the payer company jurisdiction to levy withholding tax on dividends, and many others do not reduce the withholding tax on interest and royalties to zero. Although often at relatively low rates, it is another tax issue to be managed in post-Brexit UK.

There may also be wider impacts as a result of the UK exiting the EU. For example, European treaties with the US often contain an 'equivalent beneficiaries' test. This extends the benefits of the treaty to a company owned by an EU/EEA resident whose treaty provides for withholding tax rates at least as low those contained in the US treaty in the recipient company's jurisdiction. UK companies will no longer be equivalent beneficiaries if UK leaves the EU/ EEA, and therefore groups containing UK, US and EU companies may lose treaty benefits they previously had.

Groups should be reviewing their group structures and identify whether they are benefiting from the equivalent benefits test within the treaties between the US and EU countries.

c) Group expansion and reorganisation in Europe

Groups can currently take advantage of EU provisions in order to undertake reorganisations or mergers of their European operations on a tax neutral basis. These rules are incorporated into UK tax law, with a direct link into EU regulations. Outside of the EU, the UK Government may seek to retain such rules to assist its competitiveness as an international holding company regime, although without the corresponding exemptions in other EU countries applying to the UK this may prove unworkable. It is likely that the local rules in the remaining 27 EU Member States would no longer extend to include the UK, and therefore group reorganisations could carry a tax cost post Brexit, if involving both a UK and EU company.

Bearing this in mind, if businesses are considering acquiring an EU business or restructuring their existing European group, it could be prudent to move more quickly before Brexit negotiations are completed, or even ahead of the triggering of Article 50 by the UK.

d) Impacts of Brexit on UK and EU transfer pricing positions

UK transfer pricing rules should not be significantly affected by Brexit, since they are not reliant on EU regulations or principles, but rather the OECD Transfer Pricing Guidelines are incorporated into UK law.

However the indirect effects of Brexit may impact on groups' transfer pricing. The post-referendum volatility in the value of sterling, for example, could impact the arm's length result of existing transfer pricing models and therefore some groups operating in the UK will need to reassess their related party transactions, in particular where:

- A group is using foreign currency denominated fixed fees or market prices;
- A Group's functional currency is not sterling and their transfer pricing relies on comparable third party prices; or
- A UK entity has non-sterling denominated related party debt.

Businesses operating within the regulated industries that are planning to transfer functions (e.g. banks or other financial services companies) within the EU in order to continue to benefit from the 'passporting' across the single market, should consider the following:

- The tax implications of any business transfers will need to be assessed. Is there a risk of an exit charge?
- The transfer pricing arrangements after the transfer will need to be considered, bench-marked and documented.

e) What should UK businesses be doing to prepare for these changes?

Businesses should start to consider the following in relation to their group tax position:

- Will the current group structure trigger withholding tax under the double tax treaties in place?
- Will potential withholding taxes have a large enough impact to justify a group restructure?
- Will group financing arrangements within the EU need to change (e.g. to minimise withholding tax re interest payments)?
- Is there scope to extract significant value from EU subsidiaries through dividends ahead of Brexit?
- Are all transfer pricing policies still valid in the light of the economic changes resulting from the referendum result, and will they continue to be valid through any business changes required as a result of Brexit?
- Would it be better overall to have foreign branches than foreign subsidiaries in the future?

Conclusion

Brexit will be a long and complex process, with its final form unclear at present. At this point in time, as stated above, it is therefore a matter of companies starting to consider the possible implications for them and being prepared to make changes when needed. This will include discussing and taking a view on whether to progress certain matters before Brexit negotiations are concluded, such as attempting to resolve a VAT dispute based on EU legislation or transactions involving EU members of their corporate groups.

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AUSTRALIA

NEW MANAGED INVESTMENT TRUST REGIME

The Australian Government has introduced a new tax regime for Managed Investment Trusts (MITs). The use of MITs is a popular investment vehicle for investments in Australia by international funds, particularly for Australian real estate property investments.

This new taxing regime for MITs is expected to enhance the competitiveness of Australia's funds management industry.

The main changes under the new tax regime for MITs apply to MITs that qualify as an Attribution Managed Investment Trust (AMIT). These new rules started from 1 July 2016, but trustees can choose to retrospectively apply the new tax system for the 2015-16 income year.

Definition of an AMIT

An AMIT is a sub class of a MIT. Generally, a MIT is a trust which:

- Has an Australia resident trustee;
- Has central management and control in Australia;
- Invests in and manages mostly Australian assets in Australia;
- Does not carry on or control an active trading business;
- Is sufficiently widely held and not closely held; and
- Is operated or managed by an appropriately regulated entity.

Generally an AMIT is a MIT where the members have clearly defined interests. There is no definition of when members of the MIT will have clearly defined interests. However, there are legislative safe harbours that deem members to have clearly defined interests if:

- The trust is a managed investment scheme that is registered under the Corporations Act; or
- The rights and capital arising from each of the membership interests in the trust are the same.

Attribution of income

Members of an AMIT will be assessed on the amount of income or gains attributed to them on a fair and reasonable basis by the trustee of the AMIT. The current rules for taxing trust distributions are complex and can cause inappropriate outcomes with the wrong beneficiaries being taxed or the trustee being taxed at penalty rates.

Retention of income character

The attributed income and gain amounts retain their character in the hands of the members and expenses are allocated/deducted from the respective individual trust income characteristics. As a result, for income tax purposes, members of the AMIT will recognise the amounts attributed to them in the same way that the amounts were recognised by the AMIT.

AMMA statement

AMIT must characterise its income and capital gains into categories and attribute amounts under these categories to the members on a reasonable basis and issue an Attribution MIT member annual (AMMA) statement for an income year to each member during that income year setting out the income characters/components for that income year.

Deemed fixed trust

The AMIT will be deemed to be a 'fixed trust' for income tax purposes. This is important to allow the AMIT to claim a tax deduction for previous year losses and getting imputation credit from company dividends out to the AMIT members

Under and overs variances

The trustee can include under and overs variances in the distribution for the year the variance is discovered, instead of reissuing the previous year's AMMA statements. This allows AMITs to make adjustments for errors, mis-estimations, late developments and other problems in the year of the discovery or resolution. However, the regime is optional and the trustee can still revisit the AMMA statement of the relevant year and re-issue them as an alternative way of addressing these issues.

Trustee assessments

Under the new rules the trustee of an AMIT will be liable to pay tax if a discrepancy occurs in attributing amounts of determined trust components to members in some circumstances. This will occur where, as a result of that discrepancy the taxable income of the AMIT for an income year is not fully attributed to members, or where amounts are attributable in a way that is inconsistent with the attribution principles.

Cost base adjustments

The Capital Gains Tax (CGT) cost base of an AMIT Member's units will be increased or decreased where the member's entitlements from the AMIT are less than or more than the assessable amounts attributed from the AMIT. The previous rules only allow for cost base reductions on receiving non-assessable amounts, which can result in double taxation where the non-assessable distribution is as a result of a timing difference and the timing difference subsequently reverses. For investors in AMITs the new regime will be made more symmetrical as the new provisions would increase the cost base of the units where the trustee distributes less cash to unitholders than the member components reported by the unit holder.

Withholding taxes

The withholding tax regime for MITs has been changed to align with the new AMIT regime. While the existing withholding tax provisions for MITs depend specifically on the cash flow, the AMIT attribution mechanism ignores cash flow, so that the withholding tax needs to be calculated on the attributed amounts as per the AMMA statement, even if they are not paid in cash. However, there is no change to the withholding tax rate of 15% for residents of Exchange of Information (EOI) countries and 30% for residents of other countries.

