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There have been significant recent changes in the global tax landscape as highlighted in the OECD annual report on global tax policy reforms published on 5 September 2018. The report noted the impact of major tax reform in a number of countries, notably in the United States, Argentina and France. At the time the US tax reform became effective on 1 January 2018, Goldman Sachs estimated there was US$3.1 trillion of overseas profit kept outside the United States, which highlights the significance of this reform. One aspect of the US tax reform was lowering of corporate taxes, which reflects a global trend, with the average corporate income tax rate across the OECD dropping from 32.5 per cent in 2000 to 23.9 per cent in 2018. Other tax reform trends identified were the lowering of personal income taxes and new excise taxes, to deter harmful consumption, such as sugar taxes.

An area where coordinated tax reform has not materialised, despite being identified as a key area in the BEPS Action Plan in 2015, is in the taxation of the digital economy. The OECD produced an interim report in April 2018, with further work scheduled for 2019, with the aim of arriving at a ‘consensus based solution by 2020’. Although there is widespread recognition of the need for change, consensus on how such change should come about has been limited. Some countries, including the UK, have decided to take unilateral action, pending an international solution. The UK’s 2018 Autumn Statement announced a digital services tax (DST) to be introduced from April 2020. The proposal is that a 2 per cent tax will apply to the revenues above £25 million of certain digital businesses to reflect the value they derive from the participation of UK users, with consultation on the detail of the legislation to take place between now and the introduction of the tax in the Finance Act 2020. One may conclude that this reflects the UK’s view on the likelihood of an OECD solution by 2020. The UK is not alone: Malaysia revealed plans in November 2018 to introduce a consumption tax on the supply of digital services to Malaysian residents from 1 January 2020; Quebec is introducing a digital sales tax in January 2019; and Chile, Uruguay and Colombia all have plans to tax foreign suppliers of digital services. Potentially, as more countries start to fill the vacuum with their own domestic digital taxes, the possibility of conflict with the regimes in other countries arises.

The potential for tax conflict, rather than competition, is not restricted to the digital economy and is much more likely than in recent years. It is possible that 2019 will see some nations retaliate to US tax reforms and also see the US and certain jurisdictions use tariffs and duties as weapons in their trade wars. Brexit is another potential source of tax conflict.

It is hoped that this volume will prove to be a useful guide to the tax rules in the jurisdictions where clients conduct their businesses. Each chapter aims to provide topical and current insights from leading experts on the tax issues and opportunities in their respective jurisdictions. While specific tax advice is always essential, it is also necessary to have a broad
understanding of the nature of the potential issues and advantages that lie ahead; this book provides a guide to these.

I should like to thank the contributors to this book for their time and efforts, and above all for their expertise. I would also like to thank the publisher and the team for their support and patience. I hope that you find the work useful, and any comments or suggestions for improvement that can be incorporated into any future editions will be gratefully received.

The views expressed in this book are those of the authors and not of their firms, the editor or the publishers. Every endeavour has been made to ensure that what you read is the latest intelligence.

Tim Sanders
London
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I INTRODUCTION

Australian taxation regimes largely reflect Organisation for Economic Co-operation and Development (OECD) models, at least at the federal taxation level. Australian tax revenue is largely from personal and company income taxes and a goods and services tax (GST, a value added tax). For a long time, Australian legislative efforts endeavoured to broaden tax bases and lower tax rates, but with reducing momentum. With reductions in company tax rates elsewhere in recent years, Australia has again become a relatively high-taxing country. It is also a leading proponent of the OECD’s base erosion and profit shifting (BEPS) action plan.

Australia departs from many leading economies in several respects.

First, Australia operates a full imputation system of company taxation. Imputation tends to favour Australian shareholders at the expense of foreign investors, because the credits available to local shareholders could equally fund a lower company tax rate. The Australian general company income tax rate, at 30 per cent, is comparatively high by OECD standards now, and has not changed since 2001.

Second, Australian GST is set at a comparatively low rate of 10 per cent, and includes large-scale exemptions, for example, for health and education.

Third, Australia has six states and two territories each with semi-independent taxing powers, and as a result has several inefficient local taxes such as payroll tax and stamp duty.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

The most common business entities used in Australia are companies, trusts and partnerships. Of these, the company is probably the default vehicle.

Companies are taxable entities, whereas most trusts and partnerships are tax-transparent. The general company tax rate is currently 30 per cent. There is a 27.5 per cent rate for active business companies with annual turnover of less than A$50 million (scheduled to decline to 25 per cent by 2021–2022). These rates apply both to resident companies and to foreign companies earning income through Australian branches.

Although companies are taxed, dividends can be ‘franked’ such that Australian shareholders obtain a credit for taxes paid by the company, and non-resident shareholders are free of dividend withholding tax (regardless of their treaty status).
Wholly owned groups of resident companies can be ‘consolidated’ and taxed as a single entity, with inter-company transactions ignored.

Australian limited partnerships are becoming increasingly common in cross-border structuring arrangements. They are generally taxed as companies in Australia.

Trusts are generally tax-transparent provided they distribute their income each year, and trust losses are not distributed but carried forward. Widely held ‘attribution’ managed investment trusts with passive income can elect to maintain tax-transparency and at the same time retain their income.

Some foreign investors operate through a branch in Australia, but that is not common.

i  Corporate

Australian companies may be registered either as a public or ‘limited’ company, or as a private or ‘proprietary limited’ company. A proprietary limited company generally cannot engage in public capital raisings but, because the public is not at risk, is exempt from various investor protection (e.g., disclosure) requirements.

A limited partnership, which is taxed as a company, is a partnership in which the liability of at least one of the partners is limited. Each Australian state allows for the creation by registration of limited partnerships. The limited partner must not participate in the management of the partnership. A limited partnership does not have separate legal personality. Some states and the Australian territories also make provision for incorporated limited partnerships.

ii  Non-corporate

A trust is the relationship of a legal titleholder (trustee) of an asset to a person for whose benefit the asset is held (beneficiary). The trustee must file an income tax return separately for the trust as if the trust were a taxpayer, but tax on the income is payable by the beneficiary currently entitled to the income (or by the trustee on behalf of a non-resident beneficiary).

In the case of a discretionary trust where the trustee has a power to ‘appoint’ beneficiary entitlements to income, the trustee is taxed on any income to which no beneficiary is entitled by year-end. The rate of tax payable by the trustee in these cases is the maximum personal rate (currently 47 per cent).

Managed investment trusts with passive income can elect to ‘attribute’ their taxable income to unit holders on a fair and reasonable basis in accordance with the trust’s constituent documents regardless of whether the income is retained or distributed. Withholding tax is applied to income attributed or distributed to non-residents by these trusts.

Income tax returns must also be filed separately for partnerships, but the partners are taxed on the partnership income regardless of current distribution entitlements. Unincorporated joint ventures in which the joint venture parties are not jointly and severally liable for liabilities and are not in receipt of income jointly (i.e., they divide the product of the venture) are disregarded for tax purposes. This is common in the mining industry.

III  DIRECT TAXATION OF BUSINESSES

i  Tax on profits

Australian taxpayers are taxed on worldwide ‘taxable income’, typically with a 30 June tax year-end. Substituted periods can be approved for foreign-owned entities to match foreign parent balance dates.
Determination of taxable profit

Taxable income is ‘assessable income’ less allowable ‘deductions’, both as defined by statute. Income and expenses recognised for tax and accounting purposes are often different, mainly as to timing but sometimes also as to amount. Tax adjustments, therefore, often produce differences between a company’s taxable income and its reported profits. Common differences arise from differences in the timing of recognition of income and expenses (or depreciation); in the case of tax-consolidated groups, different calculations of the tax cost of assets; and elimination from taxable income of certain impairment, fair value and mark-to-market type adjustments made for accounting purposes.

Although Australian companies are generally subject to Australian tax on worldwide income, a capital gain or loss made by a resident company on shares in a foreign company may be reduced (in some cases to zero) under a ‘participation exemption’. The Australian company must have held a 10 per cent or greater direct voting interest in the foreign company for a continuous period of 12 months in the preceding two years. In that case, the capital gain or loss is reduced by the proportion of the foreign company’s active business assets to its total assets.

Australia also has complex rules to attribute income earned by controlled foreign companies to their Australian owners. The Australian owners generally are not attributed active business income, and dividends paid into Australia are exempt from tax. Foreign active business income derived directly is also generally exempt.

Capital and income

Comprehensive rules within the income tax legislation include capital gains (net of capital losses) in assessable income. The rules also contain capital gains tax exemptions and concessions.

Non-residents are only subject to capital gains tax on assets that are ‘taxable Australian property’. These assets include direct and indirect interests in Australian real property and the business assets of Australian branches. A non-resident investor is not subject to capital gains tax on a sale of shares in an Australian company, unless its shareholding exceeds 10 per cent and the Australian company’s value is mostly attributable to Australian real property.

A non-final 12.5 per cent withholding tax applies to the proceeds of sales by non-residents of direct and indirect interests in Australian property. The tax does not apply to sales of real estate for less than A$750,000.

The capital gains tax rate for a company is the same as the income tax rate.

Losses

Companies and stock exchange-listed trusts can carry forward losses indefinitely subject to continuity of majority ownership rules, or if those rules are failed, a same business rule. Carry-back of losses was briefly available for losses incurred by small companies, but is no longer available.

Revenue account losses can be offset against both income and capital gains. Capital losses can only be offset against capital gains.
Rates
The headline rate of company tax is currently 30 per cent. However, a reduced rate of 27.5 per cent applies to companies with annual turnover of less than A$50 million (scheduled to decline to 25 per cent by 2021–2022). The turnover threshold is measured on a group-wide basis if the company is a member of a group.

Administration
Companies are generally required to pay tax under a ‘pay-as-you-go’ collection system. This requires large companies and other large taxpayers to pay monthly (if their income is sufficiently high) or quarterly instalments of tax estimated by reference to income derived during the month or quarter (as applicable). Any variance from the estimate is reconciled, in the case of a company, five months after year-end.

Tax grouping
Australian-resident companies and trusts may form a tax-consolidated group. A group consists of an Australian-resident ‘head’ company (which cannot be a wholly owned subsidiary of another Australian-resident company) and all its wholly owned Australian subsidiary entities. The consolidated group is taxed as a single entity, and intra-group transactions are ignored. The head company is primarily liable for group income tax, but subsidiaries may be jointly and severally liable if it fails to pay. The regime allows pooling of losses and movement of funds and assets within the group without income tax consequences. The cost of a subsidiary company’s assets is set on joining the group by reference to the cost of its shares and its liabilities; the cost of shares in a subsidiary company is set on leaving the group by reference to the cost of its net assets.

Foreign-owned groups that have multiple entry points into Australia may form a ‘multiple entry’ consolidated group, with the head company chosen by the group from that point or ‘tier 1’ entities.

ii Other relevant taxes

GST
GST applies to supplies connected with Australia’s ‘indirect tax zone’, and to the importation of goods and services into Australia. The rate is 10 per cent. Australian GST is similar to the European VAT regimes.

Supplies classified as ‘GST-free’ do not attract GST. They include education and health-related services, most basic types of food, exports of goods and services, and certain supplies to businesses. Importers are liable to GST on the customs value of goods worth more than A$1,000 imported into Australia; remote sellers with Australian turnover exceeding A$75,000 are liable to register for Australian GST and collect GST on goods sold to Australian consumers costing A$1,000 or less.

Other supplies that do not attract GST are known as ‘input-taxed’ supplies. These include financial supplies, residential tenancies and sales of residential premises other than new constructions.

These labels express the distinctions that other countries refer to as exempt or zero-rated supplies: input tax credits cannot be claimed for the GST incurred on acquisitions that relate
to input-taxed supplies, but can be claimed for credits that relate to GST-free supplies. Input tax credits are generally otherwise available for GST paid with acquisitions in the course of a business.

Input tax credits are offset against the taxpayer’s GST liabilities so that only a net GST amount is payable, usually on a calendar-month basis. Examples of financial supplies in relation to which input tax credits are not available include money lending, and other dealings with debt and equity interests. Apportionment for ‘mixed use’ acquisitions is required.

Corporate groups with 90 per cent common ownership may be registered as a single GST group. The group is separate from any consolidated income tax group and requires a separate election. A GST group may include non-corporate entities such as trusts and partnerships. A nominated member is responsible for the GST payable by the whole group. Supplies and acquisitions within the group are ignored.

The GST also applies to offshore supplies of digital products and services provided to Australian consumers. All supplies of intangibles will be caught, regardless of value.

Fringe benefits tax (FBT)

FBT is payable by employers on the value of non-salary ‘fringe’ benefits provided to employees. Taxable benefits include the free or subsidised employee use of motor vehicles, housing, expense reimbursements and low-interest loans. Superannuation benefits are not subject to FBT.

The FBT rate is 47 per cent (i.e., the maximum personal tax rate) applied to the ‘grossed-up’ value of the benefit. The gross up ensures that the FBT payable is equivalent to the income tax that would have been paid in respect of an equivalent amount of after-tax salary.

Petroleum resource rent tax

Petroleum resource rent tax is imposed on income from the recovery of petroleum products from offshore petroleum projects. It also applies to onshore oil and gas projects, and previously excluded North West Shelf projects.

State royalties

Various natural resource royalties are applied by state governments.

Payroll tax

Payroll tax is imposed by each state and territory on wages, salaries and other employee benefits, up to a rate of 6.1 per cent depending on the jurisdiction.

Stamp duty

The various Australian states and territories all levy stamp duty. Although largely aligned, the duty regimes all differ in important details.

Duty is levied on transfers of interests in land, the creation of beneficial interests in land, transfers of shares and units in landholder entities, motor vehicle transfers and insurance contracts. The rate of duty can be up to 7 per cent depending on the jurisdiction. All Australian states also impose a foreign purchaser surcharge (which can be as high as a further 8 per cent) on foreign purchases of residential land.
Queensland, Western Australia and the Northern Territory also levy duty on transfers of business assets such as goodwill.

Nominal duty sometimes also applies to documents such as trust deeds. Without payment, these documents are not enforceable.

**Customs duty**
Goods imported into Australia may be subject to customs duty.

**Excise duty**
Excise duty is levied on alcohol, tobacco and petroleum produced in Australia.

**Land tax**
Each state and the Australian Capital Territory impose a tax on ownership of commercial real estate. The maximum rate differs depending on the jurisdiction, but ranges from 1.5 per cent to 3.7 per cent. Agricultural land is excluded.

Queensland, Victoria and New South Wales have also introduced a surcharge of up to 1.5 per cent per annum for foreign owners of residential property with effect from 1 January 2017.

**Luxury car tax**
Luxury car tax is levied, at 33 per cent, on the excess over A$66,331 (indexed; A$75,526 for specified fuel-efficient cars) of the retail value of a new car sold in or imported into Australia.

**Wine equalisation tax**
Wine equalisation tax is levied at 29 per cent of the wholesale value of wine for consumption in Australia.

### IV TAX RESIDENCE AND FISCAL DOMICILE

#### i Corporate residence
A company incorporated in Australia is an Australian resident for tax purposes. A foreign-incorporated company can also be Australian tax-resident if its central management and control is in Australia and it carries on business in Australia. The Australian High Court addressed these rules in its November 2016 *Bywater Investments and Hua Wang Bank* decision.

Australia’s double taxation treaties (DTTs) generally contain ‘tie-breaker’ clauses for dual-resident companies, although these provisions will be replaced in some of Australia’s treaties because of Article 4 of the Multilateral Instrument.

Tax is not imposed upon the incorporation of companies, other than nominal administrative charges levied by the Australian corporate regulator (ASIC). Administrative charges also apply to the registration of foreign branches. Foreign companies carrying on business through branches in Australia are required to register with ASIC.

#### ii Branch or permanent establishment
Australia’s tax rules generally do not differentiate between operations conducted through an Australian subsidiary or the Australian branch of a foreign company; both are subject to the (currently) 30 per cent company tax rate (27.5 per cent for small companies). An
Australian-resident subsidiary of a foreign company with offshore investments, however, pays tax on worldwide income (subject to the conduit foreign income rules – see below), whereas a branch of a non-resident company is only taxed on Australian-sourced income. Subsidiary company profits on which tax has been paid in Australia can be repatriated as dividends free of Australian dividend withholding tax, and Australia does not impose a branch profits tax on the repatriation of branch profits.

Australia’s DTTs generally allow source country taxing rights where a treaty resident carries on business through a PE in Australia. In determining the taxable income of a branch, Australia’s treaties require use of arm’s-length principles. Australian domestic law specifically requires the application of the principles set out in the OECD Transfer Pricing Guidelines.

Non-residents are generally taxed in Australia by reference to Australian source, which can be established through carrying on business in Australia. General law rules determine the source of income, and indicators include the place where contracts are concluded or performed and the place where business decisions are made. The use of an agent in Australia, particularly a dependent agent such as an employee, can locate the activity and therefore the source of income in Australia. Various other factors can also be relevant in particular cases, such as the residence of a debtor in the case of interest income and the location of a share register in the case of dividend income.

Residents of countries with which Australia has concluded a DTT are generally protected from Australian tax on business income (other than dividends, interest and royalties) if they do not carry on business through a PE in Australia.

V. TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i. Holding company regimes

Australia does not have a holding company regime per se, but a number of concessions are available for cross-border investment.

Capital gains tax

Non-residents are only subject to capital gains tax on assets that are ‘taxable Australian property’ as defined. These assets include direct and indirect interests in Australian real property and the business assets of Australian branches. A non-resident investor is not subject to capital gains tax on a sale of shares in an Australian company unless its shareholding exceeds 10 per cent and the Australian company’s value derives primarily from Australian real property. As previously mentioned, a non-final 12.5 per cent withholding tax, retained by the buyer, applies to the proceeds of the sale of these assets by non-residents. Sellers can invoke administrative procedures that allow the buyer to pay the full price without withholding on settlement.

Non-portfolio dividends

Profit distributed to an Australian-resident company owning a non-portfolio (more than 10 per cent) stake in a foreign company that is ‘equity’ under Australian tax law is generally exempt from Australian tax. This exemption does not apply to legal form shares that are ‘debt’ under Australian tax law, such as some redeemable preference shares.
Conduit foreign income
Foreign source income received by Australian companies can pass through an Australian company to non-resident shareholders without triggering either Australian corporate tax or dividend withholding tax under a special regime for ‘conduit foreign income’. Conduit foreign income is foreign income paid on to a foreign-resident shareholder rather than accumulated by the company in Australia.

Withholding tax
Australian domestic law imposes withholding tax on dividends, interest, royalties and trust distributions paid to non-residents. However, exemptions in the domestic law remove withholding tax on dividends paid out of taxed company profits, foreign source income, interest paid to unrelated lenders, interest paid to foreign tax-exempt entities, foreign pension funds and foreign sovereign wealth funds. Australia’s DTTs generally also reduce the rate of withholding tax on dividends, interest and royalties (see below). Recently concluded or renegotiated treaties eliminate some withholding taxes entirely.

ii IP regimes
A 43.5 per cent refundable tax offset is available to companies with an annual aggregate turnover of less than A$20 million that conduct eligible research and development. This is equivalent to a deduction of 145 per cent for a 30 per cent tax rate company. Other companies are entitled to a 38.5 per cent non-refundable tax offset, which may be carried forward for use in future years. This is equivalent to a deduction of 128 per cent for a 30 per cent tax rate company.

Australia does not have a patent box regime.

iii State aid
The federal government and the state governments administer various support programmes to assist non-residents to invest into Australia. Details of these programmes are available from Austrade, the Australian government’s investment promotion agency.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)
Dividends paid to a non-resident are subject to dividend withholding tax unless ‘franked’. Australia operates an ‘imputation’ or franking system whereby dividends paid by an Australian-resident company out of post-tax profits may carry a tax credit for income tax already paid by the company. Franked dividends are exempted from dividend withholding tax by domestic law.

The withholding rate for unfranked dividends is 30 per cent unless reduced by a DTT, generally to 15 per cent.

The Finnish, German, Japanese, New Zealand, Norwegian, Swiss, UK and US treaties usually also reduce dividend withholding tax to zero for certain corporate shareholders (generally listed companies and their subsidiaries) that hold more than 80 per cent of the
Australian company’s shares, and to 5 per cent for a shareholder that is a company holding more than 10 per cent of the Australian company’s shares. The Chilean, French, South African and Turkish treaties also apply the 5 per cent concession.

Unfranked dividends are also exempted from dividend withholding tax by domestic law if paid from ‘conduit foreign income’ (see above), even if not franked.

Royalties are subject to 30 per cent withholding tax unless reduced by a DTT, generally to 10 per cent. The Finnish, French, German, Japanese, New Zealand, Norwegian, South African, Swiss, UK and US treaties reduce the rate to 5 per cent.

The term ‘royalty’ is broadly defined, and includes fees paid for the use of commercial property and rights. Recently negotiated treaties exclude natural resource payments and equipment royalties. (Interest withholding tax can apply to rental payments pursuant to cross-border leases structured as hire purchase arrangements.)

Royalties effectively connected with an Australian branch of a non-resident are treated as business profits and taxed on an assessment (i.e., net income) rather than withholding-tax basis.

Interest is generally subject to a 10 per cent withholding tax. A domestic law exemption applies to interest paid on debentures and other debt instruments (such as Eurobonds) offered publicly. The French, Finnish, German, Japanese, New Zealand, Norwegian, South African, Swiss, UK and US treaties also exempt interest paid to an unrelated financial institution.

Interest income that is effectively linked with an Australian branch of a non-resident is taxed in Australia on an income tax assessment rather than withholding-tax basis.

Any interest or royalty withholding tax payable must be paid before the local company is entitled to an income tax deduction for the relevant interest or royalty payment.

ii DTTs

Australia has comprehensive DTTs with 44 countries and Taiwan, including the United Kingdom, the United States, most western European countries, most Eastern and South East Asian countries and New Zealand. Australia also has tax information exchange agreements with an additional 36 countries, including low-tax jurisdictions, but has not negotiated any further information agreements after signing the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. It is a signatory to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, and to the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (Common Reporting Standard). Australia has entered into a ‘Model 1’ intergovernmental agreement with the US government, and has enacted domestic legislation to give effect to the US Foreign Account Tax Compliance Act for Australian financial institutions and intermediaries.

Australia’s DTTs generally follow the OECD model, but the US treaty follows the US model, and differences also exist in various other treaties. Recent treaties allocate rights to tax land-rich entities as well as real property.

Limitation of benefits articles are included in some of Australia’s more recent treaties, including the treaties with the United States, Germany and Japan. Australia’s treaties generally have not included anti-treaty shopping rules, but treaty benefits may be denied under Australia’s domestic general anti-avoidance rules in treaty shopping cases. Other recent treaties contain specific limitations within the dividend, interest and royalty articles.
and Articles 6 and 7 of the Multilateral Convention of BEPS measures will introduce anti-avoidance measures (changes to the Preamble and inserting ‘a principal purpose’ test) into some of Australia’s treaties.

The treaties generally override domestic law to the extent of conflict, subject to the operation of the general anti-avoidance rules referred to in Section IX.i.

iii Taxation on receipt
An exemption system applies to dividends received by Australian companies from non-portfolio (more than 10 per cent) shareholdings in foreign companies that are ‘equity’ under Australian tax law.

Dividends received by Australian companies from non-portfolio shareholdings that are ‘debt’ under Australian tax law and from portfolio (less than 10 per cent) shareholdings in foreign companies are taxable subject to an ‘offset’ (credit) for any withholding tax deducted at source. Foreign interest income is also taxable on receipt subject to an offset for withholding tax deducted at source.

Local dividends received by Australian companies are also taxable subject to an offset for any attached franking credits.

VII TAXATION OF FUNDING STRUCTURES
Foreign-owned Australian companies are often funded to the maximum extent possible by debt to ensure that tax is paid in the parent company jurisdiction rather than Australia. Interest payments can be deducted by the local Australian company at the company income tax rate, but are taxed to the foreign parent at the 10 per cent withholding tax rate.

Statutory rules determine whether an instrument is debt or equity. If an entity has an ‘effectively non-contingent obligation’ to repay the amount subscribed, the instrument will be debt for tax purposes such that returns on it are taxed as interest. Amounts repayable within 10 years are calculated in nominal terms, and amounts repayable outside 10 years are calculated in current value terms.

These rules can lead to, for example, redeemable preference shares being classified as debt for Australian tax purposes. Returns on non-share equity interests are taxed as dividends and can be franked.

i Thin capitalisation
Australia’s thin capitalisation rules limit the interest deductions otherwise available. The rules apply to foreign controlled Australian groups and Australian groups that invest overseas. The rules limit interest deductions (for inward and outward investors) where the amount of debt used to finance Australian operations exceeds the amount that could be borrowed at arm’s-length (i.e., from commercial lenders), judged by reference to strict statutory criteria. There are also ‘safe harbours’, which most groups choose to remain within: a maximum debt-to-equity ratio of 1.5:1 (15:1 for financial institutions); or gearing in Australia up to 100 per cent of the group’s worldwide gearing.

The thin capitalisation rules apply to all debt, including amounts owed to both related and unrelated parties, regardless of related-party support, and whether the lenders are Australian or foreign-resident.

Exemptions apply to taxpayers with interest deductions of less than A$2 million; and outward investors whose Australian assets make up 90 per cent or more of their total assets.
Separate rules apply to authorised deposit-taking institutions and are based on capital adequacy standards determined pursuant to Australian banking laws.

Domestic law extensions of Australia’s transfer pricing rules in 2012 also require Australian operations to have an arm’s-length capital structure, which can further restrict deductions for interest paid to related parties even within the thin capitalisation safe harbours. In addition, Australia’s Foreign Investment Review Board is actively considering tax aspects in deciding whether to approve significant foreign investment into Australia.

ii Deduction of finance costs
Generally, finance costs such as interest, discount, premiums and bank arrangement fees can be deducted provided they have the required nexus with assessable income, and subject to the thin capitalisation and transfer pricing rules. Asset acquisition finance costs are deductible in the same way as other finance costs.

Australia introduced a comprehensive accruals regime in 2010 to determine the timing of recognition of finance cost deductions.

iii Restrictions on payments
There are no currency exchange or other restrictions on payments to non-residents. Transactions with foreign countries are, however, monitored by an Australian government agency (AUSTRAC) under Australia’s anti-money laundering and anti-terrorism financing laws.

iv Return of capital
Companies can return capital to shareholders via a shareholder-approved reduction of share capital or an off-market share buy-back. There are various company law requirements for both procedures. Unlike a share buy-back, a return of capital does not involve sale of the shares, but reduces their tax cost base.

Australia does not have a profits first rule for tax, or otherwise. The character of a distribution generally reflects the source from which it is paid. However, there are anti-avoidance rules that recharacterise capital returns that are, in substance, disguised dividends. Notwithstanding this, the Australian Taxation Office (ATO) often effectively imposes a capital first rule for off-market share buy-backs. Because of these rules, companies often seek a tax ruling before returning capital.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition
Foreign companies acquiring existing Australian enterprises generally use an Australian-resident company as an acquisition vehicle. It can be used as a ‘head’ company for a new consolidated tax group that includes a target company; acquisition finance costs can then be offset against or ‘grouped’ with target company income, and target company asset cost bases can be stepped up to current market value.

ii Reorganisation
‘Scrip’ acquisitions of companies, whereby an acquirer company issues its own shares in return for target company shares, generally are not taxable sales provided the acquiring company
acquires at least 80 per cent of the target. The cost base for the target company shares are rolled over to the shares in the acquiring company. The rules apply to Australian shareholders regardless of whether the acquirer is an Australian or foreign company.

Tax relief is also available for demergers provided the demerging group owns at least 20 per cent of the demerged company, and distributes at least 80 per cent of its shares in the demerged company to its shareholders in proportion to their pre-existing shareholdings. The cost base of the recipient shareholders’ initial holding is spread over that holding and the demerged company’s shares in proportion to their market value. Any component of the demerger distribution that is properly classified as a dividend is tax-exempt, and the demerging company is exempt from capital gains tax on disposal of the shares in the demerged company.

### iii Exit

Non-residents are broadly only subject to capital gains tax on transactions involving taxable Australian property, which includes Australian real property; a holding of greater than 10 per cent of an Australian company whose value is mostly attributable to Australian real property; and assets used in carrying on business through an Australian PE. A non-final 12.5 per cent withholding tax also applies to the proceeds of a sale of real property and indirect real property interests by non-residents as mentioned in Section III.i. A sale of a foreign holding vehicle may be taxable in Australia if its value derives principally from Australian real estate held by subsidiaries.

A change of residence would trigger a taxable sale of all assets that do not remain taxable Australian property. However, it is not possible to change the residence of a company that was incorporated in Australia.

### IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

#### i General anti-avoidance

A general anti-avoidance rule – Part IVA – supplements other more specific anti-avoidance rules dealing with, for example, franking credit streaming and dividend stripping.

Part IVA applies to schemes entered into for the dominant purpose of gaining a tax benefit. A tax benefit is a reduction of assessable income or increase in tax deductions (including tax deferral), or access to a tax credit. The application of Part IVA is discretionary, but the Commissioner of Taxation is becoming less constrained in his use of it.

Part IVA prevails over other provisions of the Australian tax legislation and Australia’s tax treaties. If Part IVA is applied, the tax benefits will be denied and penalties imposed. Taxpayers can seek an advance ruling for an assurance that Part IVA will not be applied to a transaction.

In December 2015, the Multinational Anti-Avoidance Law (MAAL) extended the application of Part IVA to schemes for the avoidance of an Australian PE. It applies from 1 January 2016 to groups with worldwide income in excess of A$1 billion.

In May 2016, the government announced the introduction of two further BEPS-inspired measures: a 40 per cent diverted profits tax (DPT) commencing 1 July 2017, also applicable to groups with worldwide income in excess of A$1 billion; and anti-hybrid rules with effect from the later of 1 January 2018 or six months after enabling legislation has been passed.
Australia has also recently enacted rules to counter hybrid financial instruments and hybrid entities modelled on the OECD BEPS Action 2 report. This legislation also enacted a measure (the ‘integrity rule’) to counter the effect of deductible payments made to related entities located in low-tax jurisdictions. These rules commence in 2019.

ii Controlled foreign corporations
Australia’s controlled foreign company rules attribute Australian-resident companies their proportionate shares of income earned or gains made by foreign companies they control, regardless of distributions.

A foreign company is a ‘controlled foreign company’ if a group of five or fewer Australian entities, each individually controlling at least 1 per cent of the company, collectively controls at least 50 per cent of the company’s shares; a single Australian entity controls 40 per cent or more of the company, unless it is controlled by another person or group; or a group of five or fewer Australian entities controls the company.

Attributable taxpayers are 1 per cent interest holders within a group of five controllers, and other 10 per cent interest holders.

iii Transfer pricing
Australia’s domestic transfer pricing rules are tied to the OECD Transfer Pricing Guidelines. The rules apply to non-arm’s length cross-border transactions. The ATO has provided guidance in a number of public rulings on the meaning of ‘arm’s length’.

The rules give the Commissioner of Taxation discretion to adjust non-arm’s length outcomes to increase taxable income in Australia. Conversely, treaties can require Australia to reduce taxable income.

Taxpayers can apply for an advanced pricing agreement with the ATO for an assurance that international prices are arm’s length. The ATO released a Practical Compliance Guideline on pricing cross-border debt between related parties, which has proved to be controversial.

Legislation enacted in December 2015 introduced a country-by-country (CbC) reporting regime. Multinational entities with worldwide income in excess of A$1 billion are required to comply with CbC reporting requirements for income years commencing on or after 1 January 2016.

iv Tax clearances and rulings
The ATO can and does make binding rulings in relation to all sorts of transactions and circumstances. Rulings can be either public or private; a private ruling is only binding for the transaction it relates to, and only insofar as the transaction is accurately described in material respects.

While not mandatory, complicated and large transactions are commonly supported by tax rulings.

X YEAR IN REVIEW
Rather than a year of new bold initiatives (compare the Tax Cuts and Jobs Act in the US), in Australia 2018 was a period for ‘bedding down’ the many major changes recently made to domestic and international tax laws.

In international tax, this has meant 2018 was a period for detailed reflection by practitioners and administrators on measures such as the MAAL, the DPT, the anti-hybrid
rules and the ‘integrity rule’, and more nuanced analysis of Australia’s (relatively) new transfer pricing rules. The ATO is no doubt starting to collect and analyse the information arising from CbC reporting and the exchanges occurring under the Common Reporting Standard, though we have yet to see any cases based on this information. Australia deposited its instrument of ratification of the OECD Multilateral Convention on BEPS in September 2018 and so the ATO has been working on how to implement some of the measures in the Convention, importantly the procedures for mandatory binding arbitration of tax disputes. The government also rewrote some key elements of the rules affecting non-residents investing into Australian real estate and infrastructure projects.

In domestic tax, greater attention has been paid by the government to the problem of tax evasion in the underground economy, with new measures gradually being introduced directed especially at the problem of ‘phoenix companies’. The government abandoned its three-year effort to secure a staged reduction of the corporate tax rate for all Australian companies from 30 per cent to 25 per cent over 10 years, settling instead for further reductions to the rate for small companies. The political enthusiasm for the reduction has probably evaporated and the economic pressure for a general reduction may have dissipated as well, with the increasing levels of foreign investment and unexpected increases to (corporate) tax revenue realised in the second half of the year.

XI OUTLOOK AND CONCLUSIONS
The outlook for large corporate taxpayers seeking to invest into Australia remains somewhat mixed, at least so far as tax law is concerned. The government no doubt remains committed to attracting new foreign investment and work continues on the design of a new form of company – a corporate collective investment vehicle or ‘CCIV’ – which will enjoy transparent tax treatment and is being developed specifically with foreign investors in mind. Yet many of the measures enacted in the past three years have been squarely targeted at increasing the tax exposure for foreign investors – the MAAL, the DPT, the anti-hybrid rules, the ‘integrity rule’ and the changes to real estate stapled groups, infrastructure investments and sovereign wealth funds are all focused on non-residents. While these measures are all notionally directed at abusive tax practices, the possibility of unforeseen and deleterious tax consequences and protracted disputes with the ATO cannot be dismissed as fanciful.

In October 2018, Treasury released a Paper examining options for taxing the income of companies operating in the digital economy but it seems clear the government has yet to decide just how to handle the issue. The announcement in November of a future digital services tax for the UK may prompt the Australian government to take similar action.
Chapter 2

AUSTRIA

Niklas JRM Schmidt and Eva Stadler

I INTRODUCTION

Austria, one of the wealthiest countries in the world and an EU Member State, continues to attract investors owing to its stable political and social situation and its geographical position in the centre of Europe. Apart from proximity, historical ties to the countries of Central and Eastern Europe (CEE) have made Austria a very attractive location for multinationals to choose as their base of operations regarding CEE.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate

The most commonly used form of Austrian business organisation for inbound investments is the limited liability company (GmbH). Owing to its less burdensome corporate governance requirements, it is generally preferred by investors to the more complex stock corporation (AG), a corporate form that has to be used if a listing on a stock exchange is being considered.

Both entities are subject to Austrian corporate income tax on their income. Shareholders are taxed separately on dividends received from these corporations.

ii Non-corporate

Partnerships, such as the general partnership (OG) or the limited partnership (KG), are of lesser relevance for inward investments into Austria. In a general partnership, all partners are subject to unlimited liability for the partnership’s debts and obligations, while in a limited partnership, only one partner must have unlimited liability. A structure commonly seen is the GmbH & Co KG; this is a limited partnership with the general partner being a limited liability company.

Partnerships are treated as transparent for Austrian tax purposes. Thus, the income of a partnership is not taxed at the level of the partnership, but rather attributed to its partners and subject to (corporate) income tax at the level of the partners.

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III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

Austrian tax-resident corporations are taxed on their worldwide income. The tax base for income from an active trade or business is generally the profit as shown in the financial statements. Adjustments have to be made where mandatory tax provisions deviate from financial accounting rules. Profits are generally taxed on an accruals basis.

As a general rule, expenses incurred in acquiring, securing and maintaining taxable income are tax deductible. The following types of expenses are, however, partly or fully non-deductible: restaurant expenses, penalties and fines, income taxes, remunerations paid to supervisory board members, remunerations paid to employees and managers exceeding €500,000 per person per year, and expenses in connection with earning tax-exempt income. As explained below in further detail, certain interest and royalty expenses may also be non-deductible.

Assets subject to wear and tear are in general depreciated on a straight-line basis over their ordinary useful life. If in the tax year of purchase or construction an asset is used for more than six months, the yearly depreciation amount applies; otherwise, only half of the yearly depreciation amount may be deducted from the tax base. Depreciation for extraordinary technical or economic loss in value is possible. For certain assets the statute mentions the depreciation rates to be used, namely buildings (generally 2.5 per cent), goodwill (6.67 per cent) and cars (12.5 per cent). Assets having an acquisition cost of not more than €400 can be fully depreciated in the year of purchase.

Only the following provisions are deductible for tax purposes: provisions for severance payments, provisions for pension payments, provisions for other contingent liabilities and provisions for anticipated losses from pending transactions.

Capital and income

Regarding Austrian tax-resident corporations, there is no distinction between the taxation of capital gains and the taxation of ordinary income in Austria. As regards personal income taxation, flat tax rates are applicable to specific types of income, including capital gains from the sale of financial assets and real estate (see below).

Losses

Under Austrian law, tax losses carried forward from past years reduce the corporate income tax base. The utilisation of such losses carried forward is limited to 75 per cent of the income of the respective year in the case of corporations (no time limit applies). A carry-back of losses is not permitted.

A corporation’s tax loss carry-forwards are forfeited upon an ownership change if there is a material change in its organisational (e.g., replacement of all directors of the corporation), economic (e.g., a new area of business is pursued by the corporation) and shareholder structure (e.g., the majority of shareholders of the corporation are replaced).

Rates

Corporate income tax is levied at a rate of 25 per cent. In the event that a corporation has not made a profit, a minimum corporate income tax in an amount of 5 per cent of the statutory minimum stated capital of a corporation is due. For example, in the case of a limited liability
company this minimum corporate income tax generally amounts to €1,750 per year, and in the case of a stock corporation it amounts to €3,500 per year, with lower rates applying to limited liability companies for the first 10 years. Minimum corporate income tax is creditable against the final amount of corporate income tax assessed for that and the following tax years. Apart from corporate income tax, no other taxes or surcharges are levied on a corporation’s income.

**Administration**

The tax year is generally the calendar year. Corporations may, however, apply to the tax authorities for permission to use a different tax year, if reasons other than tax considerations exist for such application.

Corporate income tax returns must be filed electronically by 30 June of the year following the tax year (in the case of paper-based filings, the deadline is 30 April). Taxpayers making use of tax advisers benefit from longer deadlines. An extension of the filing date is possible in justified cases. Failure to file generally triggers a penalty.

Quarterly prepayments of corporate income tax are due on 15 February, 15 May, 15 August and 15 November. Such prepayments are creditable against the final amount of tax assessed. Any balance is payable within one month after receipt of the tax assessment notice.

Assessment notices of the competent tax office can be challenged before the Austrian Federal Tax Court.

**Tax grouping**

Austria has a group taxation regime for affiliated companies. Affiliated companies are those that are connected through a direct or indirect participation of more than 50 per cent of the nominal capital and voting power. Such participation must exist throughout the entire fiscal year of the member of the tax group (and in total for at least three years).

The formation of a tax group results in 100 per cent of the taxable income of each resident member of the group being attributed to the top-tier company in the tax group. In the case of non-resident companies that are members of a tax group, only negative income of such companies is attributed to the top-tier company, and only on a pro rata basis (this makes the utilisation of foreign losses possible; note that this is only of a temporary nature, with a claw-back provision applying). In the case of losses of non-resident companies there is a limitation insofar as only losses amounting to 75 per cent of the sum of the income of the top-tier company in a tax group and the Austrian-resident members of the tax group may be offset immediately.

ii Other relevant taxes

**Value added tax**

Austria levies value added tax in line with the pertinent EU directives at a standard rate of 20 per cent. Reduced rates of 10 and 13 per cent apply to certain supplies. There are a number of exemptions applicable (e.g., for financial services and health services).
Austria

Real estate transfer tax
The transfer of Austrian real estate triggers real estate transfer tax. In the case of a sale of Austrian real estate the tax base is generally the purchase price, and the tax rate amounts to 3.5 per cent. In addition, a 1.1 per cent court registration fee based on the fair market value of the property transferred falls due.

Further, real estate transfer tax at a rate of 0.5 per cent of the fair market value of the real estate is triggered if Austrian real estate is part of the assets of a corporation or a partnership, and at least 95 per cent of the shares in such corporation or interests in such partnership are pooled in the hand of a single buyer or in the hand of a tax group. The same applies in the case of a partnership holding Austrian real estate if at least 95 per cent of the interests in such partnership are transferred to new partners within a period of five years.

Stamp duty
Austria levies stamp duties on a wide range of legal transactions, including, *inter alia*, assignment agreements, lease agreements and surety agreements, if a written deed evidencing such stamp-dutyable transaction is signed and a certain Austrian nexus exists. However, these stamp duties can in many cases be avoided by way of careful structuring.

Bank tax
Austria levies a bank tax on the adjusted balance sheet total of credit institutions licensed pursuant to the Austrian Banking Act and foreign credit institutions authorised under the Austrian Banking Act to carry out banking business in Austria by way of a branch (in the case of the latter, only the balance sheet total attributable to the Austrian operations is taken into account).

Wage tax
While income tax is levied by way of assessment, income tax on employment income is in general levied by way of withholding by the employer (provided that the employer has a permanent establishment in Austria). Such wage tax is a prepayment of the employee’s final income tax and is credited against the employee’s assessed income tax liability if the taxpayer files (voluntarily or in certain cases on an obligatory basis) an annual tax return.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence
Corporations having their legal seat, their place of effective management, or both, in Austria are deemed to be tax residents of Austria, and are thus subject to unlimited corporate income tax in Austria on their worldwide income. The legal seat of a corporation is the place defined as such by law, by contractual agreement, in its articles of association, etc. The place of effective management of a corporation is the place where all the measures are taken that are required and essential for the management of the corporation.

ii Branch or permanent establishment
Corporations having neither their legal seat nor their place of effective management in Austria are taxable only on specific types of income with an Austrian nexus, which are exhaustively enumerated in the statute. This, *inter alia*, includes income from an Austrian permanent
establishment, which is defined as a fixed place of business through which the business of an enterprise is wholly or partly carried out. A permanent establishment for Austrian domestic tax purposes is quite similar to the OECD concept.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes

Under the national participation exemption, dividends received by an Austrian corporation from its Austrian subsidiary are exempt from corporate income tax regardless of the extent of the participation or the holding period.

Under the international qualified participation exemption, an Austrian corporation is exempt from corporate income tax on dividends received from a foreign subsidiary or capital gains realised on the alienation of shares in that foreign subsidiary if the parent demonstrably holds a participation of at least 10 per cent of the stated share capital of the foreign subsidiary for a minimum duration of one year, and if the foreign subsidiary qualifies as a company of a Member State pursuant to Article 2 of the EU Parent–Subsidiary Directive or is legally comparable to an Austrian corporation.

Under the international portfolio participation exemption, an Austrian corporation is exempt from corporate income tax on dividends received from a foreign subsidiary, regardless of the participation or the holding period, if the Austrian international qualified participation exemption outlined above is not applicable, and if the foreign subsidiary qualifies as a company of a Member State pursuant to Article 2 of the EU Parent–Subsidiary Directive or is legally comparable to an Austrian corporation and has its legal seat in a state with which Austria has agreed to the comprehensive exchange of information. This exemption does not cover capital gains.

These participation exemptions are subject to special anti-abuse provisions outlined below. Further, they do not apply to payments received from foreign subsidiaries under hybrid instruments if such payments are tax deductible at the level of the foreign subsidiary.

ii IP regimes

Austrian tax law provides that companies conducting qualified research and development activities may claim a credit (over and above the full deduction of the expense) equal to 14 per cent of eligible expenses.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)

Dividends distributed by Austrian corporations to their (resident or non-resident) shareholders are subject to Austrian withholding tax at a rate of generally 27.5 per cent.

Royalties paid to non-residents are subject to Austrian withholding tax at a rate of 20 per cent.

Interest on loans (not in the form of bonds) is not subject to Austrian withholding tax.
Certain services rendered by non-residents are subject to Austrian withholding tax at a rate of 20 per cent. This category includes:

a remunerations in connection with an occupation as an author, lecturer, artist, architect, sportsperson or performer in Austria;
b payment for a right of use regarding works protected by copyrights or industrial property rights;
c supervisory board remunerations; and
d payment for commercial or technical consulting work.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

As an EU Member State, Austria applies the EU Parent–Subsidiary Directive and the EU Interest and Royalties Directive.

Pursuant to the Austrian provisions implementing the EU Parent–Subsidiary Directive, the distribution of dividends is fully exempt from Austrian withholding tax if the recipient of the dividends is a company of a Member State pursuant to Article 2 of the EU Parent–Subsidiary Directive that has held at least 10 per cent of the capital in the paying company for an uninterrupted period of at least one year and meets certain substance requirements.

Similarly, pursuant to the Austrian provisions implementing the EU Interest and Royalties Directive, the payment of royalties is fully exempt from Austrian withholding tax if the recipient of the royalties is an associated company of another Member State. A company is an associated company of a second company if, at least, the first company has a direct minimum holding of 25 per cent in the capital of the second company or the second company has a direct minimum holding of 25 per cent in the capital of the first company, or a third company has a direct minimum holding of 25 per cent both in the capital of the first company and in the capital of the second company. Such holdings must apply for an uninterrupted period of at least one year.

iii Double tax treaties

There are currently 88 treaties in force in Austria. Austria generally follows the OECD Model Convention and the commentary thereto in respect of its treaty policy and interpretation. Since under Austrian rules of interpretation the more specific provision takes precedence over the more general provision, double tax treaties generally take priority over domestic law.

VII TAXATION OF FUNDING STRUCTURES

i Thin capitalisation

There are no statutory thin capitalisation rules in Austria. However, the Austrian Supreme Administrative Court has established certain broad guidelines that are used to determine whether the equity funding at hand is adequate for the purposes of taxation. If the equity is inadequate, a portion of the indebtedness to shareholders may be regarded as the equivalent of shareholders’ equity. Interest paid on such debt may not be deducted from the taxable income and may be subject to withholding. In practice, debt-to-equity ratios of 4:1 are not uncommon.
ii  **Deduction of finance costs**

In general, interest (including interest incurred in connection with the acquisition of an Austrian or non-Austrian participation) may be fully deducted from a corporation’s tax base. Two restrictions regarding deductibility apply.

Firstly, financing costs incurred in connection with the acquisition of shares that were directly or indirectly purchased from a group company or from a controlling shareholder are not deductible.

Second, no deduction is possible for interest paid to a corporation if the payer and recipient are, directly or indirectly, part of the same group, or have, directly or indirectly, the same controlling shareholder; and the interest paid at the level of the recipient (or the beneficial owner, if different) is:

- *a* not subject to corporate income tax owing to a comprehensive personal or material tax exemption;
- *b* subject to corporate income tax at a rate of less than 10 per cent;
- *c* subject to an effective tax rate of less than 10 per cent owing to an applicable reduction; or
- *d* subject to a tax rate of less than 10 per cent owing to a tax refund (here, tax refunds to the shareholder are also relevant).

The latter provision also applies to royalties.

iii  **Restrictions on payments**

Under Austrian corporate law, Austrian corporations may only pay out dividends to their shareholders to the extent they have sufficient balance sheet profits.

iv  **Return of capital**

As mentioned above, dividends paid out by Austrian corporations to shareholders trigger a withholding tax of generally 27.5 per cent. However, the repayment of capital – whether resulting from a formal capital reduction or from the distribution of capital reserves – does not trigger withholding tax under Austrian domestic law. Such repayment of capital reduces the tax basis of the shares (which might be relevant in the case of a later sale: if the repayment of capital exceeds the tax basis, the excess is considered a capital gain, which is generally taxable). Austrian companies must keep a capital account for tax purposes to document the amount distributable as a repayment of capital.

**VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES**

i  **Acquisition**

Austrian businesses are typically acquired by way of a share deal (rather than by way of an asset deal), with the shares in the Austrian company being purchased by a special purpose vehicle in a country with a favourable participation exemption.

ii  **Reorganisation**

Under Austrian corporate law, many types of reorganisations are possible, including mergers, demergers, conversions of partnerships into corporations and *vice versa*, and share-for-share exchanges.
While such transactions would under the general tax law rules normally constitute a taxable event (making them prohibitively expensive), the Austrian Reorganisation Tax Act allows such restructurings to be carried out in a tax-free manner if certain prerequisites are met.

iii Exit
If, owing to the relocation of a business abroad, Austria loses its right to tax hidden reserves contained in these assets, then corporate income tax is generally triggered on the hidden reserves at the time of exit. Relief might be possible if Austria’s right to tax is lost as regards an EU Member State or a state that is a party to the Agreement on the European Economic Area.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance
Under Austrian tax law, there is the principle that taxpayers are free to arrange their economic affairs in the manner they deem most beneficial to themselves, which includes choosing those structures and approaches that incur the least tax costs. Nevertheless, Austrian law contains a general anti-abuse provision pursuant to which one’s tax liability cannot be avoided by abusing the legal forms or methods available under civil law. If such an abuse has been established, tax may be levied at the amount it would have been in case of a legal arrangement that is genuine in view of economic processes, facts and circumstances, had such abuse not occurred. Additionally, an action not seriously intended by the parties (i.e., a sham transaction) but performed only to cover up facts that are relevant for tax purposes will be disregarded and the applicable taxes will be based on the facts the taxpayer sought to conceal. In addition, various specific anti-abuse provisions exist, for example, a switchover clause in connection with the international participation exemptions discussed immediately below.

ii Controlled foreign corporations (CFCs)
In order to transpose the EU Anti Tax Avoidance Directive, Austria, inter alia, introduced CFC legislation. Pursuant thereto, for financial years starting after 31 December 2018, non-distributed passive income of a low-taxed CFC (wherever resident) shall be included in the tax base of the controlling corporation if the following prerequisites are fulfilled:

a the passive income of the CFC exceeds one-third of its total income (the income is to be calculated in line with Austrian tax provisions, whereby tax-exempt dividends and capital gains are also taken into account when calculating the total income);

b the controlling corporation – alone or together with its associated enterprises – holds a direct or indirect participation of more than 50 per cent of the voting rights or owns, directly or indirectly, more than 50 per cent of the capital or is entitled to receive more than 50 per cent of the profits of the CFC;

c the CFC does not carry out a substantive economic activity supported by staff, equipment, assets and premises (in case a substantive economic activity exists, the controlling corporation has to furnish proof thereof); and

d the CFC is low-taxed, meaning that its effective foreign tax rate is not more than 12.5 per cent (to determine the effective foreign tax rate, the foreign company’s income is to be calculated in line with Austrian tax provisions and compared to the foreign tax actually paid).
In the event the CFC provision kicks in, the amount of the CFC’s passive income to be included in the tax base of the controlling corporation is calculated in proportion to the (direct or indirect) participation in the nominal capital of the CFC; if the profit entitlement deviates from the participation in the nominal capital, then the profit entitlement ratio is decisive. The passive income of the CFC is included in that financial year of the controlling corporation in which the CFC’s financial year ends. Losses of the CFC, if any, are not to be included.

The CFC rules also apply to Austrian corporations having their place of management outside of Austria and to foreign permanent establishments (even if an applicable double tax treaty provides for a tax exemption in Austria).

Further, dividends and capital gains from the following types of subsidiaries do not benefit from the international participation exemptions outlined above, but are taxable (and a credit is given for underlying taxes in the case of dividends), if they are low-taxed and have a predominant focus on earning passive income:

- **a** shareholdings of at least 10 per cent held for a minimum duration of one year in a foreign subsidiary qualifying under the EU Parent Subsidiary Directive or being legally comparable to an Austrian corporation; and
- **b** shareholdings of at least 5 per cent in a foreign subsidiary qualifying under the EU Parent Subsidiary Directive or in a foreign subsidiary being legally comparable to an Austrian corporation and having its legal seat in a state with which Austria has agreed to the comprehensive exchange of information.

This switchover provision does not apply if passive income has demonstrably been taken into account under the CFC provision mentioned above.

Both the CFC rules and the switchover provision are not applicable to foreign financial institutions if not more than one-third of the passive income stems from transactions with the Austrian controlling corporation or its associated enterprises.

### iii Transfer pricing

Pursuant to the case law of the Austrian Supreme Administrative Court, agreements between related parties (e.g., between the shareholder and its company) are only recognised for tax purposes if they have been concluded in writing, if their content is unambiguous and if they have been concluded in accordance with the arm’s-length principle (i.e., on terms that unrelated parties would have agreed upon). The Austrian tax authorities in practice follow the OECD Transfer Pricing Guidelines in this respect. Pursuant to the Austrian Transfer Pricing Documentation Act, multinational groups with consolidated group revenues of at least €750 million in the preceding fiscal year are required to prepare a country-by-country report, which Austria will automatically exchange with other countries. Additionally, the Act obliges a separate business unit (which is tax-resident in Austria and which has had revenues of at least €50 million in the two preceding fiscal years) of a multinational group to prepare transfer pricing documentation in the form of a master file and a local file.

### iv Tax clearances and rulings

A legally binding formal tax ruling procedure exists in connection with questions concerning restructurings, tax groups, international tax law, value added taxation (as of 1 January 2020) and the existence of abuse of law. If certain formal prerequisites are met, the competent tax office must issue a tax ruling, generally within a period of two months from application.
This ruling has to contain the facts and statutory provisions on which it is based, a legal assessment of the facts and the time frame during which it is valid. In addition, the applicant may be required to report on whether the facts of the case have been implemented and also on whether the implemented facts are different from those outlined in the request. A fee of between €1,500 and €20,000, depending on the applicant’s annual turnover, is due in conjunction with any such request.

X YEAR IN REVIEW

The Austrian legislator was not very active in 2018 of its own accord. Most of the tax laws passed in that year were the result of EU developments or developments at an international level (in particular in relation to the Anti Tax Avoidance Directive).

XI OUTLOOK AND CONCLUSIONS

Austria, as a wealthy and sophisticated jurisdiction with a stable political system in the centre of the EU, will remain a strong candidate for inward investment for years to come.
I INTRODUCTION

Belgium offers a wide range of tax-planning opportunities for companies (and Belgian branches). At first glance, the rather high corporate income tax rate (29.58 per cent) and the absence of a fiscal consolidation regime ought to restrain foreign investors from making an investment in Belgium; however, Belgium plays an important role in the international tax arena as a result of some advantageous features of the tax system resulting in planning opportunities for companies.

These advantageous features, further discussed in this chapter, include:

a the participation exemption, which virtually exempts income from qualifying subsidiary companies (i.e., dividends received and capital gains on shares);

b the notional interest deduction regime, which reduces the effective corporate income tax rate;

c the extensive and beneficial tax treaty network;

d the deductibility of finance costs;

e the application of the EU Parent-Subsidiary Directive to all tax treaty countries;

f the ruling practice, allowing companies to obtain a legally binding advance opinion from the Belgian tax authorities on various tax issues;

g the absence of capital tax and of a net wealth tax; and

h the innovation income deduction (IID).

An important modification of the corporate income tax system was enacted at the end of 2017 and mid-2018, including a decrease of the nominal corporate income tax rate to 25 per cent as from 2020.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

A new Companies Code is currently under discussion in the Belgian parliament. The bill is expected to be approved at the end of 2018 or beginning of 2019 and would apply as of 1 May 2019. The section below is based on the Companies Code as applicable at the time of writing.

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Belgium

Corporate

In Belgium, businesses generally conduct their activities through a subsidiary that adopts a corporate form. Several legal forms exist under Belgian law, but the most commonly used are:

- the public limited liability company (NV or SA); and
- the private limited liability company (BVBA or SPRL).

Originally, the NV/SA was mainly seen as a vehicle for medium-sized or large undertakings, whereas the BVBA/SPRL was intended to be used for small businesses where management and ownership often coincide. To this day, the BVBA/SPRL is used most often for smaller (privately owned) businesses. Large multinational groups most often incorporate their Belgian subsidiaries under the form of an NV/SA (although some may opt for the BVBA/SPRL for foreign tax transparency reasons). Under the new Companies Code, a more modern version of the BVBA, the BV/SRL, will be introduced. The BV/SRL will offer more flexibility in terms of governance, funding and distribution of proceeds.

From a Belgian tax perspective, an NV/SA and a BVBA/SPRL (BV/SRL) are subject to the same corporate tax rules.

<table>
<thead>
<tr>
<th>NV/SA</th>
<th>BVBA/SPRL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registered or dematerialised shares</td>
<td>Registered shares only</td>
</tr>
<tr>
<td>Shares are freely transferable (limitations on transferability possible but subject to statutory restrictions)</td>
<td>Shares are not freely transferable</td>
</tr>
<tr>
<td>Issue of profit shares, warrants and convertible bonds possible</td>
<td>No issue of profit shares, warrants or convertible bonds possible</td>
</tr>
<tr>
<td>Board of directors with possibility to delegate daily management power, install a management committee, or both</td>
<td>One or more managers (board optional) without possibility to delegate daily management power, install a management committee, or both</td>
</tr>
<tr>
<td>Minimum capital: €61,500</td>
<td>Minimum capital: €18,550</td>
</tr>
<tr>
<td>Possibility to solicit public funds and obtain quotation on the stock exchange</td>
<td>No possibility to solicit public funds or obtain quotation on the stock exchange</td>
</tr>
</tbody>
</table>

In addition, several forms of real estate investment companies with fixed capital for investment in real estate exist; for example, the specialised real estate investment fund (SREIF).

The SREIF is dedicated to institutional investors. Its shares may be held by institutional and professional investors. It is not listed on any stock exchange, but must be registered in a special list by the Federal Public Service Finance (i.e., the Ministry of Finance).

Important legal requirements for the new vehicle include the following:

- it must have an investment policy;
- it must be established for a minimum period of 10 years, which may be renewed by periods of five years each;
- its accounting records must be kept in accordance with international financial reporting standards (IFRS); and
- at least 80 per cent of its net profits must be distributed.

SREIFs are taxed in the same manner as regulated real estate companies. This means that they are subject to corporate income tax. However, the taxable base only includes exceptional or gratuitous benefits received and costs and expenditure not deductible as professional costs.
This means, inter alia, that dividends, interest, capital gains on real estate assets and rental income are exempt.

Dividends distributed by SREIFs to Belgian corporate shareholders arising from foreign-taxed income benefit from the participation exemption regime. Such income includes income from foreign real estate and foreign dividends.

Dividends distributed by SREIFs arising from foreign income that has been taxed in the foreign country are exempt from dividend withholding tax.

An ‘exit tax’ is levied on Belgian real estate attributed to a SREIF through conversion of an existing company, a (de)merger or a contribution. The tax is due on unrealised capital gains at a favourable tax rate of 12.75 per cent (increased to 15 per cent as of 2020). This tax also applies if Belgian real estate assets are contributed to a SREIF.

Management services rendered for the benefit of a SREIF will be exempt from VAT to the extent that these services are specific to and essential for managing the SREIF. The SREIF is subject to the annual tax on collective investment institutions. This tax is levied at a rate of 0.01 per cent of its total net assets.

ii Non-corporate
In Belgium, the use of non-corporate entities remains relatively limited. The most commonly used forms are:

- the limited partnership;
- the partnership limited by shares;
- the general partnership;
- the partnership;
- the temporary commercial company; and
- the undisclosed company.

The partnership limited by shares is often used in structuring succession planning. The temporary commercial company is used in the framework of structuring certain (development) projects, such as large construction works. The undisclosed company is sometimes used to structure joint ventures.

The limited partnership, the partnership limited by shares and the general partnership have a separate legal personality, and are therefore treated as non-transparent entities. Consequently, they are subject to corporate income tax at the level of the partnership.

The partnership, the temporary commercial company and the company in participation have no separate legal personality, and are treated as transparent entities for tax purposes. Tax is, therefore, not levied at the level of the partnership, but in the hands of the different partners. Each partner will be apportioned his or her share of the profits and the losses of the partnership in accordance with the relevant provisions of the partnership agreement.

The existence of some entities that have a separate legal personality but that are nevertheless treated as tax-transparent entities should be noted. This is, for example, the case for the economic interest grouping.
III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

Companies are subject to Belgian corporate income tax if they meet all three of the following conditions:

a they are validly incorporated and have a separate legal personality;
b they carry out a business or are engaged in profit-making activities; and
c they have their registered office, main establishment or place of management in Belgium.

Corporate income tax is levied on the total worldwide profit realised by a company, including distributed dividends. The profits are taxed on an accruals and not a receipts basis.

Contrary to, for example, the Netherlands, Belgium does not recognise the concept of a separate fiscal balance sheet. The taxable income of resident companies is, therefore, determined on the basis of the financial accounts and the accounting rules, unless the tax laws provide otherwise (such as for transfer pricing adjustments).

In general, all business expenses are tax-deductible to the extent that they are borne in order to obtain or preserve taxable income; however, special tax provisions limit the tax deductibility of certain items, such as fines, certain social benefits granted to employees, 31 per cent of restaurant expenses, some regional taxes, up to 50 per cent of car expenses (depending on the carbon dioxide emission factor of the car), a 40 per cent portion of the fringe benefit related to company cars (including fuel cards), granted non-at arm’s length benefits, clothing costs, capital losses on shares and write-downs on shares. In addition, the corporate income tax paid constitutes a non-deductible item. Please note that the (formula that determines the) percentage of tax deductibility for car expenses will be amended as of 2020 (i.e., tax assessment year 2021 relating to the taxable period starting at the earliest on 1 January 2020).

The depreciation of establishment costs, tangible assets and intangible assets constitutes a tax-deductible item to the extent that it is necessary and corresponds to a decline in value that actually occurred during the taxable period. Belgian tax law currently allows the use of both straight-line depreciation and declining-balance depreciation. However, the latter method can only be used for certain assets and cannot be applied to intangible assets, for example. The double declining depreciation method is abolished as of 1 January 2020. Goodwill acquired from third parties may be depreciated (as a rule, over five years).

Minimum taxable basis

A minimum taxable basis has been introduced as of 1 January 2018. The deduction of certain tax attributes is limited to 70 per cent of the remaining taxable result exceeding €1 million. In other words, a minimum taxable basis equal to 30 per cent of the remaining taxable result that exceeds this amount is introduced.

The minimum taxable basis is calculated as follows: first, the result of the taxable period is determined under the normal rules. Then, in the following order, dividends received deduction of the year, patent income deduction, innovation income deduction, investment deduction and (as of 2019) the group contribution pursuant to the tax consolidation regime are deducted (i.e., ‘fully deductible tax attributes’). If after the above-mentioned deductions the remaining taxable basis exceeds €1 million, the following deductions can only be applied to 70 per cent of the taxable basis exceeding €1 million, again in the following order: the current
year notional interest deduction, carry-forward dividends received deduction, carry-forward innovation income deduction, carry-forward tax losses, and finally, carry-forward notional interest deduction. The excess can be carried forward to the following years. An exception to the minimal taxable basis exists for carry-forward tax losses incurred by start-up companies that qualify as small or medium-sized enterprises (SMEs) during the first four taxable periods.

**Capital and income**

In Belgium, there is no separate capital gains tax. Capital gains are, therefore, taxed as ordinary profits.

Unrealised capital gains that are recorded on certain assets remain untaxed if they are booked in a special blocked reserve account on the liabilities side of the balance sheet. Note, however, that unrealised capital gains on stocks and orders are taxable.

Capital gains realised by a company upon the sale of any asset are, in principle, included in the taxable basis of the company. Two exceptions must be mentioned in this respect.

First, capital gains realised on shares qualifying for the participation exemption regime (see below) are fully exempt from corporate income tax.

Second, it is possible to apply a deferred taxation regime on capital gains realised on fixed tangible and intangible assets that, at the time of the disposal, have been owned by the company for at least five years already. It must be noted that intangible assets qualify only under the deferred taxation regime if they have been depreciated. Consequently, capital gains realised on, for example, a self-established client base cannot benefit from the deferred taxation.

The capital gains realised on the qualifying assets will only benefit from the deferred taxation if the entire selling price (thus, not only the capital gain realised) is reinvested in intangible or fixed tangible assets that are used in the European Economic Area and that can be depreciated (thus, for example, not in land).

The total reinvestment must, in principle, be implemented before the end of the third year following 1 January of the year during which the assets were sold. It is important to note that the term for reinvestment is increased to five years in the case of reinvestment in real estate (other than land), planes or ships.