Debt-like instruments

The new rules allow AMITs to issue units that are to be treated as debt for tax purposes. This would allow a distribution in relation to such an instrument to be treated as interest, which is tax deductible for the AMIT and, if paid to a non-resident holder, the interest withholding tax provisions would apply accordingly (generally 10% instead of the higher MIT withholding rates). The debt-like instrument is also treated as debt for the thin capitalisation provisions.

Arm's length income rule

To protect the integrity of the corporate tax base an arm's length income rule for AMITs and MITs has been introduced whereby the trust would be liable to pay tax on non-arm's length income received by an AMIT or other MIT. There is no requirement that both parties be related or under common ownership.

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MARKETING HUBS AND OFFSHORE HOLDING COMPANIES UNDER THE SPOTLIGHT

The Australian Taxation Office (ATO) is putting on notice multinational entities that use overseas marketing hubs to review their structures to see how they rate under the ATO's new "traffic light" risk analysis process for marketing hubs.

Marketing hubs

In the case of Australian mining and liquefied natural gas (LNG) projects, it has been common for global businesses to set up 'marketing hubs' in Singapore to sell iron ore and LNG to potential customers. From a commercial perspective, Singapore is a key financial centre with an educated workforce that has good language skills and can sell into the local Asian market, thereby providing advantages over an Australian sales force.

From a tax perspective, Singapore can also yield significant benefits. A marketing hub will typically receive a commission, e.g. 5% on sales passing through the sales hub. This income could be taxed at a low corporate tax rate in Singapore (the headline corporate tax rate is 18%, but a broad range of incentives can be negotiated locally).

Australia does have anti avoidance rules under our Controlled Foreign Company (CFC) regime that will impute all or part of this low taxed Singapore income to be taxed in Australia. However, some group structures minimise the impact of these CFC rules, allowing significant tax benefits to be achieved.

ATO discussion document

The ATO issued a discussion document calling for groups with overseas marketing hubs to self-assess and document their arrangements under the ATO's new traffic light system approach. A marketing hub will receive a 'green light' where the hub profit equates to less than or equal to 100% of the costs associated with that sales operation and the profit earned is commercially realistic. Where groups do not have a significant presence offshore and have a handful of well-paid sales people, it may be very hard to achieve a green light.

Groups not achieving a green light will need to estimate the potential tax at stake and consider approaching the ATO for an Advanced Pricing Agreement (APA) to agree their current and past transfer pricing position for the hubs. If the group has over AUD 50 million of tax at stake it will be rated as amber. If the group fails to assess the tax at stake and put in place documentation or voluntarily and co-operatively engage with the ATO, the group will be rated as red. A red rating could lead to continual audit or litigation. There is a strong behavioural element to how the ATO rates taxpayer risk.

Groups are offered an incentive to bring their arrangements into the green zone. If the group is prepared to restructure arrangements to operate as a 'low risk' business, the ATO will offer a one year amnesty from penalties and interest to encourage compliance with the new regime. The ATO is clearly hoping for a bumper tax take for agreeing to settlements on existing hubs and to discourage high risk structures.

Commerciality and economic substance of hubs

A key focus of the ATO in the review of marketing hubs will be the commerciality of the hubs and their level of economic substance. The ATO will test whether the hub does actually provide the suggested commercial benefits, e.g. in terms of increased volumes of sales versus local Australian sales operations. The ATO will also carry out a forensic review of source documents such as emails and board memos, together with a consideration of the salaries and qualifications of the local sales people in order to assess whether in substance the sales function is directed locally or in Australia.

The ATO is likely to heavily scrutinise the validity of any economic analysis for comparability (an area where the Court was very critical in the recent Chevron transfer pricing case). In order to assess economic substance, groups may need to invest more time in the functional analysis to understand in detail the key value drivers of the sales function, which individual/s drive the key decisions and where these decisions are made. In our experience many groups have not made a significant investment in preparing robust functional analyses leaving them potentially exposed during an ATO audit.

Wider impact of the ATO discussion document

The ATO discussion document focuses on marketing hubs. However, the position taken by the ATO is likely to have a wider impact on Australian businesses that hold intellectual property (IP) or assume risks, e.g. cash pooling in low tax jurisdictions. The ATO clearly views offshore businesses that have a cost plus mark-up greater than 100% as being higher risk from a transfer pricing perspective.

If a group owns IP offshore and that operation derives significant profits that are disproportionate to the local cost base of the operations, there will be a higher likelihood of an ATO audit. Under an audit, the ATO is likely to raise similar questions to marketing hubs challenging the commerciality of the arrangements (what is the commercial benefit of holding IP offshore?) and the economic substance in terms of key operational people to direct and manage development and exploitation of the intellectual property. They are also likely to scrutinise the comparability of any royalty benchmarking studies prepared to support these arrangements.

Key points

The key learning point for multinational businesses, whatever their size, is to get their house in order and spend some time considering their arrangements from an ATO viewpoint, i.e.:

- Does the purported distribution of profits stack up from a commercial perspective?
- Do the key people managing sales, intangibles or assets reside in Australia, or are they located offshore?
- Has the company evidenced this sufficiently in robust transfer pricing documentation?

Our experience to date has shown that a number of businesses have not done this effectively, leaving them potentially exposed to an ATO audit.

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INDIA

RELAXATION FROM HIGHER WITHHOLDING FOR NON-RESIDENTS IN ABSENCE OF PAN

The Indian law requires the recipient of income to furnish a PAN (Indian Tax Identification Number) to the payer. In the absence of a PAN, the payer is mandated to withhold tax at the higher of rates under the Indian tax law, or under a Tax Treaty, or 20%. As a result, non-residents receiving income (royalties, technical fees, interest, etc) from India were forced to register in India and seek a PAN to avoid higher withholding.

The Finance Act 2016 sought to relax this provision for non-residents subject to certain conditions. The Rules announced in this regard provide that requirement of higher withholding will not apply to non-residents in relation to payments of interest, royalties, fees for technical services and transfers of any capital assets upon furnishing the following:

1. Name, Email ID and Contact Number of the non-resident;
2. Address in the country of residence;
3. Tax Residency Certificate, if required by the laws of that country;
4. Tax Identification Number (or other unique identification number), issued in the country of residence.

[Notification No. 53/2016 dated 24 June 2016]

GENERAL ANTI AVOIDANCE RULES (GAAR)

The Indian anti-avoidance regulation, GAAR, is scheduled to be implemented from April 2017. With respect to the applicability of GAAR provisions, the Rules have recently clarified that:

a. GAAR provisions will not apply to any income arising from transfers of investments made before 1 April 2017.
b. However, GAAR provisions will apply to any arrangement, irrespective of the date it is entered into, in respect of a tax benefit obtained on or after 1 April 2017.

[Notification No. 49/2016 dated 22 June 2016]

INDIRECT TRANSFER RULES

Overturning the apex court decision in the infamous Vodafone case, the Indian income tax law was amended to counter tax evasion from international shareholding structures. Under the amendment, a non-resident will be liable to tax in India upon transfer of shares/an interest in another overseas entity, if such share/interest derives its value substantially from assets located in India (popularly known as indirect transfer provisions). The share/interest is said to derive its value substantially from assets located in India if the:

- Value of assets located in India as on the specified date exceeds INR 100 million; and
- Value of assets represents at least 50% of the value of all assets owned by the foreign company/entity.