If the reinvestment is made in qualifying assets and in due time, the capital gain realised is only taxable in proportion to the annual depreciation on the fixed assets in which the reinvestment is made. If the total selling price is not reinvested within the aforementioned terms, the capital gain realised will be taxable in the tax year during which the reinvestment period has expired. As of tax assessment year 2019 (related to a taxable period starting at the earliest on 1 January 2018), this will equally be the case if the capital gain becomes taxable prior to the expiry of the reinvestment period if no reinvestments were (fully) made. In this respect, an anti-abuse provision is introduced as well in order to avoid that a tax-free reserve for spread taxation of capital gains is recorded in order to benefit from the new lower tax rates (that are introduced as of 2018 – see rates below) upon reversal at a later stage: a reversal of such reserve that is recorded during a taxable period that starts at the earliest on 1 January 2017 and ends at the latest on 30 December 2020 will be taxed at the tax rate that was applicable when the reserve was recorded if (1) the capital gain becomes taxable prior to the expiry of the reinvestment period without the required reinvestments being made or (2) the capital gain becomes taxable because the company did not reinvest in a timely manner. Furthermore, interest for late payment will be due.
**Losses**

Losses incurred by a Belgian company can be carried forward without limitation. They cannot, however, be carried back.

Losses carried forward may be proportionally reduced (or even cancelled) if the company is involved in a tax-neutral restructuring (merger, spin-off, etc.).

The losses carried forward will, moreover, be cancelled upon a change in control over the company that does not correspond to legitimate financial or economic needs. For these purposes, ‘control over a company’ is defined as the ability to exercise a decisive influence on the appointment of the majority of the directors or on the orientation of the company’s policy.

Even if there is a change in control, the losses carried forward will not be cancelled if it can be established that the change in control corresponds to legitimate financial or economic needs. With respect to the presence of the latter, one can request an advance ruling from the Belgian tax administration. From a number of published advance rulings, one can deduct that legitimate financial or economic needs will be deemed present if the following conditions are (cumulatively) met:

\begin{enumerate}
\item the change in control forms part of an (international) reorganisation of the group that has the objective of rationalising or simplifying the group structure in view of the development of new activities or the strengthening of the market position; and
\item the transactions envisaged (causing the change in control) are aimed at ensuring the continued existence of the company, maintaining the present employment, and continuing or even expanding the present activities of the company.
\end{enumerate}

The crucial criterion in this discussion seems to be the maintaining of the activities and the employment after the change of control.

Tax losses incurred by a PE of a Belgian company or with respect to assets of such a company located abroad and of which the income is exempt in Belgium by virtue of a double tax treaty can no longer be deducted from the Belgian taxable basis as of tax assessment year 2021 (relating to the taxable period starting at the earliest on 1 January 2020). The tax treatment of these losses in the foreign state is irrelevant. An exception is made for definitive losses within the EEA. Definitive losses are losses that exist in a certain Member State upon the final termination of the activity or possession of the asset if these losses have not been deducted in that state and cannot be deducted by another tax subject in that state. If an activity is restarted within three years after the termination, there is a recapture of the losses deducted from the Belgian taxable basis.

**Capital losses**

Losses originating from the transfer of assets are first set off against other positive income. If these losses exceed the positive income, they are treated as ordinary losses.

Capital losses on shares are, in principle, not tax-deductible. The only exception to this rule is that the loss incurred on the liquidation of a company in which shares are held remains deductible up to the loss realised on the fiscal paid-up share capital represented by those shares. The scope of application of this tax non-deductibility is limited to capital losses realised on shares. Capital losses realised on other securities (e.g., bonds) or derivatives (e.g., options) are fully tax-deductible.
**Rates**

The standard corporate income tax rate is 29.58 per cent and will be reduced to 25 per cent in 2020. SMEs benefit from a reduced rate of 20.4 per cent on the first tranche of €100,000 taxable income as of 2018 (further decreased to 20 per cent by 2020). The definition of ‘SME’ for the purpose of the reduced rate refers to companies that fulfil all of the following conditions:

*a* in accordance with Article 15, Section 1-6 of the Belgian Companies Code, the company may not exceed more than one of the following criteria (1) annual average number of 50 employees; (2) annual turnover of €9 million (excluding VAT); and (3) a total balance sheet of €4.5 million (if applicable to be determined on a consolidated basis);

*b* the company pays a minimum annual remuneration of €45,000 (or, if lower, at least the amount of the taxable income of the company), to at least one company manager that is a natural person;

*c* more than 50 per cent of the company’s shares are held by natural persons;

*d* the company is not an investment company; and

*e* the company does not hold participations for an acquisition value that exceeds 50 per cent of either the revalued paid-up capital or the paid-up capital, taxed reserves and recorded capital gains (participations of at least 75 per cent being excluded for the calculation).

**Administration**

Federal taxes, such as corporate income tax, are handled by the Federal Public Service Finance. Companies must file their corporate income tax return with the tax office responsible for the area in which they are established. In principle, tax returns must be filed by the date mentioned on the official return forms that are sent to each company. The filing period may not be shorter than one month following the approval of the accounts, nor longer than six months following the end of the financial year. However, the tax administration may deviate from these time limits. In practice, the date mentioned on the forms is often nine months after the closing of the financial year. Corporate income tax returns must be filed using an online application, BizTax. Paper returns are no longer allowed.

Companies must, in principle, estimate their corporate income tax liability during the financial year and must pay the tax in advance. If insufficient tax is paid in advance, a tax increase is applied.

The statute of limitations is three years. In the event of (alleged) fraud, it is extended to seven years. Even longer audit and assessment periods are possible, for instance in case the tax authorities spontaneously receive information from foreign tax authorities. Tax audits may take place within these terms, but there is no regular routine audit cycle. A tax audit is in most cases preceded by a request for information. The taxpayer must, in principle, reply within one month to such request for information, but extensions are often granted.

If the tax administration wants to change the filed tax return upon a tax audit, it must send a notice of change of tax return. The taxpayer can reply to this notice within one month. If the tax administration does not agree with the position taken by the taxpayer and intends to assess the company on a modified tax return, it must send another notification by registered mail to the taxpayer.

If a taxpayer disagrees with an assessment imposed after a tax audit, it may file a notice of objection with the regional director. This notice, which must include specific grounds for
the objection, must be filed within six months following the date on which the assessment was sent. If the regional director fails to take a decision within six months, the taxpayer may challenge the assessment before court. If the taxpayer waits for the decision of the director, or if the director takes a negative decision within the time frame mentioned above, the taxpayer can still challenge this decision before court within three months after notice of the director’s decision was given to the taxpayer.

In order to stimulate taxpayers to fulfil their duties in the field of corporate income tax compliance, no deduction of current year losses and deferred tax assets (e.g., carried forward tax losses) is allowed against a taxable basis determined as a result of a tax audit. An exception is made for the participation exemption for dividends received during the same taxable period. The new rule does not apply for infractions committed negligently and for which no tax increases are applied. In an M&A environment, an increased need for thorough due diligence may therefore arise. The rule applies as of tax assessment year 2019 (relating to the taxable period starting at the earliest on 1 January 2018).

**Tax grouping**

The taxable income of resident companies is determined on an individual basis. Belgian tax law does not yet provide for a system of consolidation for corporate income tax purposes.

A CIT consolidation regime will, however, be introduced as of assessment year 2020 (relating to the taxable period starting at the earliest on 1 January 2019) and will allow the transfer by a Belgian taxpayer of taxable profits to another loss-making qualifying taxpayer via a group contribution agreement. Certain taxpayers that benefit from a special tax regime are excluded. A qualifying taxpayer is a Belgian company or a foreign company established in the EEA that:

- is the parent company, subsidiary or sister company of the Belgian taxpayer owning at least 90 per cent of the capital. In the case of sister companies this implies that a parent company should own 90 per cent of the capital of both the Belgian taxpayer and the qualifying taxpayer; and
- is affiliated to the Belgian taxpayer for an uninterrupted period of at least five taxable periods (including the current one). Provisions have been introduced that determine the consequence of a restructuring in which one (or both) of the parties to the agreement was involved.

Tax consolidation is achieved via a group contribution agreement that should be filed together with the income tax return. Parties to the agreement are the Belgian taxpayer and either a Belgian qualifying taxpayer or the Belgian permanent establishment (PE) of a qualifying foreign taxpayer. All the following conditions should be respected:

- the agreement relates to one and the same assessment year;
- the agreement mentions the group contribution. The (loss-making) qualifying Belgian taxpayer or the Belgian PE of a qualifying foreign taxpayer should include the amount of the group contribution in the income tax return as a profit of the taxable period concerned; and
- the Belgian taxpayer (that transfers its taxable profits) pays a contribution to the loss-making qualifying taxpayer in the amount of the tax saving resulting from the group contribution. This payment is not tax deductible in the hands of the payer and not taxable in the hands of the payee (i.e., the payment is fiscally neutral).
In addition, Belgium has an optional system of value added tax (VAT) grouping. No VAT is charged between the members of a VAT group, as they are considered as a single taxable person. This system provides interesting perspectives for optimising the VAT position.

ii Other relevant taxes

Value added tax

VAT is levied at each stage in the production chain, and on the distribution of goods and services. The tax base is the total amount charged for the transaction excluding VAT, with certain exceptions. Owing to deductions in previous stages of the chain, VAT is not cumulative. Every taxable person is liable for VAT on their turnover (the output tax), from which the VAT charged on expenses and investments (the input tax) may be deducted. If the balance is positive, tax must be paid to the tax authorities; if the balance is negative, a refund is received. The tax paid by the ultimate consumers of the goods or services is not tax-deductible. The tax is based on the VAT rate applicable to the VAT-exclusive price of the goods or services received.

The general VAT rate is 21 per cent. A reduced rate of 6 per cent applies to the supply, import and acquisition of foodstuffs, some real estate services and medicines. A reduced rate of 12 per cent applies to certain goods and services, such as social housing and certain restaurant services. An exemption applies to the Intra-Community supply of goods or to the export of goods out the EU. In business-to-business relationships, goods destined for another EU Member State will be subject to VAT in the EU Member State to which they are transported.

Capital tax

In principle, the contribution of cash or other assets to a Belgian company is only subject to a fixed fee of €50.

Net wealth tax

Belgium does not levy a net wealth tax.

Transfer taxes

Transfer tax is levied on the transfer of ownership of immovable property located in Belgium. The tax is levied at a rate of 10 per cent or 12.5 per cent, depending on the location of the property. The transfer of new immovable property is subject to VAT and not to transfer tax. The sale of shares of a company owning Belgian real estate is in principle not subject to transfer tax.

Securities tax

Transfers of public securities for consideration that are concluded or executed through a professional intermediary, whether or not established in Belgium, are subject to Belgian stock exchange tax. The standard rate per party amounts to 0.35 per cent, which is levied on the purchase price (brokers' fees excluded) if due by the transferee and on the sales price (brokers' fees included) if due by the transferor. The standard rate applies to all types of securities that do not qualify as, among others, bonds or shares held in real estate companies (0.12 per cent) or a buy-back of capitalisation shares in investment companies (1.32 per cent)). The total amount of the securities tax, per party and per transaction, is, however, capped at €1,600.
IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

A company is a resident of Belgium if it has its statutory seat, main establishment or place of effective management in Belgium. Consequently, both formal (i.e., statutory seat) and informal (i.e., place of management and control) criteria must be taken into consideration in order to determine whether or not a company is a resident of Belgium for Belgian tax purposes.

The statutory seat of a company (registered office) can be defined as the official address of the company as included in the articles of association and as mentioned in the registration at the Companies’ Register.

According to the official administrative commentary, the term ‘main establishment’ is quite similar to the notion of ‘place of effective management and control’. Both notions refer to the place where the company is generally managed, that is, where the principal directors meet, where the shareholders’ meetings are held, where the ultimate management of the company takes place and where the impulse in the company is given.

It is important to note that, according to the official administrative commentary, the statutory seat is as such not sufficient to determine whether a company is a resident of Belgium for Belgian tax purposes if the statutory seat is, on the level of the company, not the same as the place of effective management. In such case, the location of the main establishment, or of the place of management and control, will determine the tax residence. Indeed, the official administrative commentary mentions that the Belgian Income Tax Law contains, in fact, the presumption that a company having its statutory seat in Belgium also has its seat of management in Belgium, but that this presumption is refutable.

As a consequence of the above, one can conclude that the main criterion, in order to determine whether or not a company is a resident of Belgium for Belgian income tax purposes, is the place of effective management and control of the company.

Taking into account the above, a foreign company should avoid having its place of effective management in Belgium if it does not want to become subject to Belgian corporate income tax. The place of effective management is a factual discussion. No clear administrative guidelines or conclusive case law exist in this respect.

ii Branch or permanent establishment

A foreign entity that envisages making an inward investment in Belgium may opt not to incorporate a subsidiary, but rather to establish a branch or PE in Belgium.

The taxable income of a branch (taxed at 29.58 per cent) is generally determined in a similar way to the taxable income of resident companies. However, expenses are only deductible if they are attributable to the Belgian taxable income. The participation exemption applies to dividends received by a PE of a non-resident company, under the same conditions as for resident companies.

The theory of the force of attraction is not applicable in Belgium. Only the profits that are realised through the activity of the Belgian branch are taxable in Belgium.

Under certain circumstances, it is possible to obtain beneficial (transfer pricing) rulings regarding the determination of the branch’s taxable income. Known examples are rulings granted to branches that carry out activities as a service or distribution centre.

It is important to note that no withholding taxes are levied on the remittance of branch profits to the head office. Furthermore, no branch profit tax applies.
Most of the Belgian tax treaties are generally in line with the Organisation for Economic Co-operation and Development (OECD) Model Convention and, therefore, offer the international recognised protection at the level of tie-breaker rules, exemption of PE profits, etc.

V  TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i  Holding company regimes
The holding regime (participation exemption regime) is part of the general corporate income tax system. It is not a special regime as such. Under the participation exemption, both dividends received and capital gains realised on shares are fully exempt from Belgian corporate income tax.

The application of the participation exemption is subject to the following conditions:

a  the company in which the Belgian company holds shares meets the 'subject-to-tax requirement'. The Belgian Income Tax Code defines this condition in a negative sense by setting out eight exclusions. The two last exclusions were introduced in 2016 and aim at countering hybrid mismatches (qualifying payments that are deductible for the paying entity) and abuse of the participation exemption regime;

b  the participation is held for an uninterrupted period of 12 months; and

c  the participation amounts to at least 10 per cent of the nominal share capital or, alternatively, has a historic acquisition price of at least €2.5 million.

ii  IP regimes
In accordance with the Lisbon strategy that has insisted on the promotion of ‘research’ within the European Union, Belgium encourages the R&D culture. In this regard, the patent income deduction (PID) enacted in 2007 was introduced to encourage entities to sustain and promote technological innovation in Belgium. Coupled with other tax (and non-tax) incentives (e.g., tax credit, investment deduction, foreign tax credit on royalties), the PID was to make Belgium a tax-friendly environment for R&D.

In 2016 the PID regime was replaced with the innovation income deduction (IID) regime that is in line with the OECD modified nexus approach, requiring a link between expenses made for the development of IP and the IP incentives received with respect to that IP. The deduction has increased from 80 to 85 per cent. As a result thereof, the effective tax rate on qualifying income can be as low as 4.44 per cent taking into account the 29.58 per cent headline rate and will be even lower when the headline rate is reduced to 25 per cent as of 2020. Moreover, the scope of the IID has been substantially extended and can apply to income derived from the following IP of which the company or branch has the full ownership, co-ownership, usufruct or licence or rights to use on:

a  patents and supplementary protection certificates;

b  breeders’ rights requested or acquired as from 1 July 2016;

c  orphan drugs (limited to the first 10 years) requested or acquired as from 1 July 2016;

d  data and market exclusivity granted by the competent authorities (e.g., market exclusivity for orphan drugs or data exclusivity for reports with respect to pesticides, clinical studies of generic or animal drugs); and
e  IP of copyrighted software and adaptations thereof resulting from a research or development project as defined for the purposes of the partial exemption of wage withholding tax for research and development, to the extent it has not yet generated income before 1 July 2016.

The new deduction applies to royalty income or embedded royalties as well to process innovation gains, indemnities and capital gains. Concerning capital gains, the following conditions need to be met:

- a the intellectual property right must have been created during the previous tax year or, in the case of an acquired right, the acquisition must have taken place in the previous 24 months; and
- b the deduction only applies if the realised capital gain is reinvested within five years (or before the professional activities stop) in R&D projects that have the objective of obtaining other intellectual property rights.

iii  State aid

In principle there is no state aid. Some sectors, however, such as the diamond industry, the film industry and the shipping industry, benefit from a special tax regime that was notified to the European Commission.

Note that the European Commission has held that certain transfer pricing methodologies applied by certain large companies, which were explicitly allowed by the Belgian ruling committee, the so-called excess profit rulings, constitute state aid. While the Belgian government has filed an appeal with the European Court of Justice against that decision, the practice of these rulings has been put on hold since the beginning of 2015, and the government has published a draft bill in order to modify the legal provisions on which the excess profit rulings are based.

iv  Notional interest deduction

As mentioned above, corporate income tax is levied at the rate of 29.58 per cent; however, the effective tax rate is in many cases lower than the nominal rate of 29.58 per cent as a consequence of the notional interest deduction regime (NID). This tax incentive was introduced to encourage Belgian companies to strengthen their equity position, and to reinforce the attractiveness of Belgium as a location for treasury and finance centres, capital-intensive companies and headquarters.

It entitles all companies subject to Belgian corporate income tax, and all non-Belgian companies with either a Belgian establishment or immovable property located in Belgium (or related rights), to annually calculate a fictitious interest expense on their aggregate equity amount, thus reducing their taxable basis. Prior to 2018, the deduction was calculated by multiplying the adjusted accounting equity (‘risk capital’) at the end of the preceding financial year by a fixed percentage, determined by the government on the basis of the average of the monthly reference indices of the interest rate on 10-year linear government bonds in the third quarter of the second year preceding the assessment year. Although the percentage remains, the calculation basis is amended as of assessment year 2019 (relating to taxable periods starting the earliest on 1 January 2018) and will equal one-fifth of the positive difference between (1) the risk capital at the beginning of the taxable period and (2) the risk
capital at the beginning of the fifth preceding taxable period. This implies that no NID can be applied if the difference is negative. Adjustments during the taxable period are not taken into account.

The rate for assessment year 2019 (financial year 2018 for most companies) is 0.746 per cent or 1.246 per cent for SMEs.

The starting point to calculate the risk capital is the company’s aggregate equity amount as determined in accordance with Belgian generally accepted accounting principles, and comprises the share capital and share premium, the various retained earnings and carry-forward losses, and the revaluation surpluses and capital subsidies.

Once this base amount has been determined, the following items (among others) must be deducted:

- the net fiscal value of own shares;
- the net fiscal value of shares held as financial fixed assets;
- the net fiscal value of shares, the income of which qualifies under the participation exemption;
- the book value of assets when expenses related thereto exceed reasonable business needs and assets held as an investment when these items do not normally produce taxable recurrent income. This exclusion aims at assets such as jewellery, gold and works of art that usually qualify as private assets, but the tax administration has also applied this exclusion to shares for which the by-laws state that no dividend distribution is possible;
- the net fiscal value of immovable property used as a personal dwelling by directors of the company or their family; and
- revaluation reserves and capital subsidies.

Several new anti-abuse provisions were introduced mid-2018. First, a capital contribution by an affiliated company will be excluded from the calculation basis if the contribution was financed with a loan and the affiliated company claims a tax deduction for interest payments on this loan. In addition, it is now foreseen that the contribution of capital by or the fiscal value of a receivable towards a non-resident taxpayer or foreign PE that is established in a country with which Belgium does not exchange information is deducted from the calculation basis unless the taxpayer demonstrates that the transaction can be supported by financial or economic motives.

When the company claiming the NID has real estate or permanent establishments located abroad, the calculated NID to be deducted in Belgium must be reduced with the lower amount of:

- the NID portion relating to the net accounting value of the assets connected to the real estate or the PE; or
- (only for real estate or permanent establishments within the EEA) the positive result of the relevant real estate or PE determined in accordance with the Belgian Income Tax Code.

As of assessment year 2013 (financial year 2012), it is no longer possible to carry forward the unused part of the notional interest deduction of the relevant taxable period.

Previously, a seven-year carry-forward was allowed. Under a transitional regime, any unused and carried-forward notional interest deduction (NID stock) available as of

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2 This modification was introduced because of the ECJ Argenta Spaarbank case.
31 December 2011 (or a taxable period ending in assessment year 2012) may still be carried forward for a period of up to seven years. The amount of the deduction for each taxable period is, however, limited. Up to a taxable income of €1 million, the amounts carried forward may be set off without restriction. If, however, the taxable income exceeds €1 million, only 60 per cent of the excess may be set off. The amount of NID stock not deducted due to the latter restriction may be carried forward indefinitely.

VI WITHHOLDING TAXES

i Withholding on outward-bound payments (domestic law)

Under Belgian domestic tax law, the following withholding tax rates apply:

a dividends: 30 per cent;
b liquidation bonuses (the difference between the liquidation distributions and the fiscal paid-up capital): 30 per cent;
c interest: 30 per cent; and
d royalties: 30 per cent.

The withholding tax rate of 30 per cent applies as of 1 January 2017.

Under certain conditions, reduced rates apply to dividend distributions in respect of new shares issued from 1 July 2013 onwards by SMEs in return for a cash contribution. For such dividends, the following withholding tax rates apply:

a 30 per cent for distributions in the first two years after the shares are issued;
b 20 per cent for distributions in the third year; and
c 15 per cent for distributions in the fourth (and subsequent) years.

As of assessment year 2015 (financial year 2014 for most companies), SMEs are granted the possibility to reserve their current year profit in a separate reserve account and pay a 10 per cent tax on that occasion. Afterwards, upon liquidation, the separate reserve is treated as fiscal paid-up capital (not triggering a withholding upon liquidation) and, after a five-year waiting period, the company is able to distribute dividends out of that reserve at 5 per cent withholding tax rate (outside of a liquidation scenario). During the five-year period, a withholding tax rate of 17 per cent applies for profits reserved until assessment year 2017 and 20 per cent for profits reserved as of assessment year 2018.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

Dividends

On implementing the EU Parent-Subsidiary Directive of 23 July 1990, Belgium also provided for an exemption from withholding tax on dividends paid by a qualifying Belgian subsidiary to its qualifying EU parent company or to its Belgian parent company. This exemption applies only if the parent company holds at least 10 per cent of the share capital in the Belgian subsidiary uninterruptedly for at least one year. This exemption also applies, under certain conditions, if, at the time the dividend is paid out or attributed, the minimum 12-month holding period has not yet expired. However, in this case, the distributing company needs to provisionally withhold the dividend withholding tax (without a bank guarantee being required). As soon as the minimum holding period has expired, it can also distribute that part of the dividend withheld.
As of 1 January 2007, Belgium has extended this exemption regime from the EU to all countries with which Belgium has concluded a tax treaty. Belgium provides, therefore, under the same conditions, an exemption of withholding tax on dividends paid to parent companies resident in a tax treaty country. For this extended exemption regime to apply, the relevant tax treaty must provide an exchange of information clause and the parent company must be subject to corporate tax without benefiting from a special tax regime.

At the end of 2016, a specific anti-avoidance rule was added to the requirements for the application of the above-mentioned withholding tax exemption. The anti-avoidance rule states that the withholding tax exemption:

cannot be applied with respect to dividends that are associated with a legal act or a series of legal acts of which the tax administration has demonstrated, taking into account all relevant facts and circumstances and except proof of the contrary by the taxpayer, that the legal act or series of legal acts is not genuine and has been put in place with as main goal or one of its main goals to obtain the participation exemption for dividends received, the withholding tax exemption on these dividends or one of the benefits of the EU Parent-Subsidiary Directive in another member state of the European Union. For the purposes of the above paragraph a legal act or a series of legal acts shall be regarded as not genuine to the extent that it is not put into place for valid commercial reasons which reflect economic reality.

Dividends distributed to non-resident investors (i.e., foreign individuals or entities not using these funds for a professional activity in Belgium) by Belgian public investment companies are exempt from withholding tax to the extent that these dividends do not originate from Belgian-sourced dividends. The Royal Decree of 30 April 2013 has extended this exemption regime to dividends distributed by Belgian institutional investment companies. This modification fills a gap in the Belgian legislation, revitalising the attractiveness of this form of investment company to non-resident investors.

On the liquidation of a Belgian company, the difference between the liquidation distributions and the paid-up capital is subject to a liquidation withholding tax of 30 per cent. Payments to qualifying EU parent companies or to qualifying companies resident in a tax treaty country will generally be exempt (see above).

Further to the Tate and Lyle case of the European Court of Justice, a further exemption of dividend withholding tax was introduced. The exemption applies to dividends paid by a Belgian company after 1 January 2018 to a company established in the EEA or in a country with which Belgium has concluded a double tax treaty that foresees the possibility to exchange information provided the following conditions are met:

a. the exemption is only applicable to the extent that the Belgian withholding tax cannot be credited or is not refundable in the beneficiary’s jurisdiction;
b. the beneficiary must be a non-resident corporate shareholder having a holding in the capital of the distributing company of less than 10 per cent but with an acquisition value of at least €2.5 million;
c. the holding is or will be maintained for an uninterrupted period of at least one year in full ownership;
d. the shareholder must have a legal form as mentioned in the EU Parent-Subsidiary Directive or a similar form;
e. the shareholder is subject to a corporate income tax or a similar tax and does not benefit from a regime that deviates from the common tax regime; and
the distributing company has a certificate confirming that the various conditions are met.

**Interest**

The interest withholding tax can, in most cases, be easily avoided. If the company has, for example, borrowed from an EU-affiliated company, a Belgian bank, or a credit institution located in the EEA or in a tax treaty country, or has issued registered bonds to non-resident taxpayers, no Belgian withholding tax will be due on the basis of domestic exemptions. In order to qualify for exemption, in some cases, certificates issued by the receiving company must be filed alongside the withholding tax return. Such certificate must be issued before the interest payment or attribution.

Belgian source interest payments made as from 1 December 2015 to certain non-resident EEA investment companies that are similar to certain Belgian regulated investment companies are also exempt from withholding tax.

**Royalties**

Royalty payments to an EU-associated company are generally exempt from withholding tax under the EU Interest Royalty Directive. In addition, most tax treaties concluded by Belgium fully exempt royalties from the royalty withholding tax. In order to qualify for exemption, a certificate must be filed alongside the withholding tax return. Such certificate must be issued before the royalty payment or attribution.

**iii Double tax treaties**

As the Belgian economy is an open and internationally oriented economy, it has always been one of the objectives of the Belgian government to remove any obstacles that could hinder the international flow of goods and capital. As such, the Belgian government’s policy has been to encourage international investments by minimising withholding taxes on dividend, interest and royalty income.

With this in mind, Belgium has concluded a significant number of treaties for the avoidance of double taxation with respect to taxes on income. As of 1 October 2018, Belgium has concluded 101 tax treaties, of which 95 are currently in force. Currently, the Belgian tax treaty network includes tax treaties with the following countries: Albania, Algeria, Argentina, Armenia, Australia, Austria, Azerbaijan, Bahrain, Bangladesh, Belarus, Brazil, Bulgaria, Canada, Chile, China, Croatia, Cyprus, the Czech Republic, the Democratic Republic of the Congo, Denmark, Ecuador, Egypt, Estonia, Finland, France, Gabon, Georgia, Germany, Ghana, Greece, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, the Ivory Coast, Japan, Kazakhstan, Korea, Kuwait, Latvia, Lithuania, Luxembourg, Macedonia, Malaysia, Malta, Mauritius, Mexico, Mongolia, Morocco, the Netherlands, New Zealand, Nigeria, Norway, Pakistan, the Philippines, Poland, Portugal, Romania, Russia, Rwanda, San Marino, Senegal, the Seychelles, Singapore, Slovakia, Slovenia, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Taiwan, Thailand, Tunisia, Turkey, Ukraine, the United Arab Emirates, the United Kingdom, the United States, Uruguay, Uzbekistan, Venezuela and Vietnam.

In addition, the treaty with the Soviet Union continues to apply to the following former Member States of the Soviet Union: Kyrgyzstan, Moldova, Tajikistan and Turkmenistan.

Finally, the treaty with Yugoslavia continues to apply to Bosnia and Herzegovina, Kosovo, Montenegro and Serbia.

Several other tax treaties have been signed but have not yet entered into force, such as those with Botswana, the Isle of Man, Macao, Moldova, Oman, Qatar and Uganda.
Since August 2007, Belgium has had a tax treaty model (the Belgian Model) that officially sets out the policy principles followed by Belgian negotiators. Under this Belgian Model Convention, in its latest, June 2010 version, the beneficial policy towards withholding taxes can be summarised as follows:

<table>
<thead>
<tr>
<th>Income</th>
<th>Recipient</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>Individuals and non-qualifying companies</td>
<td>15 per cent</td>
</tr>
<tr>
<td>Dividends</td>
<td>Qualifying companies (interest of at least 10 per cent) and pension funds</td>
<td>Zero</td>
</tr>
<tr>
<td>Interest</td>
<td>N/A</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Royalties</td>
<td>N/A</td>
<td>Zero</td>
</tr>
<tr>
<td>Limitation on benefits</td>
<td>N/A</td>
<td>None</td>
</tr>
</tbody>
</table>

The Belgian Minister of Finance signed the Multilateral Instrument (MLI) on 7 June 2017 on behalf of the federal government and the governments of the regions and communities (six in total). Pursuant to the constitution, the MLI can only enter into force if all six parliaments (i.e., the federal parliament and the parliaments of the regions and communities) have approved the MLI through legislation and the MLI is published in the Official Gazette. On 12 October 2018 the Council of Ministers approved a preliminary legislative proposal on the MLI, which is still subject to review by the Council of State. Given that no official legislative proposal is currently available yet, it is unlikely that the MLI will enter into force prior to 2020. Belgium submitted a list of 98 tax treaties (and corresponding amending instruments) that it designated as ‘Covered Tax Agreements’ (i.e., tax treaties to be modified through the MLI). The tax treaties concluded with Germany, Japan (including the new treaty signed but not yet in force), Norway (including the new treaty which entered into force on 26 April 2018) and the Netherlands were not notified.

Belgium mainly took the position to only implement the BEPS minimum standards through the MLI. Although for the time being Belgium has not opted for the possibility to address the artificial avoidance of the PE status through commissionaire arrangements, the legislator has announced that Belgium will withdraw its reservation once greater clarity is provided by the OECD on the profit allocation rules to such commissionaire PEs. It remains uncertain at present whether Belgium will apply the ‘commissionaire PE’ definition to the listed tax treaties upon implementation of the MLI. If so, this would be in line with Belgian law. The PE concept under national law has recently been extended so as to include PEs created via commissionaire (or similar) arrangements. This new rule applies as of assessment year 2021 (relating to the taxable period starting on 1 January 2020 at the earliest). Since Belgium considers an effective mechanism of dispute resolution of primary importance in order to mitigate any double taxation, it has been willing to implement the mandatory binding arbitration clause.

### iv Taxation on receipt

Foreign-source income (dividends, interest or royalties) is included in the taxable basis for its net amount (after foreign tax).

Dividends qualifying for the participation exemption regime are exempt for 100 per cent from corporate income tax (see above). No tax credit for foreign withholding tax is available.
With respect to foreign-source royalties, there exists a beneficial foreign tax credit. It is determined as a lump-sum amount equal to 15/85 of the net foreign-sourced income (foreign taxes), irrespective of the amount of foreign withholding taxes actually paid.

With respect to foreign-source interest, a system of actual foreign tax credit exists. However, owing to the calculation method and anti-channelling provisions, it is in most cases quite limited.