Recently, detailed Rules have been prescribed for operation of the indirect transfer provisions, that include:

- Computation of fair market value (FMV) on the specified date:
  - Specific valuation methodology for different categories of Indian assets;
  - The manner of arriving at the FMV of assets of a foreign company (in the case of transfers between connected persons or other cases);
  - Requirement for a valuation report from a merchant banker or an accountant in certain cases.
- Determination of income attributable to assets in India:
  - Power to the tax officer to use best judgement, in cases where the transferor fails to provide the necessary information;
  - Compliance rules for the foreign company transferring the share or interest.
- Compliance rules and stringent documentation requirements for the Indian entity of the group.

[Notification No. 55/2016 dated 28 June 2016]

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INDONESIA

TAX AMNESTY BILL – WHAT IS IT AND DOES IT MATTER?

The much-anticipated Tax Amnesty Bill No. 11/2016 ("Tax Amnesty Bill") is now in force as of 1 July 2016. It was designed to give Indonesia's economy a much-needed multi-billion-dollar boost to fund the development of several infrastructure projects over the next few years. The Government estimates that the tax amnesty programme is expected to bring in IDR 165 trillion by the end of 2016, equivalent to 1.3% of the country's GDP.

Under the Tax Amnesty Bill, tax rates will range from 2% to 10%, depending on how quick an individual or a corporation declares their assets and whether the asset is repatriated to Indonesia.

What is the tax amnesty?

The tax amnesty is a limited-time opportunity for qualifying taxpayers to pay a defined tax amount (referred to in the Bill as "redemption money" or "*uang tebusan*") in exchange for relief in the following three areas:

- Tax liabilities (imposition base and applicable interest penalties);
- Tax administrative sanctions (e.g. late reporting sanction); and
- Tax criminal charges that may arise from any unaudited (open) years until the fiscal year ending 31 December 2015.

Since the statute of limitation is five years, the reliefs under the Tax Amnesty Bill can be applied to any open years from fiscal year 2011 to fiscal year 2015.

Who are the qualifying parties?

All individual and corporate taxpayers are entitled to apply for tax amnesty, with the following exceptions:

- Those who are under tax criminal investigation of which the district prosecutor office (*kejaksaan*) has established their case to have fulfilled all requirements for legal proceedings;
- Those who are in legal proceedings for tax criminal charges;
- Those who are undergoing sentencing for tax criminal charges.

How does tax amnesty work?

Scope of tax amnesty

The tax amnesty program covers income tax, value-added tax and sales tax on luxury goods that may arise from owning undeclared assets.

Undeclared assets

Tax amnesty is granted on the net assets (that is, assets minus liability) for those that have not been declared in the latest annual income tax return (AITR), including assets that are located within and outside Indonesia. Declaration is to be made in the Asset Declaration Letter for Tax Amnesty (*Surat Pernyataan Harta untuk Pengampunan Pajak* or "SPHPP"). Liability covers borrowings that were used to acquire undeclared assets; an example is a mortgage to acquire a house or an apartment.

Declared assets

Declared assets are those that are already declared in the latest AITR. The latest fiscal year is defined in the Bill as:

- 2015 for the fiscal year that ends between 1 July 2015 to 31 December 2015; or
- 2014 for the fiscal year that ends between 1 January 2015 to 30 June 2015.

The value of declared assets is the IDR value as declared in the latest AITR. For taxpayers who maintain their books in English and USD currency, the value of declared assets must be converted into IDR currency using the Minister of Finance foreign exchange rate as at the close of the latest fiscal year.

Additional assets and liabilities that have not been declared in the latest AITR

Additional assets and liabilities must be declared as follows:

- Cash: IDR amount at its nominal value
- Non-cash assets: fair value as at the end of the latest financial year.

Conversion to IDR must be done using the Minister of Finance foreign exchange rate as at the close of the latest fiscal year.

Calculation of redemption money

The rates and conditions to determine redemption money are as follows: see *Figure 1* below.

For applicants who plan to repatriate their wealth to Indonesia **and** invest them within the country, the three-year time limit is calculated from the date the asset is brought into Indonesia.

Qualified investments are those made in certain financial instruments, which among others include: government securities (*Surat Utang Negara*), bonds issued by state-owned enterprises and bonds issued by state-owned financial institutions. The Indonesian financial services authority (*Otoritas Jasa Keuangan*) is in the process of formulating regulations to regulate the procedures and the type of investments that will qualify applicants for the lower rate(s).

Imposition base of redemption money

Redemption money is calculated based on the following formula: see *Figure 2* below.

	By 30 September 2016	Between 1 October 2016 and 31 December 2016	Between 1 January 2017 and 31 December 2017
Declaration of onshore assets/wealth and retained in Indonesia for at least three years	2%	3%	5%
Declaration of offshore assets/wealth, repatriated to Indonesia and invested in Indonesia for at least three years	2%	3%	5%
Declaration of offshore assets/wealth but not repatriated to Indonesia	4%	6%	10%

Declaration of assets/wealth of taxpayers with turnover of up to IDR 4.8 billion as at 31 December 2015	
Declared asset/wealth with an aggregate value ≤ IDR 10 billion	0.5%
Declared asset/wealth with an aggregate value > IDR 10 billion	2%

Figure 1

Redemption money = Rate x (Undeclared) Additional Net Asset ("ANA")

ANA = Total assets minus those that have been declared in the latest AITR.

Net Asset Value = Assets minus Liabilities (to acquire asset).

For the purpose of calculating net asset value:

The maximum value of deductible liabilities for corporate taxpayers = 75% x ANA

The maximum value of deductible liabilities for individual taxpayers = 50% x ANA

Figure 2

How does one sign up for the program?

Taxpayers can sign up for the program following these phases:

Phase 1 – filing a declaration letter

Taxpayers need to file a declaration letter to the Directorate General of Taxes ("DGT") or at the tax office where a taxpayer is registered. Prior to submission, taxpayers would ask for explanations regarding the filling in and completion of documents to be attached with the SPHPP to the DGT office or other locations determined by the Minister of Finance ("MoF").

The SPHPP must be signed by:

– The taxpayer himself (individual taxpayers);

– The highest-ranking personnel (corporate taxpayers) – e.g. the president director or the chairman);

– A proxy where the highest-ranking personnel as referred to above is not available.

An applicant must also satisfy the following conditions:

– Has tax identification number ("NPWP");

– Has settled his redemption money;

– Has settled all of his tax payables;

– Provide a statement whether he is willing (or not planning) to repatriate his wealth/asset to Indonesia;

– Has withdrawn/cancelled all requests for tax dispute resolution (e.g. tax objection, tax appeal and judicial review);

– Has filed his FY2015 income tax return.

Further to the above requirements, the SPHPP must be submitted with the following documents:

– Proof that redemption money has been settled;

– Proof that all outstanding tax payables have been settled;

– List of assets owned;

– List of the corresponding liabilities and the relevant supporting documents;

– Proof of asset title transfer;

– Proof of repatriation and investment in Indonesia;

– A statement whether the applicant is willing (or not planning) to repatriate his wealth to Indonesia;

– A statement that he is withdrawing all requests for tax dispute resolution.

Taxpayers applying for the program are effectively agreeing to relinquish their rights to:

– Use fiscal losses carried forward;

– Use tax overpayments as credits;

– Request for tax refunds;

– File a revision of tax return(s) – annual or monthly.

relating to the years (or periods within the years) of tax amnesty.

Phase 2 – administrative review

The DGT or the receiving tax office will review and determine whether the application has been filled out according to the guidelines and complete supporting documents have also been submitted.