VII TAXATION OF FUNDING STRUCTURES

In Belgium, both equity funding and debt funding are beneficial from a tax perspective. Equity funding will maximise the notional interest deduction, while a debt funding will allow the deduction of actual interest expenses. The funding of companies therefore often depends on their activities: holding companies will be debt-funded, intra-group finance companies will be equity-funded, operational companies will often combine both funding methods, etc.

i Thin capitalisation

Specific tax thin capitalisation rules apply only in the case of financing by Belgian or foreign individual shareholders or directors, or non-EU corporate directors (debt-to-equity ratio of 1:1), by low-taxed entities or by an entity belonging to the same group (debt-to-equity ratio of 5:1). These rules will change as of 2020 as a result of the general interest deduction limitations of the European Anti-Tax Avoidance Directive 2016/1164/EU of 12 July 2016.

ii Deduction of finance costs

Like other business expenses, finance costs are, in principle, deductible if borne to obtain or preserve taxable income. When acquiring a shareholding, a company may incur a certain amount of costs: for instance, interest expenses and other financial charges on loans taken up for the acquisition of a participation, and currency losses on such loans. An important feature of the Belgian corporate tax regime is that such costs are also, contrary to the situation in many other European jurisdictions, generally fully deductible for tax purposes as any other business expenses. This tax deductibility applies regardless of whether the acquisition relates to domestic or foreign shares, or whether the participation qualifies for the participation exemption regime. The deduction can be claimed against all sources of income of the corporate taxpayer.

However, this principle is not absolute. This is demonstrated by the Antwerp Court of Appeals, which ruled on 8 May 2018 that interest expenses with respect to funds borrowed from the great-parent company to cash-wise fund both a capital reduction and dividend distribution would not be deductible.

Under the general rules, however, interest expenses are not tax-deductible (in whole or in part) in some particular cases; for example, if the interest rate is not at arm’s length (only deduction of the excessive part is denied).

The implementation of the European Anti-Tax Avoidance Directive 2016/1164/EU of 12 July 2016 will imply the introduction in Belgian domestic law of a general interest limitation rule. The interest limitation rule foresees that exceeding borrowing costs will be deductible in the tax period in which they are incurred only up to the higher of 30 per cent of the taxpayer’s EBITDA or €3 million (the ‘threshold amount’). Based on the current legislation, this new rule will only enter into force as of 2020. The implementation date of the new interest limitation rule might be advanced to 2019 based on a political agreement that was reached in July 2018. This was confirmed again by the Minister of Finance in
Belgium

Exceeding borrowing costs are defined as the positive difference between (1) the amount of the deductible interest costs (and other economically equivalent costs) of a taxpayer that are not allocable to a PE if its profits are exempt in accordance with a double tax treaty and (2) taxable interest revenues (and other economically equivalent revenues) that the taxpayer receives and that are not exempt pursuant to a double tax treaty. For taxpayers that form part of a group:

a. interest expenses (or income) paid (or received) by the taxpayer to (or from) a Belgian company or Belgian PE that form part of the group and are not excluded will be disregarded for purposes of calculating the exceeding borrowing costs; and

b. the threshold amount is to be considered on a consolidated basis. This implies that:
   • the EBITDA of the taxpayer should be increased (or decreased) with the amounts paid (or received) by the taxpayer to (or from) a Belgian company or Belgian PE that form part of the group and are not excluded from this rule; and
   • the threshold of €3 million will be allocated proportionally among the members of the group (the allocation key is still to be determined by royal decree).

Interest that cannot be deducted pursuant to this new interest limitation rule can be carried forward indefinitely. The use thereof in a subsequent year is, however, limited to the threshold amount of that year. In case a taxpayer forms part of a group of companies, any non-utilised threshold amount, and even amounts exceeding this threshold amount, can however be transferred to another Belgian group company or Belgian PE.

iii Restrictions on payments

The distribution of profits may not entail that the net assets of the company would drop below the amount of the paid up or – if this is higher – the called capital, as increased by the reserves not available for distribution.

iv Return of capital

Equity capital can be repaid by a reduction or return of capital, but not below the statutory minimum capital. The decision to decrease the capital is taken by a shareholders’ meeting held before a notary. Specific quorum and majority requirements apply. If the decrease of capital is made by a repayment to the shareholders (or an exemption from the obligation to pay up the shares), a two-month waiting period must be observed allowing the creditors of the company to request security for their claim.

Prior to 2018, no withholding tax was due on capital reimbursements if the decision is taken in accordance with the provisions of the Companies’ Code and to the extent that it concerns the return of effectively paid-in paid-up capital (i.e., capital constituted through actual contributions by the shareholders). Capital reimbursements decided upon as of 1 January 2018 will be deemed to relate proportionally to taxed reserves and certain tax-free reserves. Withholding tax will then become due on part of the amount of the capital reimbursement that is deemed to relate to these reserves as it qualifies as a dividend distribution (unless a withholding tax exemption applies). Furthermore, this amount also qualifies as a deemed dividend in the hands of a Belgian shareholder. The rule therefore also applies to foreign companies having a Belgian shareholder. The measure is, inter alia, not applicable to tax-free reserves that are not incorporated in the share capital, the legal reserve up to the minimum required amount, the liquidation reserve and the negative taxed reserve recorded as a result of a corporate restructuring.
VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

The critical issue upon the acquisition of a Belgian company consists of the fact that Belgian tax law does not yet provide for a tax consolidation and that the group contribution system that will be introduced as of 2019 (see above) requires an affiliation during at least five taxable periods. It is, therefore, more difficult than in most other jurisdictions to achieve a debt push-down. Alternative solutions to nevertheless achieve a debt push-down include post-acquisition mergers, or refinancing of equity or existing debts. It must be noted, however, that recent case law denies the deductibility of interest expenses incurred in the framework of a refinancing of equity. Before implementing such an alternative debt push-down, a careful assessment of the file and the risks involved is therefore strongly recommended.

Buyers usually use either a Belgian acquisition vehicle or a Luxembourg one. One of the factors (besides other financial considerations) that will determine this choice is the question of whether the buyers can benefit from an exemption from Belgian withholding tax on future dividend distributions if a Belgian acquisition vehicle is used. As of late 2016, this question will require a thorough analysis of the consequences of the specific anti-avoidance rule of the Parent-Subsidiary Directive (discussed above).

For Belgian sellers, any capital gain realised will in most cases remain (quasi-) tax-free. Corporate sellers will benefit from the participation exemption, and for individual sellers an exemption will apply if it can be established that the capital gain is realised in the normal management of their private wealth. Individual sellers may require from non-EEA buyers that the acquisition vehicle is located in the EU and that this vehicle holds the participation in the Belgian company for at least one year. This is to avoid a substantial interest taxation in their hands.

ii Reorganisation

Further to the implementation of the EU Merger Directive, Belgian tax law now provides that a merger can take place tax neutrally if the following conditions are met:

a) the acquiring company is a Belgian or an intra-European company;

b) the Belgian company law requirements are met and, if applicable, the similar corporate law requirements that apply on the acquiring intra-European company are met; and

c) the reorganisation does not have as its principal objective, or as one of its principal objectives, tax evasion or tax avoidance. The merger is deemed, unless proved otherwise, to have as its principal objective, or as one of its principal objectives, tax evasion or tax avoidance if the merger does not take place based on valid commercial reasons, such as a restructuring or rationalisation of the activities of the concerned companies.

An acquired business and an existing local business can, thus, be consolidated through a merger. Practice demonstrates, however, that the tax administration tends to scrutinise mergers through which a debt push-down is realised.

Cross-border mergers are possible as well within the EU from both a corporate and tax perspective. Such cross-border merger is subject to a fourth condition in order to achieve tax neutrality. The transaction will, indeed, only be tax-neutral from a Belgian perspective to the extent that the assets acquired as a consequence of this transaction are maintained in a Belgian establishment by the EU absorbing or receiving company. The same applies for the tax-free reserves of the absorbed Belgian company.
Exit

A Belgian company can move its registered office or place of effective management and control abroad from Belgium without being liquidated from a corporate perspective. The latter will only be true if, under the laws of the jurisdiction of immigration, the continuation of the legal personality of the company is accepted.

From a tax perspective though, the emigration of a company will be considered as a deemed liquidation of the company. Consequently, all latent capital gains, tax-free reserves and goodwill become taxable at 29.58 per cent. In the view of the tax administration, the liquidation withholding tax is also due. For emigration to other EU Member States, this exit taxation does not, however, apply, if, and to the extent that, a PE is maintained in Belgium.

As of 1 January 2019, the transfer of assets from Belgian headquarters to foreign permanent establishments (internal dealings) implying a loss of taxable substance in Belgium will also be subject to exit tax. The rules regarding inbound transfers have been adjusted as well. Previously, these rules generally provided that assets entering the Belgian territory had to be registered at their pre-transaction foreign book value (i.e., no step-up in the tax base was provided). Since this was contrary to European Anti-Tax Avoidance Directive 2016/1164/EU of 12 July 2016, the new rules now accept the market value as the starting value of the assets for tax purposes. To the extent that these assets were subject to an exit tax in the country of emigration and Belgium has concluded a treaty with this country that provides for the possibility to exchange information, the value established by this foreign country is refutably presumed to correspond to the market value (unless it is a tax haven). If these conditions are not fulfilled, the market value is presumed to correspond to the book value according to Belgian rules, unless proof to the contrary is provided.

As of assessment year 2017 (i.e., for taxable periods that end at the earliest on 31 December 2016), the taxpayer can choose between the immediate payment of exit tax or the deferred payment in five equal instalments, in case of reorganisations or a transfer of the seat, the main establishment or the centre of management to another EU or EEA member state with which Belgium has an agreement on mutual recovery assistance. With respect to the EEA, the rules will in first instance only apply to Iceland and Norway. The payment deferral is forfeited upon the occurrence of 10 different events, of which the most important are: the alienation of all or a part of the assets involved, the further transfer of seat outside the EU/EEA, the non-respect of the payment date of one of the instalments, and the opening of an insolvency procedure against the (ex-) taxpayer. Moreover, the tax administration can require a security in case of deferred payment, based on an assessment of the risk of non-recovery.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

Under the domestic anti-avoidance rule (GAAR), a legal act or series of legal acts constituting a single operation cannot be opposed to the Belgian tax administration if the tax authorities prove on the basis of objective circumstances that tax abuse exists.

The statutory provision indicates that tax abuse is deemed to exist if:

- the taxpayer places itself outside the scope of a tax provision in a manner that is incompatible with the objectives of this provision; or
- the taxpayer claims an advantage under a tax provision contrary to the objectives of that tax provision, and the transaction is in essence aimed at obtaining that tax advantage.
The tax administration will have to prove that tax abuse exists, which they may do by all legal means of evidence (including presumptions). The taxpayer then has to show the existence of motives other than tax motives. The Explanatory Notes to the Bill that introduced this GAAR specify that the tax authorities will apply the GAAR in the following situations:

- **the legal act has only a tax motive;**
- **the non-tax motives are very general and not specifically connected with the legal act concerned;** and
- **the non-tax motives are specific, but the importance of these motives is so small that a reasonable person would not have carried out the transaction because of this non-tax motive; in this case, it can be assumed that this non-tax motive is not the genuine motive.**

If the taxpayer does not establish sufficient legitimate non-tax motives for his or her act, the tax authorities may reclassify the act to bring it in line with the objectives of the relevant tax provision. The tax authorities may then determine the taxable base and the amount of tax due as though there was no abuse.

Certainty as to whether an envisaged legal act or series of legal acts does not constitute tax abuse can be obtained through a formal ruling request.

**ii Controlled foreign corporations (CFCs)**

**CFC legislation**

Belgian tax law does not currently include actual CFC rules, but will apply the CFC rules of the Anti-Tax Avoidance Directive as of assessment year 2020, for taxable periods beginning at the earliest on 1 January 2019.

Under the new CFC rules, a foreign company qualifies as a CFC if the following conditions are met:

- **the Belgian taxpayer owns directly or indirectly the majority of voting rights, or holds directly or indirectly at least 50 per cent of the capital, or is entitled to receive at least 50 per cent of the profits of the foreign company (control test);** and
- **the foreign company (or foreign PE of a Belgian company) is in its country of residence either not subject to an income tax or is subject to an income tax that is less than half of the income tax if the company would be established in Belgium. In calculating this income tax, the profits that this foreign company would have realised through a PE is disregarded if a double tax treaty applies between the country of the foreign company and the country in which the PE is located that exempts this profit (taxation test).**

The Anti-Tax Avoidance Directive left Member States the option to either include non-distributed specific types of income as defined in the Directive (i.e., interest, dividends, income from the disposal of shares, royalties, income from financial leasing, income from banking, insurance and other financial activities, income from invoicing associated enterprises as regards goods and services where there is no or little economic value added) or to include non-distributed income arising from non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage. Belgium has opted for the latter approach. An arrangement shall be regarded as non-genuine to the extent that the CFC would not own assets or would not have undertaken risks if it were not controlled by the Belgian taxpayer where the significant people functions, which are relevant to those assets and
risks, are carried out and are instrumental in generating the controlled company’s income. The attribution of income is then limited to the income attributable to the significant people functions carried out by the Belgian controlling taxpayer.

If the CFC distributes profits to the taxpayer and those distributed profits were previously taxed in the hands of the Belgian taxpayer, these profits shall be fully deducted from the tax base when calculating the amount of tax due on the distributed profits. Furthermore, capital gains realised on the disposal of shares of a CFC will be exempt to the extent that the profits of the CFC have already been taxed in the hands of the Belgian taxpayer as CFC income and these profits have not yet been distributed and still exist on an equity account prior to the alienation of the shares. Double taxation is however not fully eliminated. The taxes that the CFC pays in its country of residence are not allowed as a deduction from the Belgian tax. Moreover, the current rules do not foresee that the allocation of the profit of the CFC to the Belgian taxpayer is proportionate to the taxpayers’ participation in the CFC.

**Reporting obligation**

Furthermore, direct or indirect payments made by Belgian companies to entities, individuals, permanent establishments and even bank accounts established in a tax haven have to be reported in a separate form attached to the resident and non-resident corporate income tax return. The reporting obligation is only applicable if the total amount of payments exceeds €100,000 per tax year.

Failure to report payments to tax havens that qualify as professional expenses for the Belgian taxpayer will lead to the refusal of the (tax) deductibility of these expenses. In a worst-case scenario, an additional fine and tax increase could be imposed. On the other hand, the fact that the new reporting obligation has been observed does not necessarily imply that the Belgian tax authorities will accept that the payments are tax-deductible as professional expenses. The taxpayer must still prove that such payment was motivated by sound business reasons (i.e., the non-artificial character of the parties involved, and of the transaction giving rise to the payments).

Following the entry into force of the Program Law of 4 July 2016, the presence of a State on a tax haven list at the moment of the payment is sufficient to require its reporting instead of its presence on a list during the entire taxable period, as previously.

Tax havens are determined by two lists:

\[ \begin{align*}
\text{a} & \text{ the OECD list, which includes States which, according to the Global Forum on Tax Transparency and Exchange of Information of the OECD, do not effectively or substantially apply the OECD exchange of information standard; and } \\
\text{b} & \text{ the Belgian domestic list, which contains States without or with low taxation. The criteria used to constitute this list have been expanded with the Program Law of 4 July 2016. A new list still has to be enacted by Royal Decree. The following will be on the list: states outside the EEA, (1) in which companies are not subject to corporate tax on domestic or foreign income; or (2) that have a nominal corporate tax rate of less than 10 per cent or have an effective corporate tax rate on foreign income of less than 15 per cent. The latter (new) criterion may have far-reaching consequences for corporate groups including entities established in states with a territorial taxation system, such as Singapore or Hong Kong.}
\end{align*} \]
iii Transfer pricing

Belgian tax law includes rather stringent transfer pricing rules. The main rules can be summarised as follows.

Any abnormal or benevolent advantage granted to another person or entity is added to the taxable basis of a Belgian company, unless it is taken into account to determine the taxable income of the recipient. If the non-arm’s-length benefit is granted to another Belgian company, this transfer pricing adjustment does not apply.

Any abnormal or benevolent advantage received directly or indirectly from an affiliated enterprise constitutes the minimal taxable basis of the Belgian company (no deduction of losses, losses carried forward, notional interest deduction, etc., is allowed).

For financial years starting on or after 1 January 2016, the three-tiered approach to transfer pricing documentation proposed by the OECD, which requires multinational enterprises (MNEs) to submit a country-by-country report, a master file and a local file, applies (Program Law 4 July 2016).

Qualifying groups (with consolidated gross turnover exceeding €750 million) will have to file a country-by-country report (CbCR) with the Belgian tax authorities within 12 months of their consolidated financial statements’ closing date. Belgian taxpayers belonging to a multinational group are in any case required to notify the Belgian tax authorities of the identity and tax residency of the group’s entity that will submit the group’s CbCR on the last day of the MNE’s financial year.

A mandatory automatic exchange of CbCRs within the European Union applies. Belgium also implemented the Multilateral Competent Authority Agreement for the Automatic Exchange of CbCRs, which is signed by 74 countries. Finally, Belgium concluded a Competent Authority Arrangement for the automatic exchange of CbCRs with the US on 1 August 2017. This agreement will enable the exchange of CbCRs between Belgium and the US.

Belgian taxpayers belonging to a multinational group are required to submit a master file and a local file when exceeding one of the following criteria on an unconsolidated basis during the previous financial year:

\[ a \] a total amount of revenue including financial but excluding non-recurrent income of €50 million;

\[ b \] a balance sheet total of €1 billion; or

\[ c \] an annual average of 100 full-time employees.

The master file should be submitted within 12 months of the end of the MNE’s financial year. The local file should be annexed to the Belgian taxpayer’s annual tax return.

The master file should include, among other things, an overview of the intra-group financial transactions, the financial and fiscal position of the group on a consolidated basis and the group’s general transfer pricing policy.

The local file should include, among other things, detailed transactional transfer pricing documentation identifying the transactions between the Belgian entity and the foreign entities of the group if such transactions exceed €1 million during the previous financial year. The local file requires MNEs to disclose more figures than initially suggested by the OECD. On the other hand, MNEs are not required to enclose transfer pricing policies, transfer pricing studies and intercompany agreements (those documents can, however, voluntarily be included). MNEs only have to indicate whether such documentation is available. It follows
that Belgian taxpayers are not explicitly required to provide for transfer pricing documentation containing a functional analysis, economic analysis and benchmark studies. However, in practice, it is highly recommended to have transfer pricing documentation (in line with OECD guidance) available as indicating that no such documentation is available will increase the odds of triggering an audit. In addition, even though it is not explicitly required, it is recommended to prepare a reconciliation between the local file and the financial statements.

iv  Tax clearances and rulings

There is an important ruling practice in Belgium. Under this ruling policy, a taxpayer may apply for a ruling with respect to any tax issue. The introduction of a ruling request is, however, not possible in the following cases:

a  the ruling request concerns transactions that are the subject of litigation;
b  the ruling request concerns the application of an act regarding the collection of taxes;
c  the transaction envisaged does not have economic substance in Belgium; or

d  the essential aspects of the transaction envisaged relate to a tax haven that does not work with the OECD.

A ruling request must be filed before the transaction is implemented. In principle, the tax administration must decide on the ruling request within three months following its filing. In practice, the actual term is determined on a case-by-case basis within 15 days following the filing of the request. A ruling is usually valid for a maximum of five years, although a longer period can be granted if justified by the taxpayer. A ruling can also be renewed.

A ruling is generally not required at all to acquire a local business. Thanks to the flexibility of the ruling system, it is, however, a popular instrument that is often used by multinational groups to obtain legal certainty on issues such as transfer pricing, restructurings involving a Belgian company and hybrid financing.

A bill was introduced to parliament on 14 October 2016 proposing the introduction of binding rulings by the Belgian Accounting Standards Board (CBN) on the application of the various accounting standards applicable in Belgium. As Belgian tax law follows Belgian accounting law unless tax law expressly deviates from accounting law, the impact of the possibility to obtain binding accounting law rulings cannot be underestimated.

The EU Directive of 8 December 2015 on the automatic exchange of information has been transposed into national law via the Belgian Act of 31 July 2017. Prior to this Act, Belgium already had a system in place to exchange information (including rulings) spontaneously. However, this system was not applied in practice and was, therefore, not effective.

Belgium exchanges information automatically on advance cross-border tax rulings and advance pricing agreements (APAs) in conformity with the EU Directive. The Belgian legislator has not made use of the de minimis exception provided by the Directive that allows Member States to disregard rulings issued, amended or renewed before 1 April 2016 in the hands of companies with an annual net turnover of less than €40 million at group level. Concerning rulings issued before 2017, the following will apply:

a  in the case of advance cross-border rulings and APAs issued, amended or renewed between 1 January 2012 and 31 December 2013, the exchange will occur provided that they are still valid on 1 January 2014; and
in the case of advance cross-border rulings and APAs issued, amended or renewed between 1 January 2014 and 31 December 2016, the exchange will occur whether or not they are still valid.

v  ‘Catch-all’ provision

Payments made by Belgian taxpayers for services rendered by a related non-resident taxpayer are subject to 16.5 per cent withholding tax in the event Belgium has the power to tax such income pursuant to a tax treaty or, in the absence of a tax treaty, in the event the non-resident beneficiary does not prove that the income has actually been subject to tax in his or her state of residence. The scope of application of the catch-all provision is limited to income or profits derived from the provision of services to Belgian taxpayers that act in a professional capacity and that have a direct or indirect relationship of interdependence with the service provider (i.e., related parties), whether such services are rendered in Belgium or in a foreign country.

vi  Ultimate beneficial owner register

The fourth anti-money laundering directive obliges the Member States of the EU to install a register in which the ultimate beneficial owners (UBOs) of legal entities are identified. UBOs of Belgian companies will need to be identified in the Belgian UBO register. The natural persons who (1) directly hold more than 25 per cent of: the shares, the share capital, or the voting rights of a Belgian company, (2) control a holding company that holds more than 25 per cent of the shares or the share capital of a Belgian company, or (3) control the Belgian company by other means, are considered as UBOs. At least the name, the date of birth, the nationality and the address will need to be reported, as well as the nature and the extent of the beneficial interest held. A similar obligation applies to UBOs of foundations, (international) non-profit organisations, trusts and fiduciaries. The directors of the entity will need to comply with the obligation to report the aforesaid information to the Belgian UBO register.

The Act of 18 September 2017, introducing the UBO register, was published in the Belgian Official Gazette on 6 October 2017. The implementing Royal Decree of 30 July 2018 (published on 14 August 2018) mentions 1 December 2018 as deadline for the registration. However, this deadline has been postponed until 31 March 2019.

vii  Common reporting standard (CRS)

As of 1 January 2016, the CRS applies to Belgian financial institutions, such as banks, investments entities and certain insurance companies. Reporting to the Belgian tax authorities should be done by 30 June of each year, after which the Belgian tax authorities will exchange the information to the relevant jurisdictions.

X  YEAR IN REVIEW

Most of the changes that were introduced in the course of 2018 are discussed above.
XI OUTLOOK AND CONCLUSIONS

Since 2019 is an election year, we do not expect major developments in tax legislation during 2019. Nevertheless, the following developments may require the tax legislator to enact some amendments to the tax laws:

a The approval of the new Companies Code by the Belgian parliament. Since the new Companies Code includes some far-reaching measures such as the change from the real seat theory to the statutory seat theory and the abolishment of the reference to ‘capital’ for the new BV, the tax legislation will need to be amended to avoid these measures having a (negative) tax impact.

b Brexit. All in all, the impact of Brexit on the Belgian tax practice is expected to be limited. Nevertheless, some measures might be required to further reduce the impact such as, for example, measures to compensate the future non-applicability of the Interest-Royalty Directive.
Chapter 4

BRAZIL

Silvania Tognetti

I INTRODUCTION

The main source for Brazilian civil law is the Civil Code, dated as of 2002. The administration of justice has undergone some improvement with the implementation of virtual procedures at all levels; it is still very slow, but becoming faster every year. Alternative methods of dispute resolution are gaining more and more importance. In fact, arbitration has become the first option in dispute clauses in many commercial agreements and mediation in business disputes is usual in some sectors, such as construction services. Law 13,140/15 introduced general provisions regarding mediation in Brazil and its use has increased in the country in recent years.

The Brazilian economy is large by almost any standard and plays host to many diverse activities. There is also still state and semi-state participation in many strategic sectors, such as transport and infrastructure. Some business sectors are limited for foreign investors.

A recent Provisional Measure No. 863, enacted by President on 13 December 2018, increased the participation of foreign investors in airline companies from 20 per cent to 100 per cent. Although the Provisional Measure is effective from the day it was issued, it must be confirmed by Congress in 2019 to be definitively inserted in the Brazilian legal system.

The main concern of foreign investors in Brazil is dealing with a very complex tax system, with laws enacted on three different federative levels (federal, state and municipal). A tax reform is expected in Brazil for the following years. Among many proposals there are initiatives to simplify the Brazilian tax system by unifying five different taxes (ICMS, ISS, IPI, PIS and COFINS) into one federal value added tax. It is not possible to anticipate when the tax reform will happen, but it will surely improve business in Brazil.

By the end of November, the federal government enacted Federal Decree 9,580/2018 with a new consolidated income tax ruling. This new ruling is an attempt to facilitate the access to income tax rules that are spread across more than 400 laws and regulations.

The Brazilian economy is still suffering from crisis, which was connected with a long political crisis. Inflation is settled at lower levels and the recession has stopped, but the unemployment rates are still a problem. There is an expectation of improvement with the new presidential government to initiate in January 2019. In addition, the recent elections renewed a great part of Brazilian Congress, which gave good expectations for the years to come.

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Undoubtedly, the following years will be a positive time for businesses in Brazil. The economy will continue to grow from a very low base, and it is going to take some time before the benefits of growth have an impact on the lives of ordinary people. However, for foreign investors now is the best time to be part of this growth.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

For foreign investors, the most common form of doing business in Brazil is through a corporation/subsidiary (SA) or a limited liability company (Ltda). Branches in Brazil require authorisation from the Ministry of Justice and receive no special treatment compared with a subsidiary regarding tax, labour and civil obligations.

Income in Brazil is taxed by corporate taxable income (IRPJ) and a federal social contribution on profits (CSLL). There are two basic forms of assessing a company’s income tax and social contribution on profit: through the actual taxable profit or the presumed profit method.

In an actual taxable profit assessment, IRPJ is calculated under a system whereby a single income tax rate applies (15 per cent plus 10 per cent surcharge on annual taxable income above 20,000 reais per month in the period). It is calculated and paid on an annual or quarterly basis. The CSLL is calculated on the net profits, at a 9 per cent tax rate and its tax basis is the same as for IRPJ. For some activities there are different CSLL rates, but the higher is 20 per cent. Advanced payments calculated as a percentage of gross revenues are required if the taxpayers opt for an annual assessment of IRPJ and CSLL.

On the other hand, corporate taxpayers with gross revenues not exceeding 78 million reais (or 6.5 million reais multiplied by the number of months of activity, if less than 12 months) may opt for an estimated profit assessment. In this method, the 15 per cent rate (plus 10 per cent surcharge) is calculated on a percentage of quarterly gross revenue after minor adjustments. The percentage varies according to the company’s activities from 8 per cent (commercial trades) to 32 per cent (services providers).

In any case, some gains are always submitted to the actual taxable profit method and are not included in the presumed tax basis, as explained below.

i Corporate

As previously mentioned, the most common forms used to incorporate a legal entity for the purpose of business organisation by local and foreign investors are SA and Ltda.

Both can be wholly foreign-owned, and all foreign investments in Brazil must be registered with the Brazilian Central Bank (BACEN) in an electronic system known as RDE.

In a Ltda, the number of quota holders may not be fewer than two (legal entities or individuals), whereas an SA may have only one shareholder. In both cases, if a quota holder or shareholder is a foreign entity, a representative domiciled in Brazil should be appointed by means of a power of attorney to an individual resident and domiciled in Brazil, which must be certified and apostilled (Hague Convention for recognition of foreign documents) before

2 There is a specific entrepreneur entity, called EIRELI, that can be owned by one individual and there are some disputes to interpret that it can be also formed with a company as its single member.

3 The apostilles were implemented with the adoption of the Hague Apostille Convention, which became effective on 14 August 2016, due to the end of the Requirement of Legalisation of Foreign Public Documents in the Ministry of Foreign Affairs (MRE).
the originals are sent to Brazil. Furthermore, the foreign quota holder shall be registered with the Brazilian Taxpayers’ Registry (CNPJ) and BACEN. The ‘natural persons’ who are the ultimate beneficial owners of the investments must inform the tax authorities demonstrating all the chain of control until the individual level that exercises control or significant influence over the investments.

A Ltda is formed by the signature of public or private articles of incorporation, which defines the basic governing provisions and the relationships between the quota holders and managerial body. The entity’s articles of incorporation should contain clear provisions on voting rights, management powers and transfer of capital quotas. The entity’s name should be followed by the word ‘Limitada’ or its abbreviation ‘Ltda’.

It is usually a more complex procedure to establish and maintain an SA than a Ltda, although ownership and management control and transfer of participation are more flexible in an SA.

ii Non-corporate

There are no non-corporate entities in Brazil and for the interpretation of treaties to avoid double taxation on income Brazil always considers any entity as a corporate entity, including all kind of permanent establishments.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

As mentioned, the IRPJ is a federal tax levied on the accounting profit adjusted by certain non-deductible items and non-taxable revenues, as stated in the tax legislation (actual taxable profit method).

Generally, the taxpayer calculates income tax on a quarterly basis. Alternatively, for the actual profit method, an annual calculation may be selected. Under the annual regime, monthly payments should be made (in advance) calculated on the monthly gross revenue or on the accumulated taxable income (book profit adjusted by non-deductible items and non-taxable revenues).

Some expenses may be deducted from the income tax basis. A few examples of deductible expenses are ordinary and necessary business expenses paid or incurred in conducting the business, lease or rental expenses, depreciation and amortisation, taxes and related fees or contributions, and any other cost effectively related to the production or commercialisation of goods, products or services.

Except for land, which is not depreciable, depreciation of property, plant and equipment is an allowable deduction.

Amortisation of goodwill that arises as a result of accounting for investments in subsidiary and associated companies is deferred for taxation purposes. Law4 defines goodwill as it is defined in international financial reporting standards (IFRS) norms, so it will not be calculated in the same way as it was in the past, where it was a simple difference between

4 Law 12, 973/14 resulted from Provisional Measure 627/13.
amount paid in acquisition of an investment and the equity value of the investment. Presently only amounts paid in acquisition of investments that surpass the fair value of the entity assets individually considered are allocated as goodwill for future amortisation.

Amortisation of patents, trademarks and copyrights is a deductible expense. Royalties received in relation to patents, trademarks and copyrights are a deductible expense within approved limits that vary from 1 per cent to 5 per cent of gross revenues related to the products and services with the protected intellectual property.

Profits are usually calculated on accrual basis of accounting. After the adoption of international accounting standards, and a period of four years with a special accounting GAAP exclusively for tax purposes, Provisional Measure 627/13, converted into Law No. 12,973, was enacted on 14 May 2014,5 regulating the taxation of profits calculated with IFRS accounting GAAP.

Law No. 12,973/14 harmonised the rules that govern federal taxes with the new accounting criteria introduced by Laws No. 11,638/07 and 11,941/09 (IFRS).

A foreign corporation is only subject to Brazilian tax when it directly derives income from Brazilian sources. However, services rendered to Brazilian residents are considered as income derived from a Brazilian source.

**Capital and income**

Capital profits are taxed as ordinary income for Brazilian companies. Since 1 January 2017, after the enactment of Law 13,259, capital gains on payments from a Brazilian source to foreign individuals or foreign corporations started to be taxed at a progressive rate of 15 to 22.5 per cent, depending on the total amount of the gain. This also applies to capital gains referred to transfers of Brazilian assets between non-residents. Before that, these capital gains were taxed at a 15 per cent rate.

In the case of foreign entities domiciled in a tax haven jurisdiction or countries considered by Brazilian legislation as having favoured taxation (income tax rate below 20 per cent), the taxation on capital gains is increased to a 25 per cent rate.6

Dividends are exempt unless they are paid as interest on capital (JCP), when a 15 per cent rate will apply.

**Losses**

Tax losses may be extinguished in certain situations, for example when a company cumulatively undergoes a change in control and its business activity, or as a result of split-offs or mergers and may not be used in the surviving company.