Phase 3 – issue of an approval letter

If an application is deemed complete, the DGT or the receiving tax office will issue an approval letter (*Surat Keterangan Pengampunan Pajak* or "SKPP") within ten working days after an application is received.

Subsequent declaration

Taxpayers can submit a Tax Amnesty declaration up to three times until 31 March 2017. The imposition base for the second and third application will take into account the declaration made in the first application. The MoF may revise a SKPP in case of a typing mistake or incorrect calculation.

If the subsequent declaration or revision resulted in an overpayment of redemption money, the overpayment must be refunded and/or taken into account to settle other tax liabilities within three months of the issue of the SKPP revision or the submission of subsequent declarations.

How would tax amnesty benefit an applicant?

Once SKPP is obtained, an applicant will enjoy the following benefits from the programme:

1. **Relief from tax liabilities**: that is, liabilities for years that have not been audited, the applicable interest penalty, the applicable administrative sanctions and possibility of tax criminal charges.
2. **Relief from administrative sanctions**: that is, any liabilities in respect of administrative compliance, e.g. late reporting.
3. **Relief from tax audit**, preliminary evidence tax audit (*bukti permulaan*) and tax criminal investigation (*penyidikan*): for years that have not been audited up to FY2015.
4. **Termination of ongoing tax audit**: including initial investigation and investigation for tax criminal charges.
5. **Relief from income tax on asset transfer**: if filing of request for title transfer or signing before a notary is done before 31 December 2017 and the applicable redemption money has been settled.
6. **Relief from possible mismanagement of data or information collected from the programme**: that is, the data and information cannot be used as a basis to perform a tax audit and/or tax criminal investigation and cannot be provided to other parties without consent of the applicant. Nonetheless, the DGT may use the data and information for its tax database.

How to account for the value of additional assets/wealth?

Applicants can record additional assets/wealth based on the following guidelines:

– ANA is recorded as additional retained earnings;

– Additional intangible assets cannot be amortised for tax purposes;

– Additional tangible assets cannot be depreciated for tax purposes.

Are there sanctions?

If, at a later stage, it is found that an applicant has not reported (or has under-reported) some assets/wealth, those assets will be deemed as additional income and be subject to the normal income tax plus penalty of 200%.

Key takeaways

Beside an expectation to bring in fresh funds into Indonesia, the current tax amnesty programme is intended to encourage voluntary tax compliance. Further, Indonesia is set to implement the Automatic Exchange of Information ("AEOI") framework with tax haven countries by 2018, which will allow the DGT to have greater access to Indonesian taxpayers' financial records in countries like Singapore, Mauritius or the British Virgin Islands.

Taxpayers should treat the tax amnesty period as a transition to enter into a new era of transparency that will leave little or no room for tax avoidance and tax evasion.

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IRELAND

PROPOSED CHANGES TO SECURITISATION REGIME

Irish tax legislation includes specific rules regarding the treatment of asset securitisation vehicles. In summary, the legislation allows the profits of such companies to be computed in accordance with the rules applicable to trading companies. Furthermore, these companies are also permitted to take a deduction for interest paid on profit participating loan notes (PPN), subject to certain conditions being met. This typically results in only a small amount of profits being subject to Irish tax at a rate of 25%.

In order to ensure that profits of s110 companies which derive from Irish property are subject to tax in Ireland, the Irish Government is proposing to introduce amendments to the existing legislation.

As it currently stands, the intention is that the amendments will work as follows:

- Profits derived from Irish property will be ring-fenced from the remaining profits of the company; and
- Any PPN interest attributable to those profits which exceeds an arm's length return will not be deductible in computing taxable profits.

The new rules will not apply where the PPN interest is paid to:

- A person who is chargeable to Irish tax on the receipt of the interest income;
- Certain approved pension funds; and
- EU/EEA resident persons where the interest is subject to tax in the country of residence, the recipient has genuine economic substance in that country, and the PPN does not form part of a tax avoidance structure.

The draft amendments are currently subject to review and consultation with interested parties. The final drafting of the amendment is expected to be included in the Finance Bill which will be published in mid-October. The current drafting, however, anticipates that the new rules will apply to profits arising after 6 September 2016, and not from the date of enactment of the amendment.

It is important to note that the vast majority of Irish s110 companies will not be impacted by the proposed changes. The Irish Minster for Finance has acknowledged the importance of the securitisation and funds industries to the Irish financial services sector, and stated that the aim of the proposed changes is to ensure that the s110 regime is ring fenced for bona fide securitisation purposes.

EU COMMISSION RULING ON APPLE

Following a two year investigation, on 30 August 2016 the European Commission announced its final decision on its state aid investigation into tax rulings granted by Ireland to the Apple Group.
The decision confirmed the Commission's opening decision that the rulings constituted illegal state aid. Following the decision the Commission has determined that Apple should pay Ireland back-taxes of c.EUR 13bn plus interest.

The case concerns the allocation of profits between the "head office" and "Irish branches" of two Irish incorporated, but non-Irish tax resident companies of the Apple Group. The Commission found that the allocation of the majority of profits to the head office of these companies, and not to their Irish branches, did not correspond to economic reality as the head office had no operating capacity to handle and manage the distribution business.

Under the legislation that was in force at the time when the tax rulings were granted, the profits attributable to the "head office" were not subject to tax, and only the Irish profits were taxed. The legislation has since been amended so that such "stateless" companies are no longer possible.

The Commission suggests that the unpaid taxes to be recovered would be reduced if other countries were to require Apple to pay more taxes on the profits recorded by Apple's Irish entities. Furthermore, the Commission also states that taxes to be recovered by Ireland would also be reduced if the US authorities were to require Apple to pay larger amounts of money to their US parent company to finance R&D activities. This aspect of the Commission's statement appears to create a contradiction at the heart of the decision, as it requires Ireland to recover the tax, yet acknowledges that the profits involved may in fact be taxable in other jurisdictions. However, it should be noted that the detailed ruling is yet to be released.

The Irish Government has strongly stated its intention to vigorously rebut the finding by the Commission and will now proceed to appeal the ruling to the European Courts. Finally, the Commission has stated that there is no specific concern about the Irish tax system and it has no intention of trying to harmonise tax rates. There are no other known state aid cases involving Ireland at present.

DETAILED GUIDANCE ON KNOWLEDGE DEVELOPMENT BOX PUBLISHED

As detailed in the Issue 40 of *BDO World Wide Tax News*, Ireland has introduced an OECD compliant Knowledge Development Box (KDB). The Irish tax authorities have now released detailed guidance notes on the practical operation of the regime. BDO Ireland's KDB leaflet provides further information in respect of the regime.

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ITALY

ADVANCE RULINGS FOR NEW INVESTMENTS IN ITALY

Legislative Decree n. 147-2015 (known as the Growth and Internationalisation Decree) introduced some significant changes to the domestic tax legislation which are particularly relevant to both foreign investors and resident companies, and include changes to tax rulings, migration of a company's residence, permanent establishments (PEs), tax heavens and tax consolidation regimes.

With particular reference to the tax rulings, the Decree modified the existing advance ruling regime. The new rules have broadened the scope of the ruling which now include:

1. Transfer pricing;
2. Preliminary assessment of existence of a PE;
3. Allocation of profits/losses to PEs;
4. Fair market value of company's assets;
5. Tax treatment of payments of dividends, royalties and interest;
6. A new form of advance ruling in respect of new investments, worth at least EUR 30 million, to be carried out in the Italian territory and having a significant impact on employment levels.

The Italian Tax Revenue Authorities recently issued a Circular (Circular 25/E) which provides important clarifications of the new advance ruling regime for new investments and allows investors to obtain more certainty about the tax aspects connected to their development plans before the new investments are actually carried out.

In practice, investors may submit to the Revenue a specific application regarding the tax treatment of their investment plan and the tax consequences connected to any extraordinary transaction which has to be carried out to implement that plan. The parties entitled to file a tax ruling request for new investments include:

1. Italian companies and other entities carrying on commercial activities;
2. Non-resident companies, regardless of whether they have a PE in Italy;
3. Groups of companies and any other associations of businesses (e.g. joint ventures, consortiums, temporary company associations, etc.).

The investment plan may involve:

- The creation of new businesses or the expansion of existing economic activities;
- Diversification of the output of an existing production;
- The restructuring of existing economic activity in order to enable the company to overcome or prevent a crisis situation;
- The acquisition of the equity interest in an existing company.

Qualifying investments may include cash injections aimed at creating new economic initiatives, as well as business strategies aimed to reorganise an existing activity to create more operational efficiency, and restructuring processes aimed at resolving a company crisis. Qualifying investments may also include share deals, including leveraged buy-out transactions and reorganisations.

The investment must be carried out in Italy, and its overall value must exceed the threshold of EUR 30 million; acquisition costs of tangible, intangible and financial assets, as well as any increase of the operational working capital will be relevant in determining the value of the investment.

The investment must generate positive, significant and long-term occupational effects by creating new jobs or by retaining existing jobs. The tax authorities will evaluate the employment impact of the investment on a case-by-case basis, although neither the law nor the implementation rules provide any objective parameters to be used.

Business plans will need to set out:

a) The size of the investment and the criteria used to assess the EUR 30 million threshold;
b) The timing connected to the plan;
c) The financial resources used to carry out the plan;
d) The expected increase in occupational levels;
e) The expected taxable revenues deriving from the investment;
f) The tax rules relevant to the investment plan, and the proposed interpretation of these rules.

The investor will receive, within 120 days from the filing of the application, a written ruling on the tax profiles connected to the proposed investment, including the reasons for the Authority's ruling.

A 90 day extension might be required by the Revenue if further documentation or evidence should be required. If no response is provided, the Authorities are deemed to agree with the taxpayer's approach as described in the ruling.

In addition to the interpretation of a specific provision of the tax law, rulings for new investments may address issues such as the applicability of the general or specific anti-avoidance rules or claims regarding access to specific tax regimes or other specific ruling regimes (i.e. advance pricing agreement, patent box).

The ruling must be filed before the deadline for the filing the relevant tax return to which the ruling would apply, provided that tax authorities have not already initiated an audit relating to the investment.

Once issued, the ruling continues to be valid, binding and effective until the underlying factual and legal circumstances remain unchanged. If the taxpayer conforms with the ruling, regardless of the amount of its turnover, it will be entitled to benefit from the collaborative compliance regime which allows taxpayers to jointly evaluate, through constant and preventive forms of interaction with the Tax Office, circumstances that are likely to generate fiscal risks.

The ruling regime for new investments offers an increased level of certainty on the tax rules applicable to Italian investments and it is certainly an instrument that, foreign investors in particular, should properly consider to minimise the possibility of disputes with the Italian Tax Authorities.

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POLAND

STANDARD AUDIT FILE

From 1 July 2016 taxpayers must maintain a Standard Audit File for Tax (SAF-T) and transmit details of VAT records in special SAF-T format to the tax authorities every month. This transmission has to be sent without any additional request from the tax authorities.

At present, this obligation applies to "Large Enterprises", which are defined based on two conditions which must be jointly met in one of the last two years: the number of employees is 250 or more, and revenue exceeds EUR 50 million, or gross asset value exceeds EUR 43 million.

Small and medium-sized enterprises (number of employees less than 50, revenue or gross asset value not exceeding EUR 10 million) will be obliged to transmit SAF-T files from 1 January 2017, while micro-enterprises (number of employees less than 10, revenue or gross asset value not exceeding EUR 2 million) will have to do so from 1 January 2018.

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ARGENTINA

FISCAL DISCLOSURE REGIME

During 2017 Argentina will implement exchange of information provisions under the Organisation for Economic Co-operation and Development's (OECD's) multilateral agreement.

The Legislative Power has enacted a regime enabling the reporting of the holding of assets in the country and abroad, as detailed below.

Subjects and assets included

Through this regime, individuals, undivided estates and legal persons (qualified as Argentine residents as at 31 December 2015) will be able to voluntarily report:

a. Holding of domestic and foreign currency;

b. Real estate;

c. Assets, including shares, interests in companies and other assets and rights with an economic value.

The assets must already be in existence on the following dates ("pre-existence date"):

- When reported by individuals and/or undivided estates: 22 July 2016.
- When dealing with legal persons, the closing date of the balance sheet for the fiscal year 2015.

Excluded assets

The assets which cannot be included in an outstanding voluntary report are holdings of:

- Currencies or securities abroad, which were deposited in financial institutions or safe-keeping agents residing or located in jurisdictions or countries identified by the Financial Action Task Force (FATF) as High Risk or Non-cooperative (North Korea, Iran, Afghanistan, Bosnia-Herzegovina, Iraq, Guyana, Laos PDR, Syria, Uganda, Vanuatu, Yemen);
- "Unbanked" national and/or foreign currency which are physically abroad.

Excise tax

An excise tax will be determined on the value of the assets stated in the outstanding voluntary report expressed in national currency, as follows:

a. Real Estate in the country and/or abroad: 5.00%;

b. Assets – in general – up to an amount equivalent to ARS 304,999: 0.00%;

c. Assets – in general – up to an amount equivalent to ARS 799,999: 5.00%;

d. When the assets reported are higher than ARS 800,000 "total" value (except for real estate), the percentage could rise to 10% and 15%.However, taxpayers may choose to pay the excise tax through the delivery of bonds BONAR 17 and/or GLOBAL 17, expressed at face value, at a rate of 10%.

Notwithstanding the provisions above, there are other ways to reduce the rate of the tax to 0%.

Benefits of the regime

Taxpayers who report the assets and/or holdings in national and/or foreign currency, will enjoy the following benefits:

- Freedom from any civil action and from offences to the tax criminal law, currency exchange criminal law, and customs and administrative offences, but not freedom from offences related to money laundering.
- The following taxes, which arise from the assets and holdings reported, are exempt from payment:
  - Income Tax for Undocumented Outgoings, Tax on the Transfer of Properties of Individuals and Undivided Estates and Tax on Credits and Debits in bank accounts;
  - Excise taxes and Value Added Tax. (Tax credits for Value Added Tax, arising from invoices considered apocryphal by this Administration, are excluded.);
  - Expenses and/or fiscal credits computed as a result of fake invoices are also excluded.

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CHILE

BEPS IMPLEMENTATION IN CHILE

Chile, as an Organisation for Economic Co-operation and Development (OECD) member, has been one of the first countries in South America to start implementing the Base Erosion and Profit Shifting (BEPS) action plan. Furthermore, Chile is one of the 34 countries worldwide that are bringing in the Country by Country Report (CbCR).

BEPS implementation has been so important that it has required the effort of legislators, the tax authority and specialists. For its part, the authority made an effort to give a public commitment to have almost four action plans completely implemented at the end of 2016. It is interesting to note that the local tax legislation has been continuously adapting its contents to the most important topics of the BEPS Plan. Some of the BEPS findings were even already present in the local legislation.