5 Id.
6 In order to help in the identification of these jurisdictions, Brazil enacted a list (Normative Instruction No. 1,037/10): American Samoa, Andorra, Anguilla, Antigua and Barbuda, Aruba, Ascension Island, the Commonwealth of the Bahamas, Bahrain, Barbados, Belize, Bermuda, the British Virgin Islands, Brunei, Campione D’Italia, the Cayman Islands, the Channel Islands, the Cook Islands, the Republic of Costa Rica, Cyprus, Curacao, Djibouti, Dominica, French Polynesia, Gibraltar, Grenada, Hong Kong, Ireland, the Island of Saints Peter and Miguelao, the Isle of Man, Kiribati, Labuan, Lebanon, Liberia, Liechtenstein, Macao, Madeira, Maldives, the Marshall Islands, Mauritius, Monaco, the Montserrat Islands, Nauru, Niue Island, Norfolk Island, the Sultanate of Oman, Panama, Pitcairn Island, Qeshm Island, San Marino, Seychelles, Singapore, the Solomon Islands, the Federation of St Christopher and Nevis, St Helena Island, St Lucia, St Martin, Saint Vincent and the Grenadines, Swaziland, Tonga, Tristan da Cunha, Turks and Caicos, the United Arab Emirates, the United States Virgin Islands, Vanuatu and Western Samoa.
As from 1 January 1996, tax losses should be segregated into operational and non-operational for offset purposes. Non-operational losses can absorb only the non-operational profit for the calendar year, respecting the 30 per cent limited of adjusted net profit. Losses carried forward can be accumulated for an unlimited time, but the deduction of losses is limited to a maximum 30 per cent of taxable income per fiscal year.

**Rates**

IRPJ is levied at a rate of 15 per cent (plus a 10 per cent surcharge), and CSLL at a rate of 9 per cent. Special rates apply accordingly to taxpayer activities, for example, 20 per cent for financial institutions that was introduced by Law 13,169/15 and is applicable to income generated since September 2015.

PIS and COFINS are federal social taxes, levied at a rate of 0.65 per cent (cumulative) or 1.65 per cent (non-cumulative), and 3 per cent (cumulative) or 7.6 per cent (non-cumulative), respectively. They are calculated as a percentage of the monthly gross revenue after certain deductions and exclusions. It is possible to offset certain credits on inputs and some other expenses, according to the applicable legislation (non-cumulative). COFINS and PIS are deductible for corporate tax purposes.

COFINS and PIS are also levied on the import of goods and services from abroad (tax credits are allowed).

**Administration**

With very few exceptions, the taxes due are usually calculated by the taxpayer and paid on a periodical basis, likely monthly or quarterly.

All corporate entities are supposed to file electronic tax returns. In fact, it is the government’s aim for all accounting records to be notified in a federally managed system called the Public Digital Bookkeeping System (SPED). Since 2014, the traditional income tax return has been replaced by an electronic tax return incorporated into the SPED: the Tax Account Book (ECF).

In Brazil, taxpayers are requested to present several different tax returns electronically, and the tax authorities are able to cross records to obtain information from activities of all taxpayers, which has reduced tax evasion.

The Brazilian tax system is primarily governed by the Federal Constitution and the National Tax Code (CTN). These contain all general provisions, definitions, competences and procedures concerning the tax system. The CTN is of general application and must be observed by all authorities within the Brazilian territory, including federal, state and municipal.

There are federal taxes (e.g., income tax, IOF – see below, PIS and COFINS), state taxes (e.g., ICMS) and municipal (e.g., ISS), which will be described below.

Taxpayers are allowed to formulate questions for the Federal Revenue to obtain guidance as to the correct tax treatment and other queries they may have. In the same way, taxpayers may challenge any notices of tax assessment if they do not agree with their terms. An administrative litigation procedure deals with disagreements of taxpayers with tax assessments made by the tax authorities.

Besides the administrative litigation procedure, taxpayers may submit their disagreements directly to judicial courts, at any time, observing the legal time limitations.
**Tax grouping**
The concept of tax grouping does not exist under Brazilian law; entities are taxed individually and for some taxes each establishment is considered a separate taxpayer (e.g., ICMS).

**ii Other relevant taxes**

**Federal level**
Excise tax (actually a federal VAT) on the manufacturing of products (IPI) is levied at various rates on industrialised products when sold or transferred by the industrialising establishment even if industrialisation is incomplete, partial or intermediate. IPI is also levied on imports at the same rates as on Brazilian-made products. IPI tax rates range from 5 per cent to 20 per cent, with some exceptions subject to higher or lower rates.

Import duty (II) is generally levied on an *ad valorem* basis on the cost, insurance and freight value of the product. The invoice value is usually taken as the basis for determining the normal price, but in order to protect local products or to tax non-essentials heavily the Tariff Policy Council may establish minimum import values or base prices or apply specific tax rates. As a general rule, the tax rate is around 2 per cent to 14 per cent, with some exceptions subject to higher or lower tax rates.

Financial operations tax (IOF) is levied at varying rates on loans and credit transactions, securities transactions, certain foreign exchange transactions and insurance policies. It is added to the cost of each transaction. Also levied at varying rates on income earned from certain short-term financial investments, the tax must be withheld by the financial institution from the investor. Both companies and individuals are subject to IOF.

Companies that pay royalties fees and technical services fees to foreign parties are subject to contributions to the economic intervention domain calculated at a 10 per cent rate based on the amounts paid, credited, delivered, used or remitted to the non-resident beneficiary.

**State level**
Value added tax on sales or services (ICMS) is levied on sales or physical movement of goods, on freight, transportation and communications services, and on electricity, normally at the rate of 18 per cent or 19 per cent for intrastate transactions and 7 per cent to 12 per cent for interstate transactions. In some states certain products are exempt. This tax is also payable on almost all imports at 18 per cent to 25 per cent, but most exports are exempt.

**Municipal level**
The importation of services or services rendered locally are taxed by the municipalities (by a service tax, or ISS), at rates varying from 2 per cent to 5 per cent, with the exception of services related to freight, transportation, communications and electric energy, which are subject to ICMS.

**IV TAX RESIDENCE AND FISCAL DOMICILE**

**i Corporate residence**
A corporation is considered as resident in Brazil if it has been incorporated in Brazil. Its tax domicile is where its head office is located.
ii **Branch or permanent establishment**

No foreign corporation may carry out permanent activities in Brazil other than through a registered subsidiary, branch, or permanent establishment. A branch is considered to be a permanent establishment as it is an agent who has powers to bind an overseas principal contractually. Each tax treaty should be consulted for further details and definitions of permanent establishment, but in Brazil a branch depends upon public authorisations and the qualification as a permanent establishment will be treated as irregular activity in Brazil if it is not registered as a branch.

V **TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT**

Brazil grants no special tax regimes for entities’ operations outside the country.

i **Holding company regimes**

There are no special holding company regimes for receipts of non-local dividends or income.

ii **IP regimes**

Despite the fact that intellectual property is a concept thoroughly protected by Brazilian laws and that Brazil has signed many international treaties regarding this matter, Brazilian laws do not entail any special IP tax regimes.

iii **State aid**

Some Brazilian states grant ICMS exemptions on the import of fixed assets for industrial plants where there is no comparable equipment produced in Brazil.

Apart from that, the Manaus Free Trade Zone (ZFM) is an industrial and commercial centre implemented by the Brazilian government in the 1970s to stimulate economic production and social development of northern Brazil. The ZFM has many tax incentives as well as low or no customs rates.

iv **General**

Brazilian government provides a few special regimes and tax incentives for certain areas, including the following.

**REPETRO SPED**

REPETRO SPED is a federal special tax regime for the importation and exportation of specific goods or equipment used in the exploration and production of oil and natural gas activities into the Brazilian territory and, generally, grants the full exemption of federal taxes on imports (i.e., II, IPI, PIS and COFINS).

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The Provisional Measure 795 of 17 August of 2017, converted to Law 13,586, recently added a new type of tax benefit – the definitive importation of goods with tax suspension – and has changed the old bookkeeping system and adopted the Public Digital Bookkeeping System (SPED).
This special tax regime supports the following customs transactions:

a. definitive importation of goods used in the exploration and production of oil and natural gas activities with suspension of all federal taxes;
b. temporary admission regime: when foreign or domestic goods or equipment are imported to be used into the Brazilian territory for a determined period of time and purpose with proportional payment of federal taxes; and
c. importation or domestic acquisition of raw materials and other inputs to be used on building and packaging applied to activities in the oil and gas industry with the suspension of all federal taxes.

REIDI

Brazilian tax legislation allows legal entities with infrastructure projects in the energy sector approved by the government and by tax authorities to claim a tax benefit on the acquisition of fixed assets.

Pursuant to a formal application, an exemption may be granted from PIS and COFINS, and also from PIS and COFINS on imports on the acquisition of fixed assets on domestic and foreign markets respectively. Companies can benefit from this tax incentive for five years after the approval of the infrastructure project.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i. Withholding on outward-bound payments (domestic law)

Under Brazilian domestic tax law, dividends distributed to resident or non-resident beneficiaries (individuals or corporate entities) are exempt from withholding tax.

Other payments made by Brazilian entities to foreign entities generally trigger Brazilian withholding income tax at a 15 per cent rate or 25 per cent rate (unless a lower tax treaty rate applies). The rate is increased to 25 per cent if the foreign entities are domiciled in a ‘tax haven’ jurisdiction (income rate below 20 per cent). If a Brazilian company decides to pay JCP to its shareholders instead of dividends, 15 per cent withholding tax will apply.

ii. Domestic law exclusions or exemptions from withholding on outward-bound payments

There are no exemptions regarding the elimination of the withholding taxes due, except for the remittance of dividends, which is tax-exempted under Brazilian law.

iii. Double tax treaties

Relief from double taxation is available if a treaty exists between Brazil and the country from which foreign-sourced income is generated or if reciprocal treatment is applicable.

In general, treaties cover only corporate and individual income tax and remittance taxes and do not affect the payment of capital gains tax. Each treaty should be consulted to determine the method of eliminating double taxation: tax credit or exemption.

Note that interpretation of tax treaties by the Brazilian judicial courts may differ from international interpretation and must be taken into account before any decision on using a tax treaty for tax-planning purposes.
iv Taxation on receipt
Withholding taxes on dividends was reduced to zero per cent as of 1996. Treaty rates in excess are automatically reduced to zero.

The rate for remittances of interest and royalties was reduced from 25 per cent to 15 per cent as of 1996. Treaty rates in excess of this are also automatically reduced to zero.

VII TAXATION OF FUNDING STRUCTURES
A wide range of credit and financial services is available from an extensive banking and financial network. Financing is also available for foreign-controlled companies.

Banking and financial businesses are regulated by BACEN. Loans from the BNDES are also very common.

i Thin capitalisation
Until recently, there were no statutory provisions for maximum debt-to-equity ratios of Brazilian companies (thin capitalisation rules). The deduction of interest on debt deemed excessive could be challenged by the Brazilian tax authorities on the basis that the debt transaction was not necessary to the core business activities of the Brazilian company. In this case, one of the general deduction requirements provided for under Brazilian tax law would not be complied with.

This situation was modified in December 2009. This new legislation targeted to avoid tax evasion resulting from ‘interest stripping’, which was deemed to occur when a Brazilian company paid interest on ‘excessive’ debt transactions entered into with certain non-Brazilian creditors. Whereas interest paid on such debt may be taxable by withholding income tax at the rate of 15 per cent, or, at most, 25 per cent, this interest may be deductible from the taxable basis of the IRPJ and CSLL, which represents tax savings of 34 per cent over such amount.

These new thin capitalisation rules target debt transactions entered into by a Brazilian company with a non-Brazilian creditor that either:

a is defined as a ‘related party’ to the Brazilian company, including a non-Brazilian company that controls, is controlled by, is an affiliate of, or is under common corporate or management control as the Brazilian company; or

b is a resident of or domiciled in a ‘tax-favourable jurisdiction’, or in a ‘privileged tax regime’.

The method adopted by the Brazilian legislation is the fixed debt-to-equity ratio as follows:

a debts with related parties not domiciled in a ‘tax haven’ jurisdiction or countries with favoured taxation: maximum debt-to-equity ratio of 2:1; or

b debts with corporates domiciled in a ‘tax haven’ jurisdiction or countries with favoured taxation, regardless of whether they are linked: maximum debt-to-equity ratio of 0.3:1.

ii Deduction of finance costs
All interest and financial charges paid or accrued during the taxable year are generally deductible, including those from foreign entities. However, interest paid to entities domiciled in tax haven jurisdiction (black-listed) or foreign entities with special benefit regimes (grey-listed) may incur in excess of debts and limited of deduction of interest, in accordance with thin capitalisation rules described above.
The general rule of necessary expense applies to financial expenses. For example, the deduction of expenses with interests can be disregarded if a company pays interests in a loan and lend money to subsidiaries with lower rates.

iii Restrictions on payments
There are no rules restricting the payment of dividends, as long as the investment in registered within the Brazilian Central Bank. Without the registration some restrictions may apply on remittance of the dividends abroad.

iv Return of capital
Equity capital can be repatriated. Dividends, as mentioned before, are not subject to any taxes. Interest, capital gains on sale of shares or quotas, and some other remittances are generally subject to 15 per cent income tax rate or lower treaty rate.

Some outflows of foreign currencies require prior Brazilian Central Bank permission.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition
The first thing to be done upon starting a business in Brazil is to register with the CNPJ. As starting a company in Brazil is a relatively slow process, some companies sell local ‘shelf’ companies, which is perfectly legal in Brazil. These shelf companies have a valid CNPJ registration, as well as all other registrations required to start a company.

No taxes are due at the federal level on the value of a company at incorporation.

ii Reorganisation
Entities are allowed to merge or demerge as they wish, as long as corporate rules are respected. It is important to avoid transactions that may be considered fraudulent by the tax authorities.

iii Exit
A foreign shareholder or quota holder may liquidate the investment at any time. It should be noted that in order to repatriate investment, the local company must present clearances related to labour, tax and social security liabilities.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance
Several provisions in the CTN prevent taxpayers from availing themselves of beneficial provisions of the law in situations where the principal reasons or one of the primary reasons for their actions is to avoid taxes.

ii Controlled foreign corporations (CFCs)
Different from the international models, Brazilian CFC legislation applies to all controlled and related foreign corporations (not only those resident in low-tax jurisdictions), regardless of whether they are involved in business activities (therefore embracing any kind of foreign income).
Profits will be considered available to the controlling Brazilian company at the time the CFC closes its financial statements at the end of its fiscal year.

### iii Transfer pricing

Any operation involving goods, rights, services and interest on a financial transaction conducted by a legal entity located in Brazil with a related entity resident or domiciled abroad will be subject to transfer pricing rules.

Brazilian transfer pricing rules are not the OECD’s concern, and basically provide some import and export pricing methods to build a defence file for corporate income tax purposes.

Costs of goods, services and rights acquired from related parties located outside Brazil are deductible items for corporate income tax purposes to the extent that they do not exceed the ‘prices’ determined in light of one of the transfer pricing available methods. In the event that more than one method is used, the method that provides the greater ‘price’ for the imported goods should be considered by the Brazilian tax authorities as the acceptable import price.

If the import price is equal to or lower than the price determined through one of the methods in question, no adjustment to taxable income is required. On the other hand, if the import price exceeds the price considered to be acceptable under the transfer pricing rules, an addition to taxable income is required.

The Brazilian transfer pricing methods available for import transactions are as follows:

- **comparable independent price method (PIC):** The PIC method is defined as the weighted⁸ arithmetical average of sales price of goods, services or rights, identical or similar, verified on the Brazilian or foreign markets, in transactions taken by the company or by others interested,⁹ under similar payment conditions. For this purpose, only buy-sell transactions carried out by non-related parties must be considered;

- **resale price less profit method (PRL):** The PRL corresponds to the weighted average resale price of products, services, or rights less unconditional discounts, taxes and contributions on sales and commissions paid (or brokerage fees, or both), and a gross profit margin of (1) 40 per cent for the areas of pharmaceutical products and pharmaceutical chemicals; tobacco products; optical and photographic equipment; cinematographic instruments; machinery, apparatus and equipment for medical and dental use; oil and natural gas extraction; and oil-derived products; (2) 30 per cent for the areas of chemicals, glass and its derivatives, cellulose, paper and its derivatives, and metallurgy; and (3) 20 per cent for other areas. When applying the PRL method, Brazilian taxpayers may use their own prices (wholesale or retail) adopted in transactions with non-related parties;

- **production cost plus profit method (CPL):** The CPL method has been defined as the weighted average cost incurred to manufacture or produce identical or similar products, services, or rights in the country where they were originally produced, increased for taxes and duties imposed by that country on exportation plus a gross profit margin of 20 per cent. Operating expenses, such as R&D, selling and administrative expenses are generally not considered to be production costs under the CPL method; and

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⁸ The word ‘weighted’ came into use on 1 January 2013 according to Article 78, Section 1 of Law No. 12,715/12.

⁹ The phrase ‘taken by itself or by others interested’ came into use on 1 January 2013 according to Article 78, Section 1 of Law No. 12,715/12.
From a Brazilian corporate income tax perspective, exports of goods, services and rights to related parties located outside Brazil require minimum price levels as foreseen in the transfer pricing regulations. A Brazilian taxpayer will be deemed to have appropriate export prices when the average export sales price is at least 90 per cent of the average sales price of the same goods, services, or rights in the Brazilian market during the same period and under similar payment conditions.

In the event that the Brazilian taxpayer does not pass the ‘90 per cent test’, minimum export prices determined in light of one of the transfer pricing methods will be required. If the export price is equal to or greater than the price determined through one of the methods in question, no adjustment to taxable income is required. If, however, the export price is lower than the price considered to be acceptable under the transfer pricing rules, an addition to taxable income is required.

The Brazilian transfer pricing methods available for export transactions are as follows:

\( a \) export sales price method (PVEx): The PVEx method is defined as the weighted average of the export sales price charged to other customers or other national exporters of identical or similar goods, services, or rights, during the same tax year and under similar payment conditions;

\( b \) resale price methods (PVA and PVV): The PVA and PVV methods are defined as the weighted average prices of identical or similar goods, services, or rights in the country of destination under similar payment conditions, reduced by the taxes included in the prices charged by that country and a profit margin of:

- 15 per cent: calculated on the wholesale price in the country of destination (PVA method); or
- 30 per cent: calculated on the retail price in the country of destination (PVV) method;

\( c \) purchase or production cost plus taxes and profit method (CAP): The CAP method corresponds to the weighted average cost of acquisition of production of exported goods, services, or rights increased for taxes and duties imposed by Brazil plus a profit margin of 15 per cent on the sum of the costs, taxes and duties; and

\( d \) price on quotation at exportation method: The prices of exported goods, declared by individuals or entities resident or domiciled in Brazil will be compared with current prices on internationally recognised stock markets and may be adjusted according to the average prices.

Interest paid or credited to a related part, when arising from a loan agreement, will be deductible limited up to the value calculated based at a rate determined by the tax authorities according to the type of loan plus a spread based on the market average rate, but defined by the Brazilian IRS. The rates applicable are those due in Brazilian market sovereign bonds issued in foreign markets in US dollars at a fixed rate; Brazilian market sovereign bonds issued in foreign markets in reais at a fixed rate; or LIBOR for a period of six months.\(^{10}\)

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\(^{10}\) Article 38 of Normative Instruction No. 1,312/12.
iv Tax clearances and rulings
It is not necessary to obtain advance approval from the tax authorities before acquiring a local business. However, in most businesses within the private sector, a tax clearance certificate is required.

X YEAR IN REVIEW
The past years were marked by the expectation of recovery from the long crisis Brazil has been in since 2014. Despite some reforms that were made, such as on labour law legislation, not all expected reforms for the year have been approved by Congress, such as the social security or tax system reform. Owing to the political crisis Brazil has faced, the reforms have been postponed and now, after the elections, Brazil is optimistic that changes will come. At the moment, economic growth is expected at a slow pace. Nevertheless, a steady recovery after all the recession is keeping the market’s mood for today.

XI OUTLOOK AND CONCLUSIONS
Brazilian legislation is generally subject to periodic changes and to the courts’ interpretations.

Brazil is a very prosperous country, although its economy is suffering from the recent political crisis. With all this considered, we hope for a political restructuring and tax reform that may lead the country to a regrowth. Today, Brazil is ranked among the 10 biggest economies in the world, and is likely to continue to be attractive to new investors.
Chapter 5

CANADA

KA Siobhan Monaghan

I INTRODUCTION

Canada has a skilled labour force, a stable economy and political system, and well-developed capital markets. Thus, it is an attractive jurisdiction in which to conduct business. Canada also has one of the lowest effective corporate tax rates in the world.2

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

Business may be conducted in Canada through many different types of arrangements, although corporations and partnerships are probably the most common forms of business organisation. Many factors influence the ultimate decision about how to conduct a business, including the nature of the activity, industry practice, regulatory regime and tax treatment. The most common arrangements are described below.

i Corporate

In Canada, businesses of any significant size are conducted most commonly through corporations,3 which can be established under provincial, territorial or federal law. Consistent with the principle that a corporation has a legal personality separate from its shareholders, a corporation may own property, incur obligations and carry on business. Absent an agreement to guarantee the corporation's obligations, the shareholders' obligations are limited to the capital they have invested or, in certain circumstances, to the funds they have extracted from the corporation. A corporation must file certain information, including directors' names, on the public record, must annually hold a shareholders' meeting and must provide copies of its financial statements to the shareholders. Shareholders also have rights to certain additional information from the corporation upon request.

Corporations can be incorporated quickly, and without significant cost, once certain basic decisions are made, including identifying the terms of shares to be authorised, the

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1 KA Siobhan Monaghan is a senior partner at KPMG Law LLP. This chapter is accurate as of January 2018.
2 KPMG’s ‘Competitive Alternatives 2016’. Canada is the only country (of the 10 examined in this report) that ranks in the top three most cost-competitive countries in each of the major cost factors (being labour, transportation and facility costs, and corporate income tax rates). In the category of countries with the lowest business costs, Canada ranked second out of 10.
3 One exception is real estate businesses, which are sometimes carried on by a commercial unitised trust that qualifies as a real estate investment trust (REIT).
directors and the corporate name, with the default being a number (e.g., 1478936 Canada Inc). Consistent with the principle of limited liability, the name must include ‘Limited’, ‘Incorporated’, ‘Corporation’ or a corresponding abbreviation.

Directors must be individuals. While they need not be residents of Canada, some statutes require a minimum percentage of Canadian-resident directors. Directors generally do not have to be shareholders.

Corporations may authorise and issue common shares only or shares in more than one class, with each class conferring on the shareholders different rights (e.g., dividends, votes, redemption, conversion, etc.). Corporations generally have no minimum capital requirements subject to any applicable regulatory regime (e.g., for financial institutions). Shares cannot be issued until the subscription price is fully paid in money, property or past services.

Corporations may be privately owned or offer their shares and other securities to the public. Securities offerings are regulated by securities commissions in each province (although policies are coordinated to facilitate compliance) and, if the securities are to be listed for trading on a public market, by that market. Both English and French are official languages in Canada, and offering documents delivered to residents of Quebec may have to be translated into French.

Public companies must provide investors with annual audited financial statements, have an audit committee, and hold annual shareholders’ meetings. Prior to the annual shareholders’ meetings, these public companies must send an information circular to their shareholders containing prescribed information, including information about the matters to be considered at the meeting and executive compensation.

Three Canadian provinces\(^4\) also permit unlimited liability companies (ULCs) to be established. As the name suggests, shareholders of ULCs may be liable for the debts of the ULC. The principal advantage of a ULC is that it may be disregarded or treated as a partnership (i.e., a flow-through entity) under the US check-the-box regulations. However, ULCs are treated as companies, and thus taxpayers, for Canadian tax purposes. Moreover, under the Canada–US tax treaty, payments made by a ULC to US residents may not be eligible for reduced rates of withholding if the anti-hybrid rules in that treaty apply.\(^5\)

**Taxation**

Although further details are provided below, in general terms, Canadian-resident companies are taxed on worldwide income from all sources and file returns annually.

### ii Partnerships

Partnerships are another common form of business arrangement, and are widely used in real estate, private equity and professional businesses. A partnership is generally described as the relationship between persons carrying on business in common with a view to profit. Partnerships may be general partnerships, limited partnerships or limited liability partnerships.

A general partnership is formed by contract, typically governed by the laws of a province, and has no separate legal personality. Each partner is wholly liable for all of the debts of the partnership.

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\(^4\) Alberta, British Columbia and Nova Scotia.

\(^5\) When applicable, these anti-hybrid rules deny treaty benefits on any amount received from, or derived through, the hybrid entity.
A limited partnership is formed under the laws of a particular province on obtaining a certificate of limited partnership. Each limited partnership must have at least one general partner. General partners are responsible for managing the partnership activities and have unlimited liability for partnership obligations. A limited partner's liability is limited to its capital contribution (including any capital it agreed to contribute), unless a limited partner participates in the management of the partnership business, and, thus, assumes unlimited liability.

Limited liability partnerships share features of a limited partnership and a general partnership, but are available only to the business of a profession when permitted by the legislation governing such profession.

Partnerships are contractual relationships and, although not required, are typically governed by written partnership agreements. Accordingly, the members may agree to alter rights and obligations as between themselves. Partners have flexibility in providing for the sharing of profits, for the financing of the partnership activities and how those activities will be managed.

**Taxation**

While a partnership is not a taxpayer, its income or loss from each source is generally computed as if it were a separate person, and each partner includes in its income its share of the partnership income or loss for the partnership fiscal year ending in the partner’s taxation year. The partnership activities are considered to have been carried out by the partners for the purposes of identifying the source of the income, which may affect the rate of applicable tax.

Under special rules (SIFT rules), certain publicly traded partnerships that carry on business activities or earn certain types of income may be liable for tax on that income on the same basis as a public corporation. Any after-tax income subject to that tax is treated as a dividend payable to the partners.

Generally, limited partners are permitted to deduct their share of a partnership loss only to the extent their partnership investment is ‘at risk’. Any losses denied are generally carried forward to future years for deduction when the partner’s investment becomes ‘at risk’.

Non-resident partners may be obligated to file a Canadian tax return and pay Canadian income taxes on their share of the partnership business income. A partnership with non-resident partners will be subject to withholding tax on certain payments it receives (e.g., dividends, royalties), but a resident partner’s share of such withholding taxes will be credited against its income tax.

Statutory rules generally prevent the deferral of partnership income through selection of partnership fiscal periods ending after the partner’s taxation year-end and tiering of partnerships with different fiscal periods.

**Trusts**

Although less common, business activities are sometimes carried on through trusts, most commonly in the real estate and resource industries. Trusts are taxable entities, but may reduce their income by distributing it annually to the beneficiaries, who are then taxed on their share of the distributed income. Unlike a partnership, however, a trust cannot flow any losses through to its beneficiaries and, with limited exceptions, the source of the income to the beneficiary is income from a trust rather than income of the source (character) earned by
the trust. The SIFT rules may apply to certain trusts that carry on business or earn certain types of income. However, real estate investment trusts (REITs) that meet certain conditions are exempt from the SIFT rules.

iv  Canadian permanent establishment (PE)

A non-resident corporation may carry on business directly in Canada through a branch (PE). A PE is not a separate entity from its foreign ‘parent’. A foreign business that carries on business in Canada generally must register in each of the provinces in which the business is carried on and must designate an agent for service in that province.

Non-resident corporations who carry on business in Canada are subject to tax (including branch tax) on the income from such business (subject to treaty relief) and must file tax returns in Canada.

III  DIRECT TAXATION OF BUSINESSES

i  Tax on profits

_Determination of taxable profit_

Canadian-resident corporations are taxed on their worldwide income from all sources, including business, property and capital gains. Income from business or property is the profit from such activities calculated in accordance with ‘well accepted principles of business (or accounting) practice’, adjusted as permitted or required by the tax legislation. As a practical matter, most corporations start with income as determined under generally accepted accounting principles (GAAP), although those principles are not determinative.

The tax legislation mandates certain adjustments. For example, the rates at which assets are depreciated for accounting purposes will differ from the rates at which capital cost allowance (tax depreciation) may be deducted in computing income for tax purposes.

Corporations may choose any taxation year, but no taxation year can exceed 53 weeks. Moreover, once selected, the taxation year cannot be changed unless the Canada Revenue Agency (CRA) agrees. However, certain events will result in a deemed taxation year-end (e.g., an acquisition of control) following which a different taxation year may be selected.

The most common adjustments to accounting profits to compute income for tax purposes are described below.

_Expenses_

To be deductible for tax purposes, an expense must be reasonable, not on account of capital (except to the extent expressly permitted), not contingent and incurred for the purpose of earning income.

Certain expenses that might satisfy those tests nonetheless may be prohibited from being deducted. For example, no deduction is permitted in respect of stock option benefits conferred on employees. Business entertainment expenses are only partially deductible. Costs related to vacant land held for development generally must be capitalised. On the other hand, certain expenses that might be considered capital expenditures are deductible (albeit over time), including costs incurred to issue shares or borrow money.
Depreciation (capital cost allowance (CCA))

Depreciation taken in computing accounting profits must be added to income for tax purposes. Canada has a CCA system for depreciating assets such as buildings, machinery and equipment; properties of a similar nature are typically included in the same pool for CCA purposes. With few exceptions, property is depreciated for tax purposes on a declining balance basis at rates that range from 4 to 100 per cent.

CCA is recaptured in income if a depreciated asset is disposed of for an amount in excess of the balance of the pool to which it belongs. A fully deductible loss arises if the last asset in the pool is disposed of and an undeducted pool balance remains.

Capital and income

Capital gains may arise on the disposition of capital property (including depreciable property, where the proceeds exceed the original cost). Only 50 per cent of a capital gain (a taxable capital gain) is included in income. Capital losses may be realised on the disposition of non-depreciable capital property, and 50 per cent of such a loss (allowable capital loss) is deductible but only against taxable capital gains.

Private corporations add the untaxed half (net of 50 per cent of any capital losses) to a special account (capital dividend account), the balance of which may be paid to its Canadian-resident shareholders as a tax-free dividend. In addition, taxable capital gains realised by a Canadian-controlled private corporation (CCPC) are included in investment income, which is subject to a special higher rate of tax that is refundable when the CCPC pays dividends.

Losses

Losses are generally categorised as net capital losses or non-capital losses. Net capital losses (being one-half of a capital loss not deducted in the year realised) may be carried back for three taxation years and carried forward indefinitely, but generally are only deductible against taxable capital gains realised in those years.

Non-capital losses may be carried back for three taxation years and may be carried forward for up to 20 taxation years. Non-capital losses generally may be deducted against taxable capital gains or income from other sources.

Immediately prior to an acquisition of control, a corporation has a deemed taxation year, and accrued losses on most assets are deemed realised in that year. Thereafter, losses become restricted. Net capital losses, as well as any non-capital losses incurred in the course of earning income from property (rather than from a business), will expire unless used in the taxation year ending with the acquisition of control. Non-capital losses incurred in the course of carrying on a business may be carried forward for deduction in subsequent taxation years only if the loss business is carried on for profit or with a reasonable expectation of profit throughout the taxation year in which the loss is to be deducted. In such a case, the loss is

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6 There are also special categories of losses not discussed herein, such as farming losses and allowable business investment losses.

7 Non-capital losses realised in taxation years ending before 23 March 2004 had a shorter carry-forward period.

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deductible against income (but not taxable capital gains) from the loss business or certain 'similar' businesses. Similar rules apply to the carry-back of losses from post-acquisition of control taxation years to pre-acquisition of control taxation years.

To temper the effect of these restrictions, in the taxation year ending with the acquisition of control, a corporation may elect to 'step up' the tax cost of capital property (including depreciable property) it owns to fair market value by deeming a disposition of such property for the amount it designates (not in excess of fair market value), thereby generating income or taxable capital gains against which the pre-acquisition of control losses may be deducted.

The rules relating to acquisitions of control extend to trusts – the loss restriction event being tied to changes in beneficiaries. However, trusts do not benefit from the elective step-up provisions.

Rates

Income tax is imposed by both the federal government and the provinces in which a business has a PE. The combined federal and provincial rate on business income ranges from 26 to 31 per cent. A CCPC enjoys a preferential tax rate of 10.5 to 18.5 per cent (depending on the relevant province or provinces) on active business income less than a specified threshold (generally C$500,000). While CCPCs are also liable for a higher rate of tax on investment income (49.7 to 54.7 per cent), a portion of that tax is refunded when dividends are paid by the CCPC. Effective 1 January 2018, the federal small business tax rate will be further reduced to 10 per cent and then to 9 per cent effective 1 January 2019.

Administration

Tax returns for corporations

Canada has a self-assessment system of taxation. Although each of the provinces assesses provincial income taxes, the federal government administers the provincial income taxes on behalf of most provinces. A corporation must file an income tax return for each taxation year, due within six months after the taxation year-end. Most corporations with gross revenue in excess of C$1 million must file returns electronically.