- **Digital economy**: since September 2014 the tax authority has had a specialist office for detection and audit of businesses focusing on the use of the internet a commercial platform. Also, the law contains provisions requiring IT systems for a better control of tax in electronic businesses.
- **Hybrid mismatch arrangements**: the authority's efforts have been limited to taxpayers providing information in relation to schemes which qualify as *trusts*. The rules state that individuals must pay tax on income of any origin, and foreigners with a domicile or residency in Chile having the category of *trustee* of a *trust* created under foreign laws, or assuming the category of a manager of such, must submit information to the authority about the founder and manager.
- **Controlled foreign company (CFC) rules**: since January 2016 taxpayers domiciled or resident in Chile that direct or indirectly have control over entities without a domicile or residency in Chile, must recognise income that foreign entities receive as taxable income.
- **Thin capitalisation**: the new regulation is stricter than before, providing for a new way of computing the debt. It also explicitly provides for that to be applied when a debtor pays interest at a rate of withholding tax lower than 35% under a Double Tax Treaty (CDI) or local legislation.
- **Action plans 8, 9, 10 and 13 regarding transfer pricing**: current regulations use the OECD methods as valid tools to determine the application of the arm´s length principle. Moreover, it uses the definitions of Transfer Pricing and Arm´s Length principle established in the article 9 of the Model Tax Convention on Income and Capital.

  The annual Transfer Pricing Affidavit N° 1907, in force since 2013, requires taxpayers to declare all operations with related parties and/or with tax havens. With regard to the Transfer Pricing report, this is not mandatory, but the authority always requests it in the TP audit process.

In January 2016, the Chilean authority signed the Multilateral Agreement between Competent Authorities for the Exchange of Country by Country Reports on global operations of multinational companies, which will provide a global vision of the operations of companies, income distribution, and economic activities and taxes paid in different jurisdictions.

Finally, one of the last BEPS Actions in the course of being implemented by the authority, has the objective of obtaining information for a correct audit plan, with the obligation to submit the annual affidavit about Global Tax Characterisation N° 1913, including information used in seven BEPS Action Plans.

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EGYPT

TAX DISPUTE RESOLUTION LAW INTRODUCED

On 25 September 2016, the Tax dispute resolution law No. 79 of 2016 was issued, with an effective date of 26 September 2016. The law will ease and accelerate the process of settling all types of tax disputes, including income tax, stamp tax, salary tax, and sales tax.

Disputes will be considered by a committee headed by experts and including a member of the judicial authorities and a technical expert from the tax authority.

The settlement process will be started by a request submitted by the taxpayer to the tax authority, on a form prescribed in the Minister of Finance's decree, including information on the dispute, the current dispute level, and supporting documents.

The Tax office must transfer the taxpayer's request to the appropriate committee within one week of receipt of the request.

The tax resolution law will expire after one year from the date of its publication.

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PUERTO RICO

THE OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT

On 30 June 2016, The Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) was signed into law by President Obama to bring stability to Puerto Rico's economy and establish a framework for Puerto Rico to restructure its debt, through fiscal policies. This Act will affect fundamental transactions, contracts and governmental decisions for the foreseeable future, intended to restore its path to fiscal health.

An important highlight about PROMESA is the fact that during the hearing process the US Congress analysed Puerto Rico's tax framework including the long-lasting tax incentives programs, and left all them valid and unaltered, acknowledging not only the authority of the Puerto Rico Government to enter into tax abatement agreements with taxpayers but also the significant role they play in the economic development of Puerto Rico.

Moreover, a Task Force with members of Congress has been formed, focusing on economic growth for the Island, and is already analysing many tax incentives, related ideas and proposed measures. As such, we believe that the US has a genuine commitment to continue promoting the development of the Island, through highly attractive incentive acts.

Other highlights of PROMESA include:

- **Oversight Board**
  PROMESA creates an Oversight Board to oversee the development of budgets and fiscal plans for Puerto Rico's government and government departments. Other responsibilities of this Board include:
  - Holding hearings and sessions, and intervening in any litigation filed against the PR government.
  - Enforcing Fiscal Reforms.
  - Negotiating and enforcing debt restructuring agreements between creditors and debtors.
  - Establishing efficiencies including consolidating agencies and reducing the workforce.
  - Preventing the enacting of any law or action that would interfere with PROMESA or undercut the economic growth of PR.
- **Infrastructure revitalisation**
  - PROMESA also authorises an expedited approval process for critical infrastructure projects.
- **Automatic stay upon enactment**
  - PROMESA provides an automatic stay of all litigation against PR and its government departments and any other judicial, administrative or other action or proceeding to enforce or collect claims likely until 15 February 2017. During the automatic stay, the enactment of new laws authorising budgetary transfers between government departments is prohibited.
- **Restructuring of debts**
  - Only the Oversight Board has the authority to initiate a proceeding for debt restructuring, through a voluntary process by debtors and creditors in PR.
  - PROMESA lays out provisions similar to the Chapters 9 and 11 of the US Bankruptcy Code, such as the potential for a plan of adjustment to be proposed by the debtor, voted by the creditors, and confirmed by the District Court.
- **Miscellaneous provisions**
  - Special minimum wage for Puerto Rico: The Governor, subject to the approval of the Oversight Board, has the authority to designate a period no greater than four years during which employers may pay employees under 25 years of age a wage lower than the US national minimum wage.
  - PROMESA prevents the application of the US Department of Labor Final Rule that would increase the minimum weekly salary level to USD 913 per week for a total of USD 47,476 per year, for exempt employees in PR, until administrative reports and recommendations regarding the impact on PR's economy are issued and analysed.

BDO comment

BDO Puerto Rico has had a voice in the discussions during the past months over potential tax policy measures that can be implemented to help the Island. We are at the front-end analysing and bringing sophisticated ideas to the decision makers and will continue playing a key role in the months to come, ultimately for the benefit of Puerto Rico and our clients. We will keep our clients with operations in Puerto Rico informed of all pertinent developments concerning PROMESA and the Economic Task Force.

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UNITED STATES

PARTNERSHIP TAXATION: SIGNIFICANT CHANGES TO DISGUISED SALE RULES

On 5 October 2016, the IRS published final and temporary regulations (TD 9787 and TD 9788) under sections 707 and 752 of the Internal Revenue Code ("Code"). The new regulations provide guidance relating to disguised sales of property to or by a partnership under section 707, and special rules for allocating liabilities under section 752 for purposes of the section 707 disguised sale rules.

General rule under Section 707

Section 707(a)(2)(B) provides that, under regulations prescribed by the Secretary, related transfers to and by a partnership that, when viewed together, are properly characterised as a sale or exchange of property, will be treated either as a transaction between the partnership and one who is not a partner, or between two or more partners acting other than in their capacity as partners. Under section 1.707-3, a transfer of property by a partner to a partnership and a transfer of money or other consideration from the partnership to the partner will generally be treated as a sale of property by the partner to the partnership, if based on all the facts and circumstances, the transfer of money or other consideration would not have been made but for the transfer of property and, for non-simultaneous transfers, the subsequent transfer is not dependent on the entrepreneurial risks of the partnership.

The existing disguised sale regulations provide several exceptions, including one related to reimbursements of capital expenditures (the "Preformation Expenditure Exception") and another for distributions of certain debt-financed proceeds (the "Debt-Financed Distribution Exception"). Additionally, existing regulations exclude certain liabilities from disguised sale treatment (the "Qualified Liability Exclusion"). TD 9787 and TD 9788 contain final and temporary regulations, respectively, impacting these exceptions and exclusion.

Preformation expenditure exception

General rule: In general, transfers of money or other consideration from a partnership to reimburse a partner for certain capital expenditures and costs incurred by the partner are not treated as part of a disguised sale of property. Capital expenditures include partnership organisation and syndication costs, and costs capitalised to the basis of contributed property. The exception for preformation capital expenditures generally applies only to the extent that the reimbursed capital expenditures do not exceed 20% of the fair market value ("FMV") of the property transferred by the partner to the partnership (the 20-percent limitation). The 20% limitation, however, does not apply if the FMV of the transferred property does not exceed 120% of the partner's adjusted basis in the property at the time of the transfer (the 120% test).

New rule – Aggregation of assets: The final regulations clarify that the preformation expenditure exception applies on a property-by-property basis[1]. However, aggregation is permitted to the extent that:

1. The total FMV of the aggregated property (of which no single property's FMV exceeds 1% of the total FMV of the aggregated property) is not greater than the lesser of 10% of the total FMV of all property transferred by the partner to the partnership (excluding money) or USD 1 million;
2. The partner uses a reasonable aggregation method that is consistently applied; and
3. The aggregation of property is not part of a plan in which the principal purpose is to avoid sections 1.707-3 through 1.707-5[2].

New rule – Step-in-the-shoes transaction: Under the final regulations, a partner "steps in the shoes" of a person (to the extent the person was not previously reimbursed) with respect to capital expenditures incurred by the person with respect to the property transferred to the partnership. This rule applies to the extent the partner acquired the property in a non-recognition transaction under sections 351, 381(a), 721, or 731[3].

New rule – Tiered partnerships: In certain situations, an upper-tier partnership is eligible to apply the preformation expenditure exception to capital expenditures incurred by another person[4]. This rule applies where:

1. A person incurred eligible capital expenditures with respect to property;
2. Such property is contributed by the person who incurred the capital expenditures to a partnership (lower-tier partnership); and
3. Within two years from the date the capital expenditures were originally incurred, the person transfers an interest in the lower-tier partnership to another partnership (upper-tier partnership).

Under this rule, the upper-tier partnership may be reimbursed by the lower-tier partnership to the extent the person could have been reimbursed for the capital expenditures by the lower-tier partnership[5]. In addition, the person is deemed to have transferred the capital expenditures property to the upper-tier partnership and may be reimbursed by the upper-tier partnership of this section to the extent the person could have been reimbursed for the capital expenditures by the lower-tier partnership and has not otherwise been previously reimbursed[6]. The aggregate reimbursements for capital expenditures may not exceed the amount that the person could have been reimbursed for such capital expenditures.

New rule – Coordination with qualified liability rules: Special rules apply if capital expenditures were funded by the proceeds of a qualified liability that is assumed by a partnership in connection with a transfer of property to the partnership[7]. Under these rules, to the extent any qualified liability is used by a partner to fund capital expenditures, and economic responsibility for that borrowing shifts to another partner, the exception for preformation capital expenditures does not apply[8].

Further, capital expenditures are treated as funded by the proceeds of a qualified liability to the extent the proceeds are either traceable to the capital expenditures under section 1.163-8T or were actually used to fund the capital expenditures, irrespective of the tracing requirements under section 1.163-8T[9]. However, if capital expenditures are incurred under a plan in which the principal purpose is to avoid the requirements of these rules, the capital expenditures are deemed funded by the qualified liability[10].

New rule – Definition of capital expenditures: For purposes of the preformation expenditure exception and qualified liability exclusion, the term capital expenditures has the same meaning as the term capital expenditures has under the Code and applicable regulations, except that it includes capital expenditures taxpayers elect to deduct, and does not include deductible expenses taxpayers elect to treat as capital expenditures[11].

Additional notes: The IRS continues to study the appropriateness of the exception for preformation capital expenditures. Specifically, the IRS is considering whether this exception is appropriate and requests comments on whether the regulations should continue to include the exception, including any policy justifications for keeping the exception, and on the effects that removing the exception may have.

Debt-financed distribution exception

General rule: In certain situations, distributions funded with partnership liabilities that are made to a partner who transfers property to a partnership may be excluded from the disguised sale rules. A debt-financed distribution exception applies where the partnership incurs a liability and all or a portion of the proceeds of that liability are traceable to a transfer of money or other consideration to the contributing partner. However, this exception only applies to the extent that the amount of money or FMV of other consideration is does not exceed the partner's allocable share of the partnership liability. Thus, to the extent the partner receives a distribution of debt-financed proceeds and is not allocated a portion of the liability, application of this exception is limited. Determination of a partner's allocable share of the partnership liability is therefore critical in applying the debt-financed distribution exception.

New rule – Determination of share of liabilities under Section 707: Under the temporary regulations, a partner's share of any partnership liability for disguised sale purposes is the same percentage used to determine the partner's share of the partnership's excess nonrecourse liabilities[12]. This rule applies regardless of whether the liability is recourse or nonrecourse. For purposes of the disguised sale rules, a partner's share of partnership excess nonrecourse liabilities will be based on the partner's share of partnership profits[13]. The temporary regulations also provide that, for disguised sale purposes, if another partner bears economic risk of loss ("EROL") with respect to a liability, then no portion of that liability can be allocated to the contributing partner[14].

New rule – Qualified liability ordering rule: The final regulations clarify that an amount excludable as a debt-financed distribution is determined prior to applying the preformation expenditure exception under section 1.707-4[15].

Effective date: Section 707-5T(a)(2) is effective for any transaction with to which all transfers occur on or after 3 January 2017[16]. The temporary regulations are scheduled to expire on 4 October 2019[17].

Qualified liability exclusion

General rule: Provided that a transaction is not otherwise treated as a disguised sale, and the partnership's assumption of a qualified liability, or a partnership's taking property subject to a qualified liability, is not treated as part of a sale. Where the transaction is otherwise treated as a sale, however, the qualified liability gives rise to additional disguised sale consideration in an amount equal to the lesser of:

1. The consideration the partnership would have been treated as transferring to the partner if the liability had been a nonqualified liability; or
2. An amount equal to the amount of the liability multiplied by the partner's net equity percentage with respect to the property[18].

New rule – Anticipated reduction in partner's share of liability: The existing rules provide that an anticipated reduction in a partner's share of liability must be taken into consideration in determining the partner's share of a liability[19]. The final regulations expand this rule to include the requirement that the anticipated reduction is not subject to the entrepreneurial risks of partnership operations[20].

New rule – Exception related to certain liability shifts: As described above, a partner's share of a partnership liability for disguised sale purposes is based on the partner's share of partnership profits. Consequently, a partner cannot be allocated 100% of the liabilities for purposes of section 707. As a result, some amount of the liabilities will shift among partners. The shifting of a nonqualified liability that triggers a disguised sale can cause a portion of the qualified liability to be treated as consideration under the disguised sale rules as well. In order to mitigate the impact of the general rules, the final regulations include an exception in certain circumstances. Specifically, the partnership's assumption of or taking property subject to a qualified liability is not treated as a transfer of consideration made pursuant to the sale, if the total amount of all liabilities other than qualified liabilities that the partnership assumes or takes subject to is the lesser of 10% of the total amount of all qualified liabilities the partnership assumes or takes subject to, or USD 1 million[21].