The typical taxation year is 12 months, but a corporation is deemed to have a taxation year-end immediately before an amalgamation, an acquisition of control of the corporation, or the corporation ceasing to qualify as, or becoming, a CCPC.

Corporations must pay monthly instalments on account of income taxes (quarterly for small CCPCs), and must pay the balance due by the end of the second month following the taxation year-end (third month for small CCPCs). While not all corporate taxpayers are audited, any taxpayer may be selected for audit. Large corporations rated as high risk (by industry, record, etc.) typically are audited annually.

The normal period for reassessing a corporation is four years (three years for CCPCs) after the initial assessment, but longer periods are permitted for certain types of income, if misrepresentations are made, for transactions with non-arm’s length non-residents, and to accommodate loss carry-backs and similar adjustments. A corporation that disagrees with an assessment or reassessment may object (generally within 90 days). If the objection is upheld, the taxpayer may take the dispute to the Tax Court of Canada, from which an appeal to the Federal Court of Appeal is available, as of right. Thereafter, the appeal may be heard (with leave) by the Supreme Court of Canada.
Canada does not have a real time audit procedure, but taxpayers may seek advance tax rulings (discussed below). The CRA has a number of well-established published administrative practices that generally may be relied on by the public.

**Tax grouping**
Canada does not accommodate consolidated income tax returns, and, thus, each taxpayer must compute its own income (or loss). However, closely connected corporations must share certain tax benefits (e.g., the C$500,000 low-rate threshold for a CCPC must be shared among associated CCPCs).

Following a study of a formal loss transfer system or consolidated tax reporting regime for corporate groups, the government announced that moving forward with a formal system is not a priority. While loss trading is generally precluded, well-accepted techniques may be used to move losses within an affiliated corporate group.

**ii Other relevant taxes**

**Taxes on goods and services**
Canada has a federal goods and services tax (GST) – a value added tax – levied at a rate of 5 per cent. Although the GST is imposed widely, input tax credits are intended to ensure that intermediaries receive a credit for the GST they pay so that the GST is borne only by the final user in the supply chain. Most provinces have adopted a harmonised sales tax (HST) based on the GST, administered for those provinces (other than Quebec, which has its own tax administration) by the federal government.

Of the non-participating provinces, Alberta does not impose a sales tax, and British Columbia, Manitoba and Saskatchewan levy and administer their own retail sales tax.

Property imported into Canada may be subject to customs or excise duties as well as GST and HST, although Canada is party to several free trade agreements.

**Property taxes**
Many provinces (and some municipalities) levy a separate tax on the transfer of land within the province (municipality). Municipalities typically levy annual property taxes on owners of real property, based on the assessed value of commercial and residential real property.

**Income tax and social security contributions**
Personal income tax rates imposed by provinces and the federal government are higher than corporate rates. The rates are progressive, increasing as income levels rise, but individuals with very low income may pay no income tax. The highest combined personal income tax rates in Canada exceed 53 per cent.

Employers are required to deduct tax at source from remuneration paid to employees and remit the tax on behalf of the employee. In addition to federal and provincial income tax, individuals and their employers are required to make contributions to the federal public pension and employment insurance programmes. Employers are subject to provincial social security levies that vary among the provinces.
IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence
A corporation will be resident in Canada if it is incorporated in a Canadian jurisdiction. However, a corporation incorporated outside Canada may be resident in Canada if its central mind and management is exercised in Canada. Directors of such corporations should not hold meetings in Canada. Tiebreaker rules in Canada’s treaties may determine in which of two jurisdictions a corporation is resident if it is otherwise unclear. For example, under the Canada–US treaty, a corporation otherwise resident in both Canada and the US will be deemed resident in the jurisdiction of incorporation; otherwise the competent authorities must decide. Under the Canada–UK treaty, the competent authorities must decide. Other treaties may default to place of management.

ii Branch or permanent establishment
Under Canada’s tax legislation, a non-resident who carries on business in Canada will be liable to income tax on its taxable income earned in Canada regardless of whether it has a PE in Canada. Certain activities are deemed to be carrying on business in Canada (including soliciting orders or offering anything for sale in Canada regardless of where the contract is completed). However, in its treaties, Canada has generally agreed not to impose tax on business income except where the non-resident carries on business through a PE in Canada.

As a proxy for dividend withholding tax, Canada imposes a 25 per cent branch profits tax on non-residents that carry on business through a PE to the extent funds are not reinvested in the branch business. The rate is generally reduced to 5 per cent under Canada’s treaties, and some treaties provide for an exemption (e.g., under the Canada–US treaty, the first C$500,000 of branch profits is exempt).

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

Canada is an attractive jurisdiction in which to carry on business because it has a low corporate tax rate, a wide treaty network, a sophisticated tax system, relatively generous provisions relating to financing costs and a relatively generous regime relevant to controlled foreign corporations (foreign affiliates).

i Holding company regimes
Dividends generally are tax-free when paid from one Canadian corporation to another. Although dividends paid to non-residents are subject to withholding tax, many treaties reduce the rate to 5 per cent for significant corporate shareholders. Moreover, capital may be returned to shareholders free of Canadian withholding tax notwithstanding that the paying corporation has significant retained earnings (see below).

Dividends received by Canadian corporations from non-resident corporations are included in income, subject to foreign tax credits and certain deductions available for intercorporate dividends under the Canadian foreign affiliate rules.

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Although complex, the foreign affiliate rules exempt from Canadian tax dividends paid by a foreign affiliate to a Canadian corporation if the foreign affiliate has earnings from an active business carried on in a country with which Canada has a tax treaty or tax information exchange agreement (TIEA). Certain ‘passive income’ arising from intra-affiliate payments may be deemed active business income for this purpose.

On the other hand, under this regime, Canadian residents are required to include, on an accrual basis, their share of any foreign accrual property income (FAPI) earned by a controlled foreign affiliate (CFA). FAPI includes passive income, but also is deemed to include income from certain businesses that derive earnings from property (e.g., rents, royalties, interest, dividends, licence fees, etc.).

**ii  IP regimes**

While Canada does not have any special IP regime, tax incentives in the form of tax credits or generous write-offs may be available for development of IP in Canada.

**iii  State aid**

Both the federal government and provincial governments provide targeted incentives for particular business activities. These may take the form of tax credits, forgivable loans, tax holidays, subsidies or accelerated write-offs for qualifying expenditures (e.g., renewable energy). Corporations in the oil and gas, mining and renewable energy industries are permitted to renounce certain deductible expenses to shareholders who subscribe for ‘flow-through shares’ to fund the expenditures, permitting the shareholders to deduct the expenses rather than the corporation. There are relatively generous incentives for expenditures on ‘scientific research and experimental development’ in the form of immediate deductions for qualifying expenditures and investment tax credits.

**VI  WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS**

**i  Withholding on outward-bound payments (domestic law)**

Canada imposes withholding tax at a 25 per cent rate on most types of passive income paid to non-residents, including dividends, management fees, rents, royalties, trust and estate distributions, and payments for restrictive covenants (e.g., non-competition covenants).

**ii  Domestic law exclusions or exemptions from withholding on outward-bound payments**

Canada does not impose withholding tax on interest paid to non-residents who deal at arm’s length with the Canadian-resident payer unless the interest is ‘participating debt interest’ (i.e., interest computed with reference to revenue, cash flow, dividends, profits, commodity price or production from property). However, interest subject to thin capitalisation rules is recharacterised as a dividend for withholding tax purposes. (See below for a general discussion of the back-to-back rules and their impact on withholding tax.)

**iii  Double tax treaties**

Canada’s extensive treaty network consists of more than 90 treaties that typically reduce the rate of withholding tax on passive income. Dividend withholding is typically reduced to 15
per cent (5 per cent where the shareholder is a corporation with a significant investment in the dividend payer), and rent (other than from real property), royalty and trust distributions generally enjoy a 15 per cent rate. Some treaties eliminate withholding on particular types of royalties, and most treat management fees as business profits governed by the PE article. Where the domestic exemption from withholding tax does not apply, Canada’s treaties typically reduce the rate of withholding on interest to 10 per cent.

iv Taxation on receipt

Canada’s system for taxation of dividends from foreign affiliates operates largely as an exemption system. As discussed above, shareholders of a CFA must include in income, on an accrual basis, their share of FAPI earned by the CFA. Otherwise, income earned by a foreign affiliate generally is not taxed in Canada unless repatriated to Canada. Moreover, active business income earned by a foreign affiliate in a country with which Canada has a tax treaty or TIEA may be repatriated to its Canadian corporate shareholders as a dividend without any further Canadian tax.

Dividends from foreign corporations that are not foreign affiliates are taxable in Canada subject to a foreign tax credit. Moreover, in some circumstances, Canada taxes residents on passive income earned offshore and not encompassed within the foreign affiliate regime (see below).

VII TAXATION OF FUNDING STRUCTURES

Canadian corporations are typically funded by a combination of debt and equity (including common and preferred shares). Preferred share dividends may result in the issuer of such shares being liable to a special tax (creditable against ordinary income tax) where the preferred shareholder does not have a significant interest in the dividend payer. This regime is intended to discourage corporations that are not in a tax-paying position from using preferred share financing.

i Thin capitalisation

Canada restricts the deduction of interest on debt held by ‘specified non-residents’ (i.e., non-resident shareholders, or non-resident persons who do not deal at arm’s length with shareholders who, alone or together with non-arm’s-length persons, own shares representing at least 25 per cent of the votes or value). In general terms, interest on debt held by specified non-residents will not be deductible to the extent that such debt exceeds 1.5 times the relevant ‘equity factors’.

Equity includes the corporation’s non-consolidated retained earnings at the beginning of the taxation year, and its monthly average paid-up capital attributable to shares held by, and its monthly average contributed surplus contributed by, specified non-resident shareholders. Because only paid-up capital and contributed surplus attributable to direct shareholders is included in equity, debt is typically advanced by specified non-residents to the first-tier Canadian corporation rather than a corporation further down the corporate chain. (See discussion below regarding potential reductions to paid-up capital.)

9 Technically, the ratio is based on a monthly average of the greatest amount of such debt outstanding in each month.
In recent years, Canada has extended the thin capitalisation rules, with modifications considered appropriate, to debt of partnerships, trusts and branches of non-resident corporations.

Any interest that is not deductible because of these rules will generally be treated as a dividend paid to the specified non-resident for withholding tax purposes.

Back-to-back (B2B) loan rules target circumstances in which an intermediary that deals at arm’s length with the Canadian borrower is funded (or given security interests in respect of property to support the loan) by a non-resident (ultimate funder) with whom the borrower does not deal at arm’s length. These rules are intended to prevent arrangements that are perceived as circumventing the thin capitalisation and withholding tax rules. Where they apply, their general effect is to treat the loan, for withholding tax and thin capitalisation purposes, as if it were made by the ultimate funder.

ii Deduction of finance costs
Financing costs are typically considered to be on capital account and therefore not deductible except to the extent expressly permitted. Like other expenses, they are also deductible only to the extent they are reasonable and not contingent.

Financing costs (such as commitment fees, investment banker fees, underwriting fees, placement fees) related to the issuance of shares or debt typically are deductible in equal parts over five taxation years, subject to proration for short taxation years.

Interest is deductible only to the extent it is payable in respect of money borrowed, or in respect of an amount payable for property acquired, for the purpose of earning income. Interest borrowed to acquire common shares typically would meet this test. Where a Canadian corporation borrows money to acquire another Canadian corporation and the two corporations merge, the interest generally will be deductible against the earnings of the merged corporation.

Subject to the thin capitalisation rules, simple interest is deductible on an accrual basis, but compound interest is deductible only when paid. Prepayment penalties related to early retirement of debt are typically treated as interest and deductible over the remaining term of the debt rather than in the year paid.

iii Restrictions on payments
Dividends must be declared by directors and may be paid only to the extent that the directors are satisfied that the corporation will meet the relevant solvency test in the governing corporate statute. Although there are variations among the corporate statutes, the most common solvency test is that the corporation must, after paying the dividend, be able to pay its liabilities as they become due and have assets with a realisable value not less than the sum of its liabilities and the stated capital of all shares.

iv Return of capital
Corporations may distribute paid-up capital to shareholders regardless of whether the corporation has undistributed income. A distribution of capital by a private corporation will not be taxable but will reduce the shareholder’s tax cost of the shares. A gain will arise only if the tax cost is reduced below zero as a result.
A distribution of capital by a public corporation will be treated as a taxable dividend absent an applicable exception. Exceptions include distributions of capital occurring on a reorganisation of capital or the business, or distributions following, and funded from the proceeds of, a disposition of assets outside the ordinary course of business.

Distributions of capital usually require shareholder approval and the satisfaction of solvency tests contained in the corporate statute governing the corporation.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Typically, but not universally, a Canadian corporation will be established to acquire a Canadian target. This approach facilitates the deduction of interest expense associated with the acquisition financing against the target’s earnings through a post-acquisition merger of the acquirer and target. Secondly, a non-resident acquirer typically wants to maximise cross-border paid-up capital to maximise the opportunity to repatriate funds free of Canadian withholding tax. Finally, in certain circumstances, the acquirer will be able to ‘bump’ the tax cost of the target’s non-depreciable capital property to fair market value. This may facilitate a sale, or a distribution to the foreign parent, of the asset free of Canadian tax.

On the other hand, paid-up capital may be reduced where a Canadian-resident corporation controlled by a non-resident corporation uses capital, retained earnings or borrowed funds to make an investment in a foreign affiliate (or in a Canadian corporation that derives 75 per cent or more of its value from foreign affiliates) under Canada’s foreign affiliate dumping (FAD) rules. If the investment in the foreign affiliate exceeds the paid-up capital, the excess may be deemed a dividend paid to the non-resident controller.

ii Reorganisation

Corporations can merge on a tax-deferred basis in Canada either through an amalgamation or by the winding-up of a wholly owned subsidiary into its parent corporation, provided both are taxable Canadian corporations. Amalgamations generally require the corporations to be governed by the same corporate statute (e.g., the same provincial statute). However, it is not difficult to continue a corporation from one Canadian jurisdiction to another with shareholder approval. As a general matter, the tax attributes of the two merging corporations are carried over to the merged corporation, subject to there not being an acquisition of control.

Assets typically can be moved between Canadian corporations or into Canadian partnerships on a tax-deferred basis if the transferee issues equity to the transferor and a tax-deferral election is made. Shares of one foreign affiliate may be transferred on a tax-deferred basis to another foreign affiliate in exchange for shares of the acquiring affiliate.

Spin-off transactions can be effected on a taxable or tax-deferred basis, although in the latter case extensive conditions must be satisfied and restrictions may be placed on the corporation that spins off the assets as well as the corporation that is the subject of the spin-off.

iii Exit

Provided that the governing corporate law permits it, corporations may continue from one jurisdiction to another. A Canadian corporation that emigrates to a jurisdiction outside Canada generally will be considered to have disposed of all of its assets for fair market value
proceeds, and to have realised any resulting income or losses in the taxation year that is deemed to end immediately before it emigrates. In addition, the corporation will be liable for a special departure tax, analogous to a dividend withholding tax, levied at 25 per cent on the corporation’s surplus (subject to reduction to a treaty rate). The tax is applied to the difference between the fair market value of the corporation’s assets and the total of the paid-up capital of its shares and its debt or other amounts payable outstanding at that time.

Corporations that are established outside Canada and continue into Canada will enjoy a step up in the cost of their assets, generally to fair market value, and generally thereafter will be treated as if they had been incorporated in Canada.

IX  ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i  General anti-avoidance
Canadian tax legislation contains many specific anti-avoidance rules, but also a general anti-avoidance rule that may be applied to recharacterise a transaction or series of transactions where a tax benefit has been enjoyed, and there has been a misuse or an abuse of tax legislation or treaties.

ii  Controlled foreign corporations (CFCs)
As discussed above, passive income (FAPI) earned by a CFA is included in the Canadian shareholder’s income on an accrual basis. Moreover, passive income earned in offshore entities other than CFAs, and not repatriated to Canada, may give rise to deemed Canadian income, based on prescribed rates applied to the ‘designated cost’ of the investment.

iii  Transfer pricing
Canada’s transfer pricing rules apply to transactions between Canadian residents (or non-residents carrying on business in Canada) and non-residents with whom they do not deal at arm’s length. Their objective is to preserve the Canadian tax base by ensuring that Canadian taxpayers do not inappropriately reduce income (and thus tax liability) through advantageous or disadvantageous pricing with non-arm’s-length persons. Related persons are deemed not to deal at arm’s length, but unrelated persons may be considered not to deal at arm’s length as a factual matter.

These provisions permit the CRA to make adjustments to any amounts relevant to taxation of the Canadian resident where the terms and conditions of the transaction differ from those that would have been agreed to by arm’s-length persons. The Canadian resident has contemporaneous documentation obligations, and failure to meet them may result in the imposition of penalties.

Transactions between non-arm’s-length Canadian residents also may be subject to adjustment if not carried out at fair market value, albeit not under the transfer pricing rules. In some circumstances, the adjustments are one-sided such that an expense may be reduced (or receipt may be increased) without an adjustment to the income of the recipient (payer) of the amount. Contemporaneous documentation is not required for purely domestic transactions.

iv  Tax clearances and rulings
Tax clearance certificates are required where a non-resident disposes of taxable Canadian property. In the absence of such certificate, the purchaser is obligated to withhold a portion of
the purchase price of the property and remit it on the non-resident’s behalf. In general terms, taxable Canadian property is now limited to Canadian-situated real property (including mineral resource properties, oil and gas properties, and timber limits) and shares and partnership or trust interests that, at any time in the 60 months preceding the disposition, derived more than 50 per cent of their value from such property.

Tax clearance certificates are not generally otherwise required, but may be advisable before assets are distributed to shareholders or trust beneficiaries. Failure to do so may result in those who make the distribution being liable for unpaid taxes to the extent of the value of the assets distributed.

The CRA will provide advance income tax rulings on particular tax issues to named taxpayers who apply for a ruling in advance of the relevant transaction. Such rulings are considered binding on the CRA with respect to the taxpayer who makes the application. Obtaining an advance tax ruling typically takes at least six months, but may take significantly longer.

X YEAR IN REVIEW

Canadian corporate tax rates have remained low with the federal small business tax continuing to decrease, while rates applicable to individuals have remained relatively high. Effective 1 January 2018, the federal small business tax rate will be reduced to 10 per cent and, effective 1 January 2019, to 9 per cent. A few of the provinces have announced increases to provincial general corporate income tax rates, but reductions to the small business rates, effective 1 January 2018.

A number of legislative changes aimed at preserving the tax base have been introduced in recent years, including extending loss restriction rules to trusts, extending the thin capitalisation rules to trusts, partnerships and non-residents carrying on business in Canada, introducing the FAD rules targeting foreign-controlled Canadian corporations using corporate surplus or capital to make investments in foreign affiliates, strengthening the FAPI system and broadening the anti-avoidance measures in the thin capitalisation rules. A number of legislative changes were made to deny the benefits of transactions that sought to change the character of amounts recognised for tax purposes from income to capital gain and to further restrict the inter-corporate dividend deduction. The B2B rules were extended to royalty and rental arrangements, and a character conversion element was introduced where the B2B arrangement includes a combination of royalty payments and interest payments. For this purpose, royalty is broadly defined and may include payments for services.

In July 2017, the federal government announced broad changes to the taxation of private corporations in Canada and launched a 75-day consultation period. Many of the proposals were sharply criticised, and the government received some 21,000 submissions. While the federal government has determined to abandon a number of the proposed changes, it remains committed to changes to prevent income splitting and to discourage the accumulation of significant passive investment portfolios by subjecting the income earned in such investments to higher rates of tax. These measures are motivated by a desire to prevent high-income individuals from gaining an unfair tax advantage over the middle class. Draft legislation to implement these changes is expected in early 2018.

Legislation to implement country-by-country reporting is in force and effective for taxation years commencing after December 2016.
Canada has continued to expand its network of TIEAs, with 22 TIEAs currently in force, two signed but not yet in force and six under negotiation. Canada has 93 treaties that are in force, but continues to negotiate changes to its existing treaties and additional treaties. Canada is one of 71 countries that signed the Multilateral Instrument\(^\text{10}\) in 2017, but has not yet ratified it. Canada has accepted the principal purpose test as an interim measure regarding treaty abuse but will consider limitation of benefits provisions in its treaty negotiations.

XI OUTLOOK AND CONCLUSIONS

The federal government has started consultations regarding its 2018 budget, which is expected to be released in early spring 2018.

In the Fall 2017 Economic Update, the federal government noted that there has been a resurgence in GDP, making Canada the fastest growing economy in the G7. GDP growth is forecast to be 3.1 per cent, up from the 2 per cent forecast in Budget 2017. The federal government suggested that overall budgetary revenues would increase by 5.9 per cent in 2017–2018 and continue to grow at an annual rate of 3.6 per cent, in line with the projected growth in nominal GDP. With the recent strength in the economy, the better-than-expected fiscal outcome in 2016–2017, and the improved fiscal outlook of private sector forecasts, the debt-to-GDP ratio is declining.

The Fall 2017 Economic Update reiterated the government’s commitment to accelerate the public investment programme. This includes strengthening and growing the middle class, making significant investments in infrastructure, including public transit and roads, green infrastructure and social infrastructure, with an emphasis on clean and renewable energy, and on seeking investment in Canada. The ultimate goal of Budget 2017 is to create an economy that works for the middle class.

Additionally, the federal government is committed to augmenting tax enforcement, both domestically and internationally. Budget 2017 emphasised the government’s commitment to provide funding to the CRA to prevent tax evasion and improve compliance. The CRA is currently on track to recover over C$5 billion in additional federal revenues over six years.

The Organisation for Economic Co-Operation and Development’s Action Plan is directed at addressing tax avoidance and base erosion and profit shifting (BEPS) measures. Canada, along with over 100 countries and jurisdictions, is committed to collaborating and implementing treaty-related BEPS initiatives. Finally, Canada is committed to working collaboratively with revenue authorities from 46 countries to enhance tax administration and transparency.

On the issue of transfer pricing, it was noted that the CRA is committed to applying the revised international guidance on transfer pricing by multinational enterprises.

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\(^\text{10}\) The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting.
Chapter 6

CHINA

Jon Eichelberger

I INTRODUCTION

China is one of the most popular destinations for inward investment by multinational corporations (MNCs).

Inward investment has long been subject to approvals, registrations and restrictions in China. Since 1 October 2016, a recordal system has been implemented nationwide for the establishment and the administration of corporate changes of foreign-invested enterprises (FIEs) in industries that are not subject to special administrative measures. For FIEs in industries that are subject to special administrative measures, namely restricted and prohibited industries as listed in the Catalogue for Guiding Foreign Investment in Industry (2017 version), an approval system continues to apply. In addition, effective from 30 July 2017, the recordal system has replaced the approval system for acquisitions of shares and assets of Chinese-invested companies by foreign investors in industries that are not subject to special administrative measures.

With regard to taxation, China provides tax incentives to promote both inward investment and domestic investment in high value-added sectors, including high-technology research and development, advanced manufacturing, clean energy technology and ‘modern services’.

MNCs have faced growing challenges from the Chinese tax authorities in recent years, including the taxation of indirect transfers of Chinese-resident enterprises; transfer pricing adjustment to intra-group payments such as royalties and service fees; and the use of transfer pricing methodologies that favour higher levels of source-country taxation.

The Chinese tax authorities have become more and more aggressive in tax enforcement and collection against MNCs. At the same time, the tax environment is gradually becoming more transparent and rules-based.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate

Wholly foreign-owned enterprises (WFOEs) and Sino-foreign equity joint ventures (EJVs) are the corporate entities commonly used by foreign investors wishing to establish a business presence in China. WFOEs and EJVs are collectively known as FIEs.
A WFOE is a limited liability company wholly owned by one or more foreign investors. An EJV is a limited liability company established on the basis of a joint venture contract between Chinese and foreign parties. The WFOE is the most common form of inward investment to China, while the EJV has been the preferred form for foreign investors to enter industries with foreign ownership or control restrictions.

Since WFOEs and EJVs are Chinese-resident enterprises, they are subject to the same tax treatment as Chinese domestically owned corporate enterprises. In particular, they pay EIT. The taxation of resident enterprises is discussed in more detail in Section III.

ii Non-corporate

Partnerships and representative offices (ROs) are the two main types of non-corporate entities for inward investment into China.

China does not yet have laws or comprehensive rules regarding the taxation of partnerships. Some general guidance is available under a 2008 circular (Circular 159), which establishes that partnership profits are first allocated to the partners, who are subject to individual income tax (IIT) or EIT depending on whether they are individuals or enterprises. The Enterprise Income Tax Law (EITL) provides further confirmation of the pass-through nature of partnerships by stating that a partnership is not an enterprise that is subject to EIT. Circular 159 also provides that a partner is not permitted to deduct partnership losses against his or her other forms of income. Apart from these basic principles, partnership taxation is not well developed in China; this is one reason why foreign investors have not commonly used partnerships for inward investment.

An RO is the most common form of non-corporate entity used by foreign investors doing business in China. In general, ROs are not permitted to engage in profit-generating activities, and must confine themselves to, for example, liaison, market research and product promotion activities. An RO constitutes a permanent establishment (PE) in China of its non-resident head office unless the RO is confirmed by the Chinese tax authorities as not being a PE based on an applicable double taxation agreement (DTA). In principle, an RO of a non-resident enterprise is required to keep full accounting books and to pay EIT on its actual profits in the same manner as resident enterprises. In practice, however, the vast majority of ROs are taxed on deemed profits, which are determined using a statutory cost-plus or deemed profit formula.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

A Chinese-resident enterprise is subject to EIT on its worldwide income. A PE of a non-resident enterprise is subject to EIT on its China-sourced income and on its non-China-sourced income that is effectively connected to the PE.
The taxable profits of an enterprise are equal to its total revenue for the tax year less its non-taxable revenue, tax-exempt revenue, deductions and prior-year losses. Enterprise taxpayers are required to use accrual accounting, and taxable net income is calculated on this basis, except where the tax authorities adopt a deeming method for determining taxable income, as is common for ROs and other types of PE. Taxpayers need to take into account certain differences between the general accounting standards for enterprises and the tax accounting requirements under the EITL when preparing EIT returns.

In general, reasonable expenditures actually incurred by an enterprise in connection with the deriving of revenue are deductible. The main types of non-deductible items include dividends, EIT payments, tax surcharges, penalties, non-qualified donations, sponsorship expenses, unapproved reserves and other expenses that are related to the generation of non-taxable income.

The straight-line method is used in computing both depreciation of fixed assets and amortisation of intangible assets. Certain fixed assets may be depreciated using an accelerated depreciation method as an incentive to encourage activities such as technological development.

**Capital and income**

The EITL does not distinguish between the tax treatment of capital income and ordinary income. A capital gain derived by a taxpayer is subject to EIT as ordinary business income.

**Losses**

Losses may be carried forward for five years after the tax year in which they are generated. Loss carry-backs are not allowed. Since a capital gain is taxed as ordinary business income, the offset of income losses against capital gains, and vice versa, is allowed. There are no specific provisions preventing loss relief in the case of an ownership change, although the general anti-avoidance rule may apply where the change is among related parties. The losses of a Chinese enterprise's foreign branches may not be set off against its domestic profits.

**Rates**

The general EIT rate is 25 per cent, but high and new technology enterprises (HNTEs) to which the state provides key support are subject to a reduced rate of 15 per cent, while qualified small-scale and low-profit enterprises are subject to a reduced rate of 20 per cent. Under several circulars, qualified technologically advanced service enterprises are also subject to a reduced rate of 15 per cent.

**Administration**

The tax year begins on 1 January and ends on 31 December. An enterprise must file a provisional monthly or quarterly tax return within 15 days of the end of each month or quarter and pre-pay provisional EIT at that time. The enterprise must file an annual tax return within five months after the end of the tax year, and the provisional tax already paid during the year will be credited to the annual tax payable.

The SAT is the central government tax authority in China. The SAT is responsible for the implementation of the tax laws and also has a role in creating tax policy, a role that it shares with the Ministry of Finance (MOF). From 1991 to mid-2018, there were two tax bureaus at each of the provincial, city and district levels in China. In August 2018, China completed a tax administration reform to merge the state and local tax bureaus. After the
merger, the new local tax authority at each of the provincial, city and district levels has assumed all of the functions previously performed by the separate state and local tax bureaus at each level.

Tax authorities are required to carry out tax audits in accordance with an audit plan that is formulated annually. 6

There is as yet no formal procedure for advance rulings in China. Chinese enterprises can consult the tax authorities on specific tax issues online 7 or via a hotline. 8 The responses of the tax authorities, however, are not binding on the tax authorities. Under Chinese law, a taxpayer may challenge a tax assessment issued by a Chinese tax authority through the administrative review procedure after paying the tax. If the taxpayer is not satisfied with the outcome of an administrative review, it may bring a lawsuit in the courts.

**Tax grouping**
Currently, there is no consolidated tax-grouping regime in China. Each Chinese company is a separate taxpayer under the EITL, and should pay tax and bear losses separately.

### ii Other relevant taxes

**VAT**
The sale of goods, repair and replacement services and the provision of labour services in relation to the processing of goods in China are subject to VAT under administrative regulations that have been in place since 1994. The provision of other services and the transfer of immovable or intangible properties are also within the scope of VAT under a VAT pilot programme that was introduced in phases between 2012 and 2016. VAT is also levied on the import of goods into China, unless the imports are specifically exempted under special rules. The standard VAT rates for general VAT taxpayers are 16 per cent, 10 per cent or 6 per cent depending on the specific taxable activity.

General VAT taxpayers may utilise input VAT credits to offset against output VAT. The standard VAT rate for small-scale VAT taxpayers is 3 per cent and no-input credits are available to small-scale VAT taxpayers.

**Stamp duty**
Stamp duty is levied on the execution or receipt in China of certain documents, including contracts for the sale of goods, documentation effecting the transfer of property or shares, business account books, and certificates evidencing rights and licences. The rates of stamp duty vary. For the transfer of shares in a resident enterprise, the applicable stamp duty rate is 0.05 per cent of the contract value for each party.

**Land appreciation tax**
Land appreciation tax is levied on gains realised from real property transactions at progressive rates from 30 to 60 per cent, based on the land value appreciation amount, which is the

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7 See hd.chinatax.gov.cn/consult.
8 The national hotline number is 12366.
excess of the consideration received from the transfer or disposition of real property over the total deductible amount, which mainly consists of the original cost of the land and the cost of improvements.

IV  TAX RESIDENCE AND FISCAL DOMICILE

i  Corporate residence

A company is a resident enterprise in China if it has been incorporated under Chinese law or if it has been incorporated outside China but has a place of effective management in China. A place of effective management refers to a place where overall management and control over business operations, staffing, finance and assets are exercised in substance.9 A tax notice issued in 200910 provides that a Chinese-controlled foreign company should be regarded as a Chinese-resident enterprise if all of the following factors exist:

a. the enterprise’s senior management personnel and the senior management bodies carry out the day-to-day management of the enterprise mainly in China;
b. finance-related decisions and HR-related decisions are decided or approved by bodies or personnel in China;
c. the major assets, accounting books, meeting records for shareholders’ meetings and directors’ meetings, etc., are located or kept in China; and
d. at least half of the directors with voting powers or the senior management personnel are habitually resident in China.

ii  Branch or permanent establishment

A non-resident enterprise with a place or establishment in China is subject to EIT on its China-sourced income and on its non-China-sourced income that is effectively connected to the PE. A ‘place or establishment’ is a domestic concept similar to that of a PE under DTAs. The distinctive feature of the domestic concept of place or establishment is that the following are deemed taxable places or establishments:

a. places of management or business organisation;
b. places of business;
c. branches;
d. ROs;
e. factories and workshops;
f. places where natural resources are extracted or exploited;
g. farms;
h. places where projects such as construction, installation, assembly, repair and exploration are undertaken;
i. places where labour services are provided;
j. business agents; and
k. other places or establishments where production and business activities are undertaken.

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10 Guo Shui Fa [2009] No. 82.
The PE definition under China’s tax treaties may override and serve to limit this broad definition of place or establishment under domestic law.

China has very limited domestic guidance on the attribution of profits to PEs. A non-resident enterprise with a place or establishment in China is required to keep complete accounting books and records to accurately calculate its taxable income in accordance with the principles of matching the functions performed and the risks borne.\textsuperscript{11} If a non-resident enterprise fails to accurately calculate its taxable income, the non-resident enterprise will be taxed using a deemed profit method. In practice, the deemed profit method is widely used, with profit rates ranging from 15 to 50 per cent.

A non-resident company may open a branch in China after obtaining approvals from the competent authorities, although in practice this has been limited mainly to the financial services sector. The EITL does not provide for a branch profits tax.

V \hspace{1em} TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i \hspace{1em} Holding company regimes

A foreign investor may establish a Chinese holding company. Dividends received by a resident enterprise from another resident enterprise are exempt from EIT; however, there is no special tax regime for holding companies in China.

ii \hspace{1em} IP regimes

There are no special regimes for IP-derived income. Instead, there are several tax incentives related to R&D and other IP-related activities. The income derived by a resident enterprise from qualified technology transfer may be granted a tax exemption or a 50 per cent tax reduction.\textsuperscript{12} There is a 50 per cent ‘super’ deduction for R&D expenditures incurred on the development of new technology, new products and new processes. In addition, as noted above, qualified HNTEs to which the state provides key support are subject to a reduced EIT rate of 15 per cent instead of the headline 25 per cent rate.

iii \hspace{1em} State aid

The EITL provides specific tax incentives for a number of sectors. For instance, enterprises investing in the operation of infrastructure construction projects, environmental protection, energy-saving or water conservation projects may enjoy a three-year tax exemption followed by another three years with a 50 per cent reduction in the EIT rate starting from the tax year when production revenue is generated.\textsuperscript{13} In addition, the income generated from agriculture, forestry, husbandry and fishery is granted an EIT reduction or exemption.\textsuperscript{14}

\textsuperscript{11} Article 3 of Guo Shui Fa [2010] No. 19.
\textsuperscript{12} Article 90 of the Implementing Regulations.
\textsuperscript{13} Articles 87 and 88 of the Implementing Regulations.
\textsuperscript{14} Article 27 of the EITL.
iv General
FIEs and domestically invested enterprises are treated equally under the EITL. The pre-2008 tax incentives that specifically targeted FIEs were phased out following the effective date of the EITL on 1 January 2008.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)
Dividends, interest and royalties paid by a Chinese-resident enterprise to a non-resident enterprise are subject to withholding tax at a statutory rate of 20 per cent on the gross amount.15

ii Domestic law exclusions or exemptions from withholding on outward-bound payments
The withholding tax rate on dividends, interest and royalties is reduced to 10 per cent under Article 91 of the Implementing Regulations. In addition, the following items of interest are exempt from withholding tax:
   a interest income from state treasury bonds;
   b interest income on loans made by foreign governments to the Chinese government;
   c interest income on preferential loans made by international financial organisations to the Chinese government and to resident enterprises; and
   d interest income on municipal bonds issued in and after 2009.16

iii Double tax treaties
As of October 2018, China is party to DTAs with 109 jurisdictions. An updated list of tax treaties that China has signed may be found online.17 China’s DTAs are based on the OECD and UN Model Conventions. Most of the DTAs that China has concluded provide a 10 per cent withholding tax rate, which is the same as the Chinese domestic rate. However, the dividend withholding tax rate is reduced to 5 per cent under certain DTAs, including those that China has signed with the following countries or regions: Barbados, Belgium, Denmark, France, Germany, Hong Kong, Ireland, Luxembourg, Malta, Mauritius, the Netherlands, Singapore, Sweden, Switzerland and the United Kingdom.

A non-resident enterprise must comply with a tax bureau recordal procedure to enjoy DTA benefits. A taxpayer that has enjoyed treaty benefits remains subject to challenge in a tax investigation or audit.18 The main focus with respect to dividends, interest and royalties is on whether the recipient of the income is the beneficial owner of the income.19 The review by the tax authority focuses heavily on whether the recipient has economic substance and is a conduit.

15 Article 4 of the EITL.
18 SAT Bulletin [2015] No. 60.
iv Taxation on receipt

Dividends, capital gains and other income derived by a resident enterprise outside China are subject to the general EIT rate of 25 per cent. The EITL allows resident enterprises to use foreign tax credits, including indirect tax credits, to avoid double taxation of income.

Foreign income taxes, including withholding taxes, actually paid by resident enterprises on non-China sourced income may be deducted from the total amount of EIT payable by the enterprise. A resident enterprise receiving dividends from a controlled foreign enterprise is also entitled to indirect foreign tax credits for the underlying taxes actually paid by the controlled foreign enterprise on the profits out of which dividends are distributed. A controlled foreign enterprise refers to a foreign enterprise in which the resident enterprise directly or indirectly holds at least 20 per cent share and that is within three tiers immediately below the resident enterprise.

The foreign tax credit is limited to the amount of tax payable on the non-China sourced income under the EITL. This limitation is calculated on a country-by-country basis. Excess foreign tax credits may be carried forward for five years.

VII TAXATION OF FUNDING STRUCTURES

i Thin capitalisation

Chinese thin capitalisation rules apply in respect of direct and indirect borrowings from related parties. The limit on the debt-to-equity ratio for financial enterprises is 5:1, while the limit for non-financial enterprises is 2:1.20 Excess interest expenses may not be deductible, but there is an exception that permits deduction if a borrower is able to prove that borrowings from a related lender are on arm’s-length terms or that the actual tax burden of the domestic borrower is no higher than its domestic related lender.21

ii Deduction of finance costs

Reasonable financing costs incurred by an enterprise during its production and business operation activities may be deductible as interest expense; however, financing costs incurred by an enterprise for the acquisition, construction or creation of fixed assets and intangible assets or of inventories with a production cycle of more than 12 months, will be treated as capital expenditure and recorded as part of the cost of assets.22 Similarly, acquisition finance costs incurred in M&A transactions must be capitalised rather than deducted as interest expense.

iii Restrictions on payments

A resident enterprise can pay dividends only from accounting profits and cannot distribute excess cash arising, for example, from depreciation of fixed assets. Under applicable corporate rules, a WFOE must allocate at least 10 per cent of after-tax profits to its statutory reserve fund until the reserve fund reaches 50 per cent of the WFOE’s registered capital. In the case of an EJV, its board of directors can decide the proportion to be allocated to the reserve fund.

20 Cai Shui [2008] No. 121.
21 Cai Shui [2008] No. 121.
22 Article 37 of the Implementing Regulations.
iv Return of capital

Equity capital may be returned by means of reduction of registered capital. An FIE, however, can reduce capital only where it is necessary owing to a significant change in the scale of its production or operations. Regulatory approval used to be required for a capital reduction, and such approval was rarely granted in practice. Starting 1 October 2016, the regulatory approval for a capital reduction has been replaced by a recordal system for industries that are not subject to special administrative measures.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

A foreign investor may directly acquire a Chinese company through a share acquisition or an asset acquisition, both of which are subject to government administration (either recordal or approval depending on the industry).

The seller in a share acquisition will be subject to EIT on capital gains at the applicable domestic rate. Each party is also subject to stamp duty at 0.05 per cent of the contract value of the acquisition agreement.

The taxation of an asset acquisition is more complicated. The foreign investor needs to establish a WFOE or an EJV as the buyer of the assets from the Chinese seller (or use an existing WFOE or EJV). The seller is subject to EIT on capital gains at its applicable rate, and may be subject to VAT, deed tax or land appreciation tax (or all of these) depending on the nature of the assets to be transferred. Both parties must pay stamp duty at a rate of either 0.03 or 0.05 per cent, depending on the type of assets.

If a foreign investor acquires a Chinese company, assets owned by a Chinese ‘place or establishment’ or real properties located in China through an indirect share acquisition (i.e., by buying the shares of the target company’s overseas holding company), the seller of the shares may be subject to EIT in China on capital gains based on China’s indirect share transfer rules.23 An indirect transfer generally will be ‘recharacterised’ as a direct transfer if it lacks reasonable commercial purpose and does not fall within any safe harbours, and the buyer should be the withholding agent.

ii Reorganisation

The income tax treatment of corporate reorganisations is governed by a tax notice that was jointly issued by the MOF and the SAT on 30 April 2009 (Notice 59).24 There are six types of corporate reorganisation under Notice 59: change of legal form, debt restructuring, share acquisition, asset acquisition, merger and demerger.

To qualify for tax-free reorganisation, the transaction must satisfy a number of baseline requirements:

a. a bona fide business purpose;

b. transfer of at least 50 per cent of assets or shares;

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c 12 months’ continuity of business operations and ownership post-reorganisation; and

d at least 85 per cent equity consideration (no more than 15 per cent cash).

For cross-border share or asset acquisitions, the transferor must also have 100 per cent direct share control over the transferee, and the continuity of ownership post-reorganisation is extended to three years.

iii Exit

If a foreign investor exits an investment in China by selling its equity interest in a WFOE or an EJV, it will be subject to tax in China as the seller in an acquisition (see Section VIII.i).

The foreign investor may instead apply to the government authorities to dissolve and liquidate the Chinese company. The company will be subject to tax on the sale of its assets in liquidation as described above. The foreign investor will be subject to withholding tax at the rate applicable to dividends on liquidating distributions up to the amount of the company’s distributable profits, and at the rate applicable to capital gains on the remainder of the liquidating distributions.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

General anti-avoidance rules (GAAR) were first introduced in Article 47 of the EITL, under which the Chinese tax authorities may recharacterise an arrangement that lacks reasonable commercial purpose, which means that a main purpose of the arrangement is to reduce, exempt or defer taxation. The Chinese tax authorities have been increasingly aggressive in using the GAAR to tax non-resident enterprises. On 12 December 2014, the SAT issued the GAAR procedural rules25 to provide procedural guidance on GAAR investigations.

ii Controlled foreign corporations (CFCs)

The profits of a CFC established in a low-tax jurisdiction will be included in the Chinese corporate shareholder’s taxable income in the current year if the CFC does not distribute profits without reasonable commercial need. A low-tax jurisdiction refers to a jurisdiction where the effective income tax rate is lower than 12.5 per cent. An overseas company is treated as a CFC if each shareholder that is a Chinese resident enterprise or an individual that directly or indirectly holds at least 10 per cent of the voting shares of the foreign company, and those shareholders with 10 per cent or more of the voting shares jointly own more than 50 per cent of the shares; or the Chinese-resident enterprise or individual has actual control over the foreign company by virtue of shares, capital, business operations, or purchases and sales in any other situation.

iii Transfer pricing

The tax authorities may adjust the taxable income of an enterprise or its related party where the transactions between the related parties are not in accordance with the arm’s-length principle. All enterprises in China that are taxed on an actual-profits basis have an obligation

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25 SAT Decree No. 32.
to report related-party transactions as part of their annual EIT filings each year. In addition, all enterprises in China must prepare contemporaneous documentation for related-party transactions, unless specifically exempted.

China’s transfer pricing rules generally follow the OECD guidelines, but some departures from these guidelines are reflected in the China chapter of the United Nations Practical Manual on Transfer Pricing for Developing Countries.

iv Tax clearances and rulings
There is no general advance ruling procedure in China. Although one exists on paper for certain very large enterprises, it has not been implemented. In practice, however, certain companies, such as large state-owned enterprises and giant MNCs, occasionally may be able to obtain written replies from tax authorities confirming the tax treatment and tax consequences of a specific transaction.

X YEAR IN REVIEW
During the past year, there have been a number of significant tax developments in China.

i New anti-treaty shopping rules

Bulletin 9 provides a three-step beneficial ownership analysis:

a Step 1 – safe harbour. Under the pre-existing rules, an income recipient that is both a tax resident and publicly listed in the treaty partner jurisdiction is treated as a *per se* beneficial owner. Bulletin 9 significantly expands the scope of *per se* beneficial owners.

b Step 2 – standard ‘negative-factor’ analysis. Bulletin 9 consolidated the seven negative factors listed by Circular 601 into five factors for determining whether an income recipient met the beneficial ownership test. The key change is the tightening of the anti-conduit factor.

c Step 3 – beneficial ownership attribution rule. The new beneficial ownership attribution rule will increase access to treaty-based dividend withholding tax rates for MNCs where the income recipient itself does not qualify for the safe harbour and does not possess enough local economic substance to pass the more general ‘negative-factor’ test. The beneficial ownership attribution test contains both a same-country scenario and a non-same country scenario.

ii New tax incentive for dividends reinvested into China
On 26 September 2018, China issued Notice 102 to allow a non-resident enterprise to defer payment of withholding tax on dividends derived from a Chinese company if the non-resident enterprise directly reinvests the dividends into industries ‘not prohibited’ by the
Chinese government. Notice 102 applies to dividend distributions on or after 1 January 2018. This incentive is a deferral, not an exemption, as the non-resident enterprise must pay the deferred withholding tax after it has recovered the reinvestment.

Direct reinvestment refers to equity investments in the form of a capital increase to an existing resident enterprise, the contribution of capital to a newly formed resident enterprise, and a share acquisition of a resident enterprise from an unrelated party. Aside from the requirement that the reinvestment must be in an industry not prohibited by the state, stringent fund flow requirements also apply. The cash dividends must be transferred directly from the distributing enterprise’s bank account to the bank account of the invested enterprise (in the case of a capital contribution) or the transferor (in the case of acquiring a Chinese target enterprise).

XI OUTLOOK AND CONCLUSIONS

The Chinese tax authorities have become increasingly aggressive about tax enforcement and collection, particularly with regard to non-resident enterprises.

At the same time, it has been our experience in recent years that the Chinese tax authorities have become more open to discussing technical issues with taxpayers, and have taken measures to promote transparency and uniformity in tax administration and enforcement. Meanwhile, China is now encouraging foreign investment by providing a tax incentive for dividends reinvested into China.
I  INTRODUCTION

During recent years, Denmark has adopted a number of reforms aiming to improve the framework conditions for operating a business in Denmark, including the reintroduction of favourable taxation of employee share programmes and a reduction of the corporate income tax rate. The current rate is 22 per cent.

From a tax perspective, the following features might be considered attractive for investors seeking business opportunities in Denmark:

- the participation exemption regime, which includes tax-free receipt and distribution of dividends from and to all countries with whom Denmark has formed a tax treaty (however, with certain exceptions);
- the tonnage tax regime under which income from shipping activities and capital gains on vessels are virtually tax-free;
- depreciation rates for tax purposes that are higher than the economic decrease in value;
- the absence of social security contributions in respect of employees;
- the possibility of obtaining binding advance rulings on tax issues;
- the possibility of tax-free reorganisation of businesses without showing business reasons; and
- the possibility of awarding employees’ shares, options, etc., with a favourable tax treatment.

On the other hand, Denmark has implemented a wide variety of specific anti-avoidance rules (SAAR) aimed at, inter alia, hybrid entities and instruments as well as limitations for interest deductions. Further, Denmark has introduced general anti-avoidance regulation (GAAR). The anti-avoidance regulation makes Denmark unattractive in terms of tax-planning techniques involving excess debt push-down, use of hybrid investment vehicles and arrangements that are not put into place for valid commercial reasons that reflect economic reality.

II  COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

Generally, there are two main forms of organising a business in Denmark: entities with limited liability and entities with unlimited liability. Parties are free to choose business form.
Common entities with limited liability are the private limited company (ApS) and the public limited company (A/S). Other entities include entrepreneur companies (IVS), associations, cooperative societies and commercial foundations.

Common entities with unlimited liability are the general partnership (I/S) where the partners are jointly and severally liable, the limited partnership with limited partners and at least one general partner with unlimited liability (K/S), and the limited partnership company (P/S).

Generally, entities with limited liability are subject to corporate taxation, whereas entities with unlimited liability are transparent for Danish tax purposes (i.e., only the partners are subject to tax).

i Corporate

Due to the limited liability and their widespread use, businesses are generally set up as an ApS or an A/S.

In general, companies are only subject to a few formal requirements, such as registration with the Danish Business Authority, preparation of annual accounts and conducting of annual general meetings.

The key difference between public limited companies and private limited companies is the required minimum share capital (ApS: 50,000 Danish kroner, A/S: 400,000 Danish kroner). Further, public limited companies are required to operate a two-tier management, while private limited companies are only required to have one governing body.

Since 1 January 2014 it has been possible to set up an ‘entrepreneur company’. Entrepreneur companies are required to have a minimum share capital of just 1 Danish krone, but are obliged to transfer at least 25 per cent of their annual net profits to a non-distributable reserve until the share capital reaches 50,000 Danish kroner.

Moreover, the European Societas Europaea company form is treated as a corporation by law.

ii Non-corporate

The most common non-corporate forms are I/S with personal liability of all the partners, and K/S or P/S with limited partners and at least one general partner with unlimited liability (however, general partners are often organised as limited companies). Except for a requirement to register with the Danish Business Authority, such businesses are not subject to formal requirements upon formation, and no capital requirements apply.

Due to the tax transparency and the limited liability of the limited partners, a limited partnership is generally the preferred investment vehicle for private equity investments, etc.

III DIRECT TAXATION OF BUSINESSES

Companies resident in Denmark for tax purposes are as a general rule taxed on their worldwide income, however excluding income from foreign permanent establishments and foreign real estate. Companies resident outside Denmark for tax purposes are taxed on income derived by a permanent establishment (PE) in Denmark as well as income from certain sources in Denmark.
i  Tax on profits

Determination of taxable profit

Corporation tax is imposed on company profits consisting of business income, passive income and taxable capital gains. Income is taxed on an accrual basis and is, as a general rule, considered accrued when the taxpayer has a legal right to the income under the relevant agreement or law. The taxable profits are determined on the basis of figures reported in the company’s annual accounts, with adjustments according to the tax regulations, including deductions and depreciations. The basic principle is that the taxable income comprises gross income less the expenses of acquiring, securing and maintaining that income, whereas expenses necessary to establish or expand income sources are not deductible. Interest paid on loans and royalties qualify for deduction with certain limitations. Dividends are not tax-deductible.

Depreciation

For the purpose of encouraging investment, depreciation is allowed at a rate exceeding the economic decrease in value of the asset in question. The rate and method of depreciation for tax purposes depends on the class of the asset.

Most operating equipment used for business purposes is depreciated as a single asset pool up to 25 per cent a year. The taxpayer is free to apply lower rates between zero and 25 per cent, and may change the rate every year. For operating equipment with a long economic life, such as certain vessels, aircraft, drilling platforms and offshore equipment, the depreciation rate is, however, reduced to 15 per cent (from 2016 onwards). Further, depreciation is only allowed at a rate of up to 7 per cent for certain infrastructure facilities. These assets are stated on separate balances.

Assets with an estimated lifetime not exceeding three years and assets with a value below 13,500 (2018) may be fully written off in the year of acquisition.

With respect to commercial equipment and some vessels, advance depreciation is permitted provided that a binding contract has been entered into; the contract is for delivery or completion of assets within four years of the award of the contract; and the contract price exceeds 1,539,100 Danish kroner (2018).

Buildings and installations are generally depreciated at a rate of up to 4 per cent, and goodwill and other intangibles may be depreciated on a straight line over seven years.

Recaptured depreciations or losses are taxed as income in the year of sale.

Capital and income

Corporate taxation applies to both income and taxable capital gains.

Losses

Tax losses may be carried forward indefinitely. Tax loss carry-forwards from previous income years may only be fully deducted in the taxable income up to a base amount of 8,205,000 Danish kroner (2018). Further tax loss carry-forwards can only reduce the remaining taxable income up to 60 per cent. Tax loss carry-forwards in excess hereof can be applied in subsequent income years.
The rules on tax losses carried forward apply at a consolidated level for companies subject to joint taxation in Denmark. Companies subject to tax consolidation share the threshold of 8,205,000 Danish kroner after setting off against income losses internally within the tax group.

Danish companies might consider whether voluntary depreciation and amortisation for tax purposes should be made if this leads to higher carry-forward losses that the company is not in a position to utilise. In certain situations, these rules may also lead to a strain on liquidity for companies with large carry-forward losses. To counter such strain on liquidity, companies can consider trying to convert tax losses into depreciable amounts, as the rules do not set up any restrictions on tax depreciations. One way to convert tax losses would be to make an intra-group transfer of assets leading to a higher depreciable amount in the purchasing entity.

Restrictions apply in the case of direct or indirect changes to more than 50 per cent of the share capital or voting rights during an income year. In addition, a subsidiary’s tax loss carry-forward may be restricted if a change of ownership takes place in the parent company. The restrictions do not apply to listed companies, and special rules exist for financial companies.

Carry-back of tax losses is not permitted under Danish tax law.

Rates
The corporate income tax rate in Denmark is 22 per cent.

Administration
The Danish Tax Authority (SKAT) is responsible for the administration of legislation on all kinds of taxes, including excise taxes and duties. Information concerning the tax system is available on the SKAT website\(^3\) and the Danish Ministry of Taxation website.\(^4\)

Complaints against decisions made by the tax authorities may be filed with the Danish Tax Appeals Agency, which will either refer the cases to a regional appeals board or the National Tax Tribunal, which decides on leading cases. Decisions by an appeals board or the National Tax Tribunal may be brought before the courts of law.

Corporations pay taxes on account twice a year, and must file a tax return with the tax authorities no later than six months following the end of the relevant income year. The actual taxable income for the year is calculated on this basis, and results in either a tax refund or payment of remaining tax.

The statute of limitations for an assessment is three years and four months after the end of the income year (five years and four months for transfer pricing adjustments). In addition, an extraordinary assessment may be made in certain specific situations, including in the event of a taxpayer’s gross negligence.

Tax grouping
There are two types of consolidated tax grouping in Denmark: mandatory joint taxation, which applies to all Danish consolidated companies and Danish PEIs under common control;

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3 \(\text{www.skat.dk/SKAT.aspx?lang=us.}\)
4 \(\text{www.skm.dk/english.}\)
and voluntary international joint taxation, under which all foreign companies and foreign PEs (downstream as well as upstream) may opt for joint taxation with Danish entities. An election of international joint taxation is binding for 10 years.

A parent company and its subsidiaries constitute a group. Further, a company, foundation, trust or association will qualify as a parent company if it directly or indirectly holds the majority of voting rights in another company (the subsidiary) or if it controls the subsidiary in any other way.

Each entity encompassed by the joint taxation is, as a general rule, treated as a separate entity, and must calculate its taxable income in the same manner as any other entity. The jointly taxed income is made up as the sum of the taxable income for each company (i.e., the incomes are pooled). The entire income of a subsidiary will be included even if the subsidiary is not solely owned by the parent company. Only income relating to the period of consolidation will be included.

The ultimate parent company and wholly owned entities within the group are jointly and severally liable for the payment of income taxes and withholding taxes on dividends, interest and royalties from other companies within the tax group. Other entities within the group are liable on a subordinated basis.

ii Other relevant taxes
The most important indirect taxes are VAT and payroll tax. The Danish VAT rate is 25 per cent. Other indirect taxes are energy duties, real estate taxes and stamp duties. Employees must pay a labour market contribution of 8 per cent of their salary.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence
A company is considered to be tax-resident in Denmark if it is incorporated and registered in Denmark. A non-domestic company is considered to be tax-resident in Denmark if it has its place of effective management in Denmark. Under Danish law, the ‘place of effective management’ first and foremost refers to the day-to-day management of the company. Accordingly, a non-domestic company will be regarded as tax-resident in Denmark if the day-to-day management is carried out from Denmark.

ii Branch or PE
Non-resident companies can be subject to limited tax liability either through a PE in Denmark (usually a branch registered as such with the Danish Business Authority), Danish real estate or through withholding taxes on income from certain Danish sources.

Non-resident companies that carry on business or participate in business in Denmark through a PE are subject to tax on all income attributable to the PE.

In general, the Danish tax treaties are based on the OECD Model Tax Convention. The tax authorities apply the OECD guidelines when determining whether a PE exists, including the agent rule; however, the guidelines will be interpreted in view of domestic law.
Denmark

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes

The taxation of dividends received by a Danish company and capital gains on shares under the Danish participation exemption depends on whether the shares are classified as subsidiary shares, group shares or portfolio shares:

a subsidiary shares: the shareholder owns directly at least 10 per cent of the share capital in a company resident in Denmark or in a country where taxation of dividends must be reduced under the EC Parent–Subsidiary Directive or according to a tax treaty;

b group shares: shareholding in a group company (controlling interest whereby the companies are subject to mandatory Danish joint taxation or qualify for voluntary Danish international joint taxation); and

c portfolio shares: shares that do not qualify as subsidiary shares or group shares.

Dividends on subsidiary shares and group shares are tax-exempt, whereas dividends on portfolio shares are subject to taxation. However, certain anti-avoidance rules may apply.

Capital gains on subsidiary shares, group shares and unlisted portfolio shares are tax-exempt, whereas capital gains on listed portfolio shares are subject to taxation. Losses on subsidiary shares, group shares and listed portfolio shares are not tax-deductible, whereas losses on listed portfolio are tax-deductible. Tax-deduction of losses on listed portfolio shares are not source-limited, if the company uses the inventory principle. Consequently, losses are deductible in other income sources. However, if the company uses the realisation principle the tax-deduction will be source-limited. A loss can be carried forward to the following income years.

Capital gains and dividends are taxed at the corporate income tax rate of 22 per cent.

ii IP regimes

No IP regimes exist under Danish tax law.

iii State aid

The Danish tonnage tax regime complies with the EU rules on state aid in the maritime sector. State aid is not available in other sectors.

iv General

Shipping companies may elect to operate under the very attractive tonnage tax regime. Under the regime, tax is levied on the basis of the gross tonnage of the vessels owned or chartered by the shipping company, and not on the basis of the profits generated by these activities. The effective tax rate is close to zero, and the regime also includes capital gains on the vessels (which are therefore de facto untaxed).

The regime is optional and, if elected, replaces ordinary taxation. An election is binding for a period of 10 years and must comprise all vessels and assets to which the regime is applicable.

The regime applies to vessels with a gross register tonnage of at least 20 tonnes, and which are owned or chartered by the shipping company. Special restrictions apply to shipping
companies of which the total gross tonnage is more than four times the tonnage owned by the company itself, and to vessels owned by the shipping company and chartered out to a third party. Parts of vessels can be subject to the tonnage tax regime.

The regime generally only applies if the shipping business on average over a tax year maintains or increases its EU or EEA-registered gross tonnage as calculated in accordance with the principles set out in the Danish Tonnage Tax Act. Furthermore, the vessels must be 'strategically and commercially managed out of Denmark'.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)

As a starting point, Danish companies are obliged to withhold tax on outbound dividends, royalties and interest in intra-group loans. However, many exceptions apply as set out below, and in practice the main rule is that no tax is withheld at source, as Denmark often waives taxation on dividends, royalties and interest paid to a beneficial owner resident in another state that has a tax treaty with Denmark or is a Member State of the EU.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

Outbound dividend payments

Dividends paid from a Danish company to a non-resident recipient are subject to Danish withholding tax at a rate of 22 per cent.

The rate is reduced to 15.4 per cent (or less) where the recipient holds less than 10 per cent of the Danish company and the tax authorities in the recipient’s state of residence are obliged to exchange information with the Danish tax authorities under a bilateral tax treaty, international treaty or an administrative agreement.

However, dividends on subsidiary and group shares (i.e., the shareholder owns at least 10 per cent) are fully exempt from withholding tax if Denmark is obliged to reduce or waive taxation on the dividends under the EU Parent–Subsidiary Directive or under a tax treaty with the recipient’s state of residence. The exemption will not apply if the dividends stem from a foreign subsidiary and the Danish subsidiary is regarded as a conduit company (stepping-stone) and the dividends are paid to a parent company outside EU. Consequently, foreign companies may not be able to use Danish companies to achieve a more favourable tax position for dividend income from other foreign companies than the foreign company itself would be able to obtain by a direct ownership without routing the dividends through Denmark.

To benefit from a tax treaty or the Parent–Subsidiary Directive, the recipient must be the beneficial owner of the dividend.

Outbound interest payments

For all practical purposes, the main rule is that no withholding tax is levied on interest payments. However, Denmark imposes withholding tax at a rate of 22 per cent on interest paid on debt between ‘related parties’ if:

- one of the companies directly or indirectly owns more than 50 per cent of the share capital or the voting rights in the other company;
the same group of shareholders directly or indirectly holds more than 50 per cent of the share capital or the voting rights in the companies; or

the foreign company exercises joint control over the Danish company together with one or more other shareholders (e.g., by a shareholder agreement between the foreign company and such other shareholders).

No withholding tax is levied if Denmark must waive or reduce withholding tax under the EU Interest and Royalty Directive or under an applicable tax treaty (no tax is levied even if the treaty grants Denmark a reduced right of taxation).

**Outbound royalty payments**

Royalty payments from Danish sources to non-resident recipients are subject to Danish withholding tax at a rate of 22 per cent.

However, royalty payments are exempt from withholding tax if Denmark is obliged to reduce or waive taxation under the EU Interest and Royalty Directive, (i.e., the EU companies involved have been associated for a continuous period of at least one year during which the royalty payments are made).

Royalty payments are defined as payments received as consideration for the use of or for the right to use any patent, trademark, design or model, print, secret formula or process of manufacture, or as consideration for information on industrial, commercial or scientific knowledge.

**iii   Double taxation treaties**

Denmark has concluded double taxation treaties with approximately 85 jurisdictions, including an important treaty with China that facilitates investments from China through Denmark into Europe and vice versa. Denmark continues to work on eliminating double taxation, and several new double taxation treaties are currently being negotiated.

The treaties are generally based on the OECD Model Convention. In general, they provide a reduction in the withholding tax rate on outbound dividends, interest and royalty payments.

**iv   Taxation on receipt**

Inbound dividends, interest and royalty payments are generally taxed as corporate income. Denmark grants credit for any paid foreign taxes. However, the credit is limited to the amount of Danish tax payable on the foreign net income calculated according to Danish principles.

**VII   TAXATION OF FUNDING STRUCTURES**

Danish entities are normally funded partially by way of equity capital from the investors and partially by indebtedness. Equity contributions are generally not a taxable event under Danish tax law.

Interest payments on debt are generally tax-deductible. However, the deductibility of interest expenses may be limited under the following three rules: the ‘thin capitalisation test’ imposes a debt-to-equity ratio of 4:1; the ‘asset test’ limits the deduction to 2.9 per cent of the operating (non-financial) assets; and the ‘EBIT test’ limits the deduction to 80 per cent of the earnings before interest and taxes.
i  
**Thin capitalisation**

The thin capitalisation test limits the deductibility of Danish company and PE interest expenses and capital losses on ‘controlled debt’. Controlled debt means debt to a related entity when the Danish entity is:

- controlled by the related entity;
- controls the related entity;
- is under common control with the related entity; or
- has a foreign PE which, in turn, is the related entity. ‘Control’ means that more than 50 per cent of the shares or voting rights are, directly or indirectly, owned or controlled.

If the Danish debtor has controlled debt, the controlled debt exceeds a minimum threshold of 10 million Danish kroner, the Danish debtor’s debt-to-equity ratio exceeds 4:1 and the Danish debtor fails to demonstrate that a similar loan could have been obtained from an unrelated third party (arm’s-length exemption), interest expenses and capital losses relating to debt in excess of the 4:1 ratio cannot be deducted (however, only for such part of the excess debt that would need to be qualified as equity for the 4:1 ratio to be complied with).

Certain sectors, such as the financial services sector, may generally operate with higher debt-to-equity ratios, and such market practices can be used as a basis for claiming interest deductions beyond the 4:1 ratio.

ii  
**Deduction of finance costs**

The general right for companies to deduct finance costs, including interest payments, is subject to several limitations, primarily to prevent foreign equity funds from reducing the tax base by disproportionate loan-taking in the company (debt push-down).

The objective of the following two main limitations is to limit the tax deductions to the amount of debt that is reasonably required to finance the company. The limitations apply to all kinds of debt (i.e., debt to unrelated parties as well as debt to related parties).

The rules apply to the extent that the company’s net finance costs exceed a threshold of 21.3 million Danish kroner.\(^5\) For companies covered by the Danish joint taxation scheme, the threshold is calculated on a group basis.

**Asset test**

Under the asset test, net financial costs exceeding a cap calculated as the standard rate of return (2.9 per cent for 2018) multiplied by the tax base of the company’s qualifying assets (i.e., on group basis) cannot be deducted.

Shares held in foreign subsidiaries will be included in the asset loss.

Net finance costs reduced according to the rules on thin capitalisation will not be included in the net finance costs when assessing a reduction according to the asset test.

**EBIT test**

Under the EBIT test, net financial costs exceeding 80 per cent of the taxable EBIT cannot be deducted in the tax year, but are, unlike under the asset test, eligible for carry-forward to future years.