New rule – Addition to qualified liability definition: The final regulations expand the definition of qualified liability to include certain liabilities not incurred in anticipation of the property transfer. Under the final regulations, qualified liabilities will also include liabilities incurred in connection with a trade or business in which property transferred to the partnership was used or held, providing all the assets related to that trade or business are transferred to the partnership[22]. Assets that are not material to a continuation of the trade or business do not need to be included in the contribution. In meeting the definition of a qualified liability, the final regulations also provide that if the liability is a recourse liability, the amount of the liability may not exceed the FMV of the transferred property at the time of the transfer[23].

New rule – Step-in-the-shoe transaction: The final regulations provide a rule similar to the rule described above in connection with the preformation expenditure exception. Specifically, a partner "steps in the shoes" of a person for purposes of the qualified liability rules with respect to a liability the person incurred or assumed to the extent the partner assumed or took property subject to the liability from the person in a non-recognition transaction described in sections 351, 381(a), 721, or 731[24].

New rule – Tiered partnerships: The pre-existing regulations provided only a limited tiered-partnership rule for cases in which a partnership succeeds to a liability of another partnership. Under the final regulations, a contributing partner's share of a liability from a lower-tier partnership is treated as a qualified liability to the extent the liability would be a qualified liability had it been assumed or taken subject to by the upper-tier partnership in connection with a transfer of all of the lower-tier partnership's property to the upper-tier partnership by the lower-tier partnership[25]. Further, the final regulations provide that in determining whether a liability would be a qualified liability, the determination of whether the liability was incurred in anticipation of the transfer of property to the upper-tier partnership is based on whether the partner in the lower-tier partnership anticipated transferring the partner's interest in the lower-tier partnership to the upper-tier partnership at the time the liability was incurred by the lower-tier partnership[26].

BDO comment

- *While the regulations clarify that the preformation expenditure exception must be applied on an asset-by-asset basis, the ability to aggregate assets in certain situations should alleviate the administrative burden associated with contributions of numerous assets. Careful attention to the aggregation exception should be paid in order to ensure the ability to maximise potential benefits.*
- *The rule coordinating the preformation expenditure exception and liability allocations effectively eliminates so-called "double-dip" transactions, where the partnership both reimburses the contributing partner's preformation expenditures and assumes the liability used by the contributing partner to finance the capitalised expenditures.*
- *Leveraged partnership transactions in which newly-obtained liabilities are used to fund distributions to property-contributing partners are severely impacted by these rules. For purposes of calculating the amount of debt-financed distribution exception, a contributing partner's share of liabilities is based solely on such partner's interest in partnership profits (excluding liabilities for which another partner bears the EROL).*
- *While it is critical to consider the final and temporary regulations addressing disguised sales, it is important to bear in mind that the determination of a disguised sale transaction is inherently driven by facts and circumstances. Consequently, careful consideration should be given to the overall facts and circumstances to determine whether the transaction should be considered a disguised sale.*

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[1] Section 1.707-4(d)(1)(ii)(B).

[2] Section 1.707-4(d)(1)(ii)(B)(1), (2), & (3).

[3] Section 1.707-4(d)(2).

[4] Section 1.707-4(d)(3).

[5] Id.

[6] Id.

[7] A qualified liability of the partner exists only to the extent the liability is:

a) A liability that was incurred by the partner more than two years prior to the earlier of the date the partner agrees in writing to transfer the property or the date the partner transfers the property to the partnership and that has encumbered the transferred property throughout that two-year period;

b) A liability that was not incurred in anticipation of the transfer of the property to a partnership, but that was incurred by the partner within the two-year period prior to the earlier of the date the partner agrees in writing to transfer the property or the date the partner transfers the property to the partnership and that has encumbered the transferred property since it was incurred;

c) A liability that is allocable under the rules of §1.163-8T to capital expenditures with respect to the property;

d) A liability that was incurred in the ordinary course of the trade or business in which property transferred to the partnership was used or held but only if all the assets related to that trade or business are transferred other than assets that are not material to a continuation of the trade or business; or

e) A liability that was not incurred in anticipation of the transfer of the property to a partnership, but that was incurred in connection with a trade or business in which property transferred to the partnership was used or held but only if all the assets related to that trade or business are transferred other than assets that are not material to a continuation of the trade or business; and

If the liability is a recourse liability, the amount of the liability does not exceed the FMV of the transferred property (less the amount of any other liabilities that are senior in priority and that either encumber such property or are liabilities described in paragraph (a)(6)(i)(C) or (D) of this section) at the time of the transfer.

[8] Section 1.707-4(d)(4)(i).

[9] Id.

[10] Section 1.707-4(d)(4)(ii).

[11] Section 1.707-4(d)(5).

[12] Section 1.707-5T(a)(2)(i).

[13] Section 1.752-3(a)(3) provides that the partner's share of the excess nonrecourse liabilities of the partnership as determined in accordance with the partner's share of partnership profits. The partner's interest in partnership profits is determined by taking into account all facts and circumstances relating to the economic arrangement of the partners. In addition to allocations based on profits, partnerships may allocate excess nonrecourse liabilities under one of the following methods:

1. **Significant Item Method**: The partnership agreement may specify the partners' interests in partnership profits for purposes of allocating excess nonrecourse liabilities, provided the interests so specified are reasonably consistent with allocations (that have substantial economic effect under the section 704(b) regulations) of some other significant item of partnership income or gain.
2. **Alternative Method**: Excess nonrecourse liabilities may be allocated among the partners in accordance with the manner in which it is reasonably expected that the deductions attributable to those nonrecourse liabilities will be allocated.
3. **Additional Method**: The partnership may first allocate an excess nonrecourse liability to a partner up to the amount of built-in gain that is allocable to the partner on section 704(c) property (as defined under section 1.704-3(a)(3)(ii)) or property for which reverse section 704(c) allocations are applicable (as described in section 1.704-3(a)(6)(i)) where such property is subject to the nonrecourse liability to the extent that such built-in gain exceeds the gain described in paragraph (a)(2) of this section with respect to such property.

The significant item method, alternative method, and additional method do not apply for purposes of the debt-financed distribution rules under section 1.707-5.

[14] Section 1.707-5T(a)(2)(i).

[15] Section 1.707-5(b)(3).

[16] Section 1.707-9T(a)(5).

[17] Section 1.707-5T(g).

[18] Section 1.707-5(a)(5)(i).

[19] Under the pre-existing regulations, a partner's share of a liability, immediately after a partnership assumes or takes property subject to the liability, is determined by taking into account a subsequent reduction in the partner's share if (i) at the time that the partnership assumes or takes property subject to the liability, it is anticipated that the transferring partner's share of the liability will be subsequently reduced, and (ii) the anticipated reduction is not subject to the entrepreneurial risks of partnership operations.

[20] Section 1.707-5(a)(3)(iii).

[21] Section 1.707-5(a)(5)(iii).

[22] Section 1.707-5(a)(6)(i)(E).

[23] Section 1.707-5(a)(6)(ii).

[24] Section 1.707-5(a)(8).

[25] Section 1.707-5(e)(2).

[26] Id.

CURRENCY COMPARISON TABLE

The table below shows comparative exchange rates against the euro and the US dollar for the currencies mentioned in this issue, as at 2 November 2016.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
Argentine Peso (ARS)	0.06034	0.06640
Australian Dollar (AUD)	0.69491	0.76460
Euro (EUR)	1.00000	1.10019
Indian Rupee (INR)	0.01361	0.01498
Indonesian Rupiah (IDR)	0.00007	0.00008
US Dollar (USD)	0.90883	1.00000

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