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\(^5\) With effect from 1 January 2014, the threshold of 21.3 million Danish kroner was frozen. Accordingly, the automatic yearly adjustments are no longer applicable.
iii  Restrictions on payments
Dividends may be distributed at any time provided that the company has distributable reserves. Dividend distributions are contingent upon the decision of the shareholders’ meeting and approval by the board of directors, which is obliged to ensure that the company has sufficient unrestricted reserves at all times.

iv  Return of capital
Repayment of equity capital to investors requires a capital reduction or liquidation of the company.

For Danish tax purposes, a capital reduction is considered to be a dividend distribution unless prior permission to consider the payments as capital gains is obtained from the tax authorities.

Liquidation proceeds are generally treated in accordance with the Danish rules on capital gains of shares if the distributions take place in the income year in which the company is dissolved. As foreign shareholders are normally not subject to taxation on capital gains on shares, such shareholders should not be taxed upon liquidation of a Danish company.

Liquidation proceeds distributed in the income year in which the company is dissolved will, however, be treated as dividends if the recipient owns at least 10 per cent and dividends would be subject to Danish withholding tax, or owns less than 10 per cent of the share capital, but is affiliated with the company being dissolved and is liable to Danish withholding tax on dividends (see Section VI.ii).

VIII  ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i  Acquisition
A Danish business may be acquired as an asset transfer or as a transfer of shares.

If the seller is not resident in Denmark for tax purposes, disposal of shares is not a taxable event in Denmark. Moreover, a valuation of the assets is not necessary. A special anti-avoidance rule applies in certain situations.

Capital gains on transfers of shares are exempt from Danish taxation if the seller is a corporate shareholder holding subsidiary shares, group shares or unlisted portfolio shares (see Section V.i).

Asset transfers are for tax purposes regarded as selling assets individually. Accordingly, gains and recaptured depreciations are taxable, and losses are deductible.

Danish corporate law prohibits certain types of financial assistance, meaning that investors cannot finance an acquisition with the target company’s capital unless such acquisition is financed with the target company’s distributable reserves. Further, investors should be aware of the limitations on thin capitalisation and deduction of financing costs (see Section VII).

ii  Reorganisation
Denmark allows for tax-exempt corporate reorganisations provided that certain conditions are met, and that tax evasion or tax avoidance are not the principal objectives of the reorganisation.
Tax-exempt reorganisations may be carried through with or without prior permission. Prior permission requires the reorganisation to be justified by business reasons. This is not a requirement if the reorganisation is carried out without obtaining prior permission, but in such case a three-year holding requirement (as well as dividend limitations) applies.

A tax-exempted merger between a foreign and a Danish company requires prior permission in certain cases. The merger is tax-exempted, but Danish exit tax will be imposed on assets not remaining under Danish taxation.

A partial demerger (e.g., the demerged company continues to exist) made without prior permission is subject to certain restrictions: the transferred assets and liabilities must constitute a branch for Danish tax purposes, and the balance between assets and liabilities must be the same prior to and following the demerger.

The date of the reorganisation must generally coincide with the date of the beginning of the financial year of the receiving company. In this sense, it is possible to give the reorganisation retroactive effect.

### Exit

It is not possible to relocate an incorporated company without liquidation. However, Denmark may be obliged to waive or reduce taxation under a double taxation treaty if the management becomes resident in another state.

If a corporation ceases to be resident in Denmark for tax purposes, Danish exit taxation is imposed on taxable assets and gains. Denmark has rules allowing companies to opt for deferred exit tax payments on unrealised capital gains on assets transferred from one EU or EEA Member State to another.

Assets remaining in Denmark may constitute a PE (see Section IV.ii), with the result that no Danish taxation will be imposed upon cessation of Danish residency.

### IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

#### i General anti-avoidance

Denmark has taken significant steps towards preventing tax avoidance and tax planning by implementing anti-abuse rules. Generally, the anti-abuse clauses seek to deny the taxpayer the tax treaty benefits and the EU tax directive benefits by tackling arrangements, or series of arrangements, that have been put into place with one of their main purposes being the obtaining of a tax benefit, and that are not genuine, i.e., that are not put in place for valid commercial reasons that reflect economic reality having regard to all the relevant facts and circumstances.

The most important Danish specific anti-avoidance provisions are the rules on reclassification of hybrid structures, controlled foreign corporations (CFCs) and transfer pricing regulations.

**Hybrid entities**

Hybrid entities are generally considered non-transparent for Danish tax purposes. However, if a Danish limited liability company is considered to be tax transparent in the jurisdiction of its foreign shareholders, the company will also be tax transparent for Danish tax purposes. In other words, the classification of the Danish entity will be changed to secure identical tax treatment in the two jurisdictions under Danish law.
If the Danish company is regarded as tax transparent, the company is not entitled to
deduct interest payments, royalty payments, etc., paid to its foreign shareholders. The Danish
activities will constitute a Danish PE of its shareholders, and all assets and liabilities of the
company will be allocated to the PE irrespective of the normal principles for allocation of
income to PEs.

**Reverse hybrid entities**

If a Danish transparent entity is treated as a non-transparent entity in the jurisdiction of the
majority of its shareholders or owners, it will also be treated as non-transparent for Danish
tax purposes. The same applies if the majority of the owners of such transparent entity are
resident in a state that has not concluded an agreement on exchange of tax information with
Denmark.

The main consequence is that distributions made by the hybrid entity to its owners will
generally be treated as dividend payments. Whether such payments are subject to Danish
withholding tax depends on the owner’s place of residence and whether the owner is eligible
for a participation exemption (see Section VI.ii).

Disposal of part of the entity will be treated as a sale of shares, which is generally
tax-exempt when the shareholder is not a Danish resident for tax purposes.

An exemption applies for ‘venture funds’, provided a number of specific requirements
are fulfilled.

**Hybrid instruments**

Moreover, debt instruments that are considered as equity in the creditor’s foreign state
(hybrid instruments) are also treated as equity for Danish tax purposes, meaning that interest
payments from Danish debtors are not tax-deductible in Denmark.

In the event a dividend distribution would be subject to Danish withholding tax,
any other forms of distribution, which are technically not dividends, may be taxed as if the
distribution was a dividend distribution.

**ii CFCs**

Danish CFC rules apply to foreign subsidiaries as well as to Danish subsidiaries of Danish
companies if:

- the Danish company controls, directly or indirectly, more than 50 per cent of the
  voting power in the subsidiary;
- more than 50 per cent of the total income of the subsidiary is of a financial nature
  (taxable interest, taxable gains on securities and foreign currency, etc., certain deductible
  commissions concerning loans, taxable dividend payments, taxable gains on shares,
  licence fees relating to intellectual property, taxable income from finance leases and
  taxable income from insurance business); and
- at least 10 per cent of the subsidiary’s assets are of a financial nature as described above.

If these conditions are met, the entire income of the subsidiary will be included in the parent’s
taxable income, and the parent is granted credit for taxes paid by the subsidiary in its country
of residence.
iii Transfer pricing
Transactions made between affiliated companies must be carried out on arm's-length terms. Companies are generally regarded as affiliated if:

a one of the companies directly or indirectly owns more than 50 per cent of the share capital or the voting rights in the other company;

b the same group of shareholders directly or indirectly owns more than 50 per cent of the share capital or the voting rights in each of the companies; or

c the company exercises joint control over the other company in conjunction with one or more other shareholders (e.g., by a shareholders’ agreement on voting rights and management).

A company and its PE are also regarded as related companies.
Related companies must prepare and file transfer pricing documentation showing how the companies have set the prices for inter-company transactions.

If the prices agreed by the companies are different from what would have been negotiated in an arm’s-length transaction between independent parties, the tax authorities are authorised to adjust the prices. Denmark generally follows the OECD transfer pricing guidelines.

iv Tax clearances and rulings
It is possible to obtain binding advance rulings from the tax authorities if uncertainty exists as to the possible tax implications of a planned or already undertaken transaction. Such ruling is binding on the tax authorities for a period of five years. Denmark has amended the rules on binding advanced rulings in relation to the valuation of assets when exiting Denmark. The amendment reduces the binding effect of such rulings to a maximum of six months.

In general, a tax clearance is not required to acquire a local business.

X YEAR IN REVIEW
The following significant changes and developments in 2018 can be mentioned.

Denmark has implemented Council Directive (EU) 2018/822 of 25 May 2018 on mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements. The purpose of the mandatory reporting obligation is ‘deterring aggressive tax-planning practice’. The reporting shall be handled as a bundle filing of all reportable arrangements in the period from the effective date 25 June 2018 to 1 July 2020. From 1 July 2020, the relevant taxpayer and the intermediaries (e.g., lawyers) have to file information that is within their knowledge on reportable cross-border arrangements with the competent authorities within 30 days. The Danish legislation must be in force no later than December 2019.

The Danish parliament has adopted a bill on permission of the deduction of payroll expenses. The rule came into force on the 1 January 2018. This new deduction rule has retroactive effect from the income year 2008. Consequently, a company can request the Danish Tax Authority for a resumption if its tax assessment in order to benefit from the possibility of deduction of payroll expenses.

The Danish Tax Authority has been subject to a major structural change. Before 2018, the Authority was one unit but has since 1 June 2018 been divided into seven different
independent agencies. The main purpose of this division was a political intention of strengthening the organising, increased specialisation and enhanced professionalism and quality. The Danish Tax Authority additionally divided into the following specialised units:

- the Danish Debt Collection Agency;
- the Danish Property Assessment Agency;
- the Danish Tax Agency;
- the Danish Motor Vehicle Agency;
- the Danish Customs Agency;
- the Danish Development and Simplification Agency of the Danish Ministry of Taxation; and
- the Administration and Services Agency of the Danish Ministry of Taxation.

The Danish Tax Council has issued a ruling on whether an employee constituted a permanent establishment in Denmark. Despite the employee's inability to enter into agreements on behalf of the foreign enterprise, an employee of a foreign company would constitute a permanent establishment because the employee's activities were an integral part of the enterprise's business and could not be considered as preparatory or auxiliary in nature.

XI OUTLOOK AND CONCLUSIONS

The Danish parliament has proposed a bill on debureaucratization of the special tax scheme as an incentive for foreign researchers. The bill proposes to make the scheme more convenient and thereby attract even more highly educated persons, which is the whole purpose of the special tax scheme.


i Exit taxation

The applicable Danish rules on exit taxation, inter alia, correspond generally with the rules in the Directive. However, the bill proposes adjustments of the Danish rules on respite, inter alia, (1) that the respite system shall no longer include situations where assets and liabilities are transferred to Liechtenstein, implied that an agreement regarding mutual assistance on recovery of tax demands; (2) that companies with a PE in Denmark can receive respite on the exit taxation provided that the assets and liabilities are transferred to another PE within the EU, Norway or Iceland; (3) that the respite amount has to be amortised with one-fifth of the respite amount per year in the first five years following the transfer; and (4) that the rules regarding the due date have to be changed. According to the bill, the rules have effect on assets and liabilities transferred on 1 January 2020 or later.

ii General anti-abuse rule

The bill proposes that the Directive's anti-abuse rule is implemented by replacing the similar provision in the Danish Tax Assessment Act. The new anti-abuse rule will apply to companies (e.g., public and private limited companies), funds, associations, and other non-taxable
companies that participate in the arrangements. According to the bill, an arrangement or a series of arrangements is prohibited if they have been put into place for the main purpose of, or if one of the main purposes is, obtaining a tax advantage.

iii  CFC rule
The bill, *inter alia*, proposes (1) that a CFC unit is defined so widely that it includes all types of companies; (2) that subsidiaries are exempted provided that they are subject to an effective taxation which corresponds with the standards of the parent company; (3) that CFC income should be defined in a way that it ensures that income that gives cause for concern regarding tax avoidance is included; (4) that the CFC income is calculated according to the rules in the parent company; (5) that both the equity interest and the period of ownership should be taken into consideration when determining the share of the CFC company’s income that has to be included with the parent company; and (6) that certain rules shall prevent the situation where the CFC taxation causes double taxation.

iv  Hybrid mismatches
Generally, the bill, which is in accordance with the underlying Directive, contains rules focused on handling situations where the different classifications of, for example, financial instruments in different countries leads to various forms of mismatch. According to the bill, such hybrid mismatches are met with various means, for example, the denial of deduction of payments, when the hybrid mismatch results in a deduction without inclusion.

v  Dispute settlement process mechanisms in the EU
The Danish parliament proposes that Directive 2017/1852/EU on tax dispute resolution mechanisms in the European Union is made applicable in Denmark. By doing so, a set of rules regarding complaints over double taxation are introduced as well as a system to solve disputes related hereto. Generally, the system consists of three phases: (1) submission of the complaint; (2) mutual agreement procedure; and (3) the settlement of the dispute by arbitration.

vi  The VAT treatment of a voucher
The bill proposes, in accordance with the Directive, that the voucher-concept is defined, hereunder when a voucher serves one or more purposes, the time of payment of the VAT and what the basis of the VAT is.

vii  Adjustments of special arrangement for electronic devices
The purpose of the bill is to implement the simplifications due to Directive 2017/2455/EU. The proposed amendments consist of the introduction of a common limit regarding intra-Community distance sales for electronic goods, amendment of the rules regarding invoicing and an adjustment of the scope of application for the non-EU-scheme.

viii  Adjustment of the rules on cost reimbursement
The proposed bill suggests that cost reimbursement should be granted in cases comprehended by the Danish law on tax dispute resolution mechanism in the European Union (see Section XI.v).
Chapter 8

ECUADOR

Alejandro Ponce Martínez

I INTRODUCTION

Ecuador was a private investment-oriented country until 2006, when the government changed its direction and unilaterally amended the participation contracts for oil exploration and exploitation, introducing a clause establishing a legal requirement for government participation of up to 99 per cent of the difference between the international price of crude oil in force at the time such contracts were entered into (mostly in 1995) and the actual price. Shortly after this, during 2007 and 2008, the Constitutional Assembly heavily amended the taxation laws, imposing barriers to the judicial discussion of tax determination, increasing the taxation rates for private individuals and limiting tax incentives for corporate reinvestment of profits. Additionally, the scheme of taxation on corporate profits was also amended to double tax dividends, with both a corporate tax on profits and tax on personal income, and introducing a system where, even without taxable profits, companies and corporations were submitted to income tax on unearned profits, based on a rate of taxation of net worth. Public enterprises, on the contrary, were widely promoted, and privatisation was eliminated.

Bilateral investment treaties (BITs) were affected by Constitutional Court decisions holding some of them as contrary to the Constitution. Several BITs were denounced by Ecuador between 2007 and 2016, as was the ICSID Convention. The still-in-force BITs with Italy, Peru, Spain, the United States, Canada, Venezuela, France, the Netherlands, Sweden, Switzerland, China, Germany and the United Kingdom were denounced last May 2017, during the last days of the term of former president Rafael Correa. The Ministry of Foreign Commerce under new president Lenin Moreno has proposed new negotiations with the United States and other countries based on a draft prepared by his office.

The free trade agreement originally signed between Peru and Colombia with the European Union, to which Ecuador adhered has been in force since 1 January 2017, with good results for free commerce.

The new government of Lenin Moreno, inaugurated on 24 May 2017, announced changes to encourage new investments, some of which became effective on 1 January 2018 and others on 21 August 2018.

The Constitutional Court has decided that the judges should not fulfil the provisional measures ordered by international investment arbitration panels, under the theory that they affect the sovereign state. Civil judges fulfilled the Constitutional Court order and compelled a foreign investor to enforce a judgment that the panel of arbitrators had ordered.

1 Alejandro Ponce Martínez is a senior partner at Quevedo & Ponce.
2 Prophar SA v. Judge Gabriela Lemos.
3 Prophar S.A. v. Merck & Co. Inc.
to temporarily stay,⁴ provisional measures that were extended in a first award that declared
the liability of the Republic of Ecuador for denial of justice. The Council of Citizenship
Participation and Social Control, empowered by the results of a referendum called by
President Moreno, dismissed the nine judges of the Constitutional Court on September
2018 grounded on allegations of corruption. A new Constitutional Court is in the process
of being appointed.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX
TREATMENT

i Corporate

For taxation purposes there is no distinction between corporations (stock corporations),
limited liability companies, partnerships, joint ventures, consortia or any other kind of
business associations for profits, whether legally established or formed de facto.

The most commonly used forms of business structures are stock corporations (SA) and
limited liability companies. The main differences between these two kinds of enterprises are
that shares may be freely negotiated in stock corporations, while quotas of limited liability
companies may only be transferred with the unanimous consent of all the partners or quota
holders, and as a consequence, quotas of limited liability companies may not be seized or sold
in public auction, although profits declared as dividends may be subject to seizure by debtors
of the partners of limited liability companies.

All of the above types of associations for business are considered under the general term
of ‘companies’, and all of them are taxed under the same taxation principles. All companies
are under a duty of registration before the Internal Revenue Service (SRI).

Branches of foreign companies authorised to conduct business in Ecuador are also
taxed under the same general rules, as are permanent establishments of foreign companies.

ii Non-corporate

Commercial trusts conducting entrepreneurial activities, independent or autonomous
patrimonies (whether with or without juridical personality), and any other entity with
economic unity not linked with its members are considered as companies for the purposes
of taxation, and their benefits are treated in the same way that corporate profits are and are
subject, in general, to the same formal tax obligations. Managers of trusts are liable for estate
and donation taxes when trusts are devised to transfer assets. Civil companies incorporated
with the approval of any notary are subject to the same taxation scheme.

Limited liability unipersonal enterprises (i.e., established by only one person as
managing owner) are treated for taxation purposes as stock corporations concerning profits
and declared dividends.

In practice, ‘civil and commercial companies’, which are not recognised by any law, have
also developed as businesses, and are subject to the same taxation treatment as all companies.

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⁴ Merck & Co. Inc. v. the Republic of Ecuador.
III DIRECT TAXATION OF BUSINESSES

i Tax on profits
Companies are subject to a flat-rate income tax of 25 per cent, which is calculated after the 15 per cent workers’ and employees’ profit share is deducted. However, companies intending to use their profits to increase their capital for the purpose of investments in new industrial plants or other specially determined capital investments are taxed at a rate of 12 per cent.

All company revenues and earnings are subject to income tax in Ecuador, except income obtained abroad if it was taxed abroad unless such income is obtained in tax havens. Under specific tax treaties implemented to avoid double taxation, including the Andean Community of Nations regulations on double taxation, source-of-income principles on income taxation are applicable.

All expenses directly incurred to obtain, maintain and increase revenues by the company are deductible provided that they are shown in legally approved invoices, and if such expenses were incurred for payments abroad, a withholding income tax of 22 per cent is withheld.

Generally, 20 years’ amortisation is applicable to buildings and constructions, while three to five years’ amortisation is applicable to moveable property, although under specific conditions faster amortisation might be applied considering the obsolescence of the assets, while amortisation of investments, including pre-operational investments, is five years. Intangibles are amortised over 20 years. However, under international accounting standards rules, companies may establish their own amortisation and depreciation rates according to the effective life of each asset. Amortisation of 100 per cent is provided for the acquisition of equipment destined to improve clean production, the generation of renewable energy or reduction of environmental harm.

Losses may be amortised or carried over for a period of five years, with a maximum of 25 per cent of the losses per year.

Individuals, including those conducting commercial business without a company structure, are taxed at a progressive rate from 5 to 35 per cent. Dividends earned from companies are added to individuals’ income, but income tax paid by the company is deemed as tax credit unless it is higher than the applicable tax on such dividends received by such individuals.

Fiscal years correspond to calendar years. Income tax returns are filed during the first four months of the year by companies, and during the first three months by individuals, when the income tax or any balance thereof is also paid. Advanced income tax payment for the next year is equivalent to 50 per cent of the income tax of the preceding year, calculated after deduction of the amounts withheld at the source of the income. This is paid in two instalments during July and September. Such advanced income tax is calculated on the basis of the mathematical addition of 0.2 per cent of the net worth, 0.2 per cent of the expenses, 0.4 per cent of the total assets and 0.4 per cent of taxable income if such sum is higher than the advanced payment calculated on the basis of 50 per cent of income tax. Tax returns and tax payments are filed and made through private banking institutions.

The SRI is the only national administrative body regarding income tax, VAT, tax on special consumption and tax on remittances of money abroad, and other national taxes except customs duties, which are under the control of the National Customs Corporation. Municipalities administer and control municipal taxes such as, inter alia, real property tax, tax on transfers of real property, tax on capital gains derived from the sale of real property, tax on business capital assets and business year authorisation tax. The SRI has offices and agencies in all cities in Ecuador.
The SRI and other tax authorities have the power to regulate the application of taxes and answer matters raised by taxpayers, which become binding. The SRI has the power to audit national taxes and to decide on administrative claims filed by taxpayers concerning the results of tax decisions. Taxpayers may claim against original tax decisions or final administrative decisions before the courts. However, to suspend the enforcement of the decision of the taxing authorities, in the event a judicial claim is filed, a bond equivalent to 10 per cent of the tax debt should be rendered, otherwise the action brought will not be admitted.

Holding companies – that is, companies whose only corporate purpose is to own shares, quotas or rights in other companies with the purpose of having direct control over such other companies – may consolidate the financial results of all of the controlled companies, but for the purposes of taxation, each company forming the economic group is an independent taxpayer.

For the purposes of control by the SRI and other tax authorities, economic groups are those where one or more persons have at least a 40 per cent participation in other companies. The importance of economic groups relates to the rules on transfer pricing either internally or externally.

ii Other relevant taxes

VAT is applicable to the transfer of ownership or to the importation of moveable goods of a corporeal nature in all phases of trading, as well as to the transfer of copyright and connected rights, and industrial property rights, and to services rendered as provided in the law. The ordinary rate is 12 per cent of the price or value of the good or service, except for some transactions that are subject to a zero per cent rate (which means that, in practice, there is tax).

Transfers for the purposes of the application of VAT are any act or contract intended to transfer ownership of the above-mentioned goods or rights, either by sale or gift, and the use or consumption of corporeal moveable goods produced by the user or consumer.

Certain transactions are not subject to VAT, including:

- contributions to the capital of companies;
- sales of total assets and liabilities of all kinds of businesses;
- adjudications in the case of partitions of estates or liquidated companies, or dissolved marital property;
- mergers;
- company divisions;
- donations to public entities or to non-profit organisations; and
- transfers of shares, quotas or participations in companies.

VAT paid in the acquisition of goods or services are tax credits with respect to VAT generated in the transfer of goods or rendering of services by a taxpayer subject to VAT.

Tax on special consumption is applicable to the importation or transfer of specific moveable goods of a corporeal nature or to specific services determined by law, such as cigarettes, alcoholic beverages, sodas, perfumes, video games, firearms, incandescent bulbs, vehicles, aeroplanes, ships, paid television services, casino services and social club affiliation services. The rates vary from 10 to 300 per cent of the price of the goods or services.

Other important taxes are:

- the 5 per cent tax on any transfer of money abroad, except importations and the payment of registered foreign loans;
b the annual contributions to the Superintendence of Companies by companies controlled by such entity, mainly stock corporations and limited liability companies, and to the Superintendence of Banks and Insurance by the companies controlled by such entity;
c the annual municipal taxes on total assets of commercial business (at a rate of 0.15 per cent); and
d customs duties.

All transfers of assets or rights to juridical persons or individuals domiciled in tax heaven jurisdictions are deemed as donations and subject to the applicable tax.

The municipalities also collect taxes on real property and on the transfer of real property, including taxes on capital gains derived from the sale of real property. There is also a tax on funds maintained abroad by financial companies and banks, and by companies managing funds and trusts.

Under the Environmental Development and State Resources Optimisation Act of 2012 (Act of 2012), banana production is subject to income tax calculated on the basis of a rate of 2 per cent on gross revenues. This way of determining income tax might be applicable, if requested by the producers’ associations, to agriculture, fisheries and aquaculture activities. The Law on tax incentives for certain sectors, in force since 12 October 2016, imposes on other subsectors of agriculture activities, as well as on other subsectors of the fishery industry and of the aquaculture industries, a tax of 1 to 2 per cent on gross revenues.

Under the Act of 2012 and its amendments, rates for a special consumption tax on beer and cigarettes were increased through different models of calculations of taxation on units and ad valorem, or a mixture of both. Special consumption tax rates on other goods were also changed, especially in connection with vehicles, to encourage the production and importation of hybrid or electrical vehicles.

A special tax on environmental contamination is applicable to persons or companies that are owners of motor vehicles. The rates are established on the basis of the impact to the environment (based on the size and the age of the vehicle).

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

Companies incorporated in Ecuador should determine the city of their domicile. Foreign companies that have decided to conduct activities in Ecuador may obtain the approval of the Superintendence of Companies to establish a branch in Ecuador, while financial institutions, insurance companies and banks may obtain the same authorisation from the Superintendence of Banks and Insurance. With such authorisations, the entities involved establish the tax domicile of such branches as Ecuador at the same time. Like most taxpayers in Ecuador, they should register as taxpayers with the SRI.

Foreign companies receiving earnings from an Ecuadorian source may appoint an attorney-in-fact to represent them with respect to tax obligations in Ecuador. Taxpayer registration should also be obtained.

Financial institutions may have representatives in Ecuador, but they are not allowed to transact business.
Branch or permanent establishment
Branches of foreign companies authorised to conduct business in Ecuador are subject, in general, to the same tax regime as domestic companies.

Permanent establishments of foreign companies are qualified by the SRI if specific factors or elements of permanent presence in Ecuador exist, such as places to conduct economic activities in Ecuador, factories, warehouses, offices or a person with enough power to act as an agent of the foreign company. Such permanent establishments are taxed on the same basis as other companies doing business in Ecuador, whether incorporated in Ecuador or established as branches of foreign companies.

TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes
Holding companies, namely, companies whose only corporate purpose is to acquire and maintain shares in other companies for the purposes of controlling them, may consolidate their balance sheets with the controlled companies, but each one of the controlled companies has an independent taxation regime. It is deemed that economic groups are formed by companies whose shares are owned in a proportion of 40 per cent or more by the same company or by the same group of companies, or belonging to the same physical persons. Holding companies are not subject to advanced payment of income tax that other companies and other taxpayers are.

ii IP regimes
No special beneficial tax regimes are allowed in Ecuador. However, special incentives consisting in exoneration of income tax have been granted to new investment in several areas, including cinematography, audiovisuals, biotechnology and applied software.

iii State aid
Investors conducting business as concessionaires of state-owned resources may enter into investment contracts with the government, whereby the state may guarantee that the economic equilibrium in the contract will be maintained if laws increasing the taxation affecting the concessionaire are implemented.

iv General
Reinvestments of company profits through capitalisation, if such capitalisation is destined for the acquisition of capital assets destined for production and scientific development (except real property), are subject to income tax at a rate of 12 per cent instead of 25 per cent.

Foreign investors not domiciled in tax havens are not subject to income tax on profits or dividends earned from local companies in which they own shares or have participation. However, as previously explained, the companies pay income tax on the companies’ profits, which, with the exception of dividends received by physical persons, dividends received by companies as stockholders or partners of other companies, are not double taxed.

Special deductions are granted for five years for expenses incurred in training aimed at research, development and innovation conducted by medium-sized companies, as well for the expenses of such companies aimed at improving productivity or incurred during travel for commercial promotion and access to international markets.
Newly incorporated companies that have their activities in cities other than the urban areas of Quito and Guayaquil, and that are carrying out food production, forestry and products thereof, or are producing or involved in metal mechanisms, petrochemicals, pharmaceuticals, tourism, renewable energy, logistical services in foreign commerce, biotechnology, software and strategic sectors determined by the president, are income tax-exempted for five years after starting productive activities on revenues derived from new investments.

New productive investments, made after 21 August 2018, in agriculture, forestry, metallic mechanical industries, the petrochemical and oil chemical sector, pharmaceuticals, tourism, cinematography, audiovisuals, renewable energy, logistic services for foreign commerce, biotechnology and applied software, exported services, development and services of software, production and development of technological hardware, digital infrastructure, digital content, online services, energy efficiency, sustainable industries on materials and technology of construction, industrial, agro-industrial and agro-associative sectors, as well as sectors considered as strategic substitutes of import will be exempted for 12 years after the first year of generation of revenues, except if such investments are located in the urban areas of the cities of Quito and Guayaquil, which will enjoy such exemption for eight years after the first year of revenues earnings.

However, private financial companies, banks and issuers of credit cards do not enjoy the benefit of a 10 per cent deduction on income for reinvestment of profits, and have the duty to anticipate income tax on the basis of 3 per cent on gross revenues (with a possible reduction to 1 per cent). The monthly tax rate on funds and investments abroad of financial institutions and companies devoted to investment funds and trusts is established at 0.25 per cent, which increases to 0.35 per cent in the case of deposits or investment in tax havens.

Financial services are subject to 12 per cent VAT, instead of zero per cent.

Banks and financial institutions are under the duty to supply the SRI with any requested information of concern to taxpayers as the clients of such entities, without restriction.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)

All kinds of payments or credits abroad representing taxable income or reimbursement of taxable income are subject to 25 per cent withholding by domestic companies and business entities. Since companies’ profits are taxable income for the companies, no withholding is applicable on taxes, unless the person or company receiving the dividend is a resident of a tax haven or of a country having a tax burden lower than the tax rate in force in Ecuador. Withholding is not applicable to reimbursement of expenses if certified by international firms of auditors doing business both in Ecuador and in the foreign country, unless reimbursement corresponds to fees, royalties or commissions.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

No withholding is applicable to:

a payments for imports;

b commissions paid for exports and tourism promotion if they do not exceed 2 per cent, except if the beneficiary is a party related to the exporter, a beneficiary of the tourism promotion or domiciled in a tax haven;
c 60 per cent of the interest in foreign loans registered with the Central Bank;
d payments abroad incurred by air or sea transportation companies connected with their
operations in Ecuador, and similar expenses of high sea fishing companies related to
such high sea activities;
e 96 per cent of reinsurance premiums paid to reinsurers not established or not having a
representative in Ecuador;
f 90 per cent of payments made to international press agencies registered in Ecuador;
g 90 per cent of ship freight; and
h payments for international leasing of capital assets if the interest is no higher than the
LIBOR rate, unless the lessee does not opt to acquire the leased assets, provided that the
leasing is not made with persons linked with the lessee or payments made to tax havens,
or the lease term is lower than the estimated life of the asset.

Indirect expenses charged from abroad to companies domiciled in Ecuador by their related
parties are deductible expenses for the local company or the company doing business in
Ecuador, provided such expenses do not exceed 5 per cent of the basis of the taxable income.
In the case of companies conducting activities in the area of non-renewable natural resources,
expenses connected with technical and administrative services are also considered among
these indirect expenses.

iii Double tax treaties

Ecuador is a member of the Andean Community of Nations (CA) and is, therefore, ruled by
Andean decisions on double taxation that establish, as a general principle, that income tax
is only applicable in the country where the activity of the company is located, and that no
withholding tax may be applied in connection with payments from one member country to
another member country of the CA.

Treaties to avoid double taxation are in force with Argentina, Belgium, Brazil, Canada,
Chile, France, Germany, Italy, Mexico, Romania, Spain and Switzerland. The treaty with
Argentina is limited to air operations.

Ecuador is also a member of the 1979 Madrid Convention to avoid double taxation on
copyright royalties and droit de suite.

Bilateral treaties are framed on the basis of the principle of origin or source of the
income to establish the power to tax and the right of taxpayers to credit tax paid abroad.
Some of them, such as the treaty with Italy, provide for a maximum rate of withholding tax.

If income that has been imposed abroad to companies domiciled in Ecuador there is
no taxation in Ecuador, irrespective of any treaty provisions, unless income was taxed in tax
haven jurisdictions.

iv Taxation on receipt

All companies should withhold 25 per cent of all dividends paid or advanced. In the case
of dividends received by physical persons residing in Ecuador, such withholding constitutes
a tax credit. If received by other companies established in Ecuador, it is a final income tax.
If dividends are remitted abroad, the withholding is attributed as income tax for the person
who has received the dividends so as to enable such foreign taxpayer to use it as a tax credit.
VII TAXATION OF FUNDING STRUCTURES

Together with original capital contributed by stockholders, quota holders or, in general, partners, companies are funded with credit, including credit from partners and issuance of debentures or bonds, which is only permitted for stock corporations.

i Thin capitalisation

Tax laws do not establish restrictions on debt or equity restrictions, but regulations on banks do provide such restrictions. Company losses should not exceed 50 per cent of net worth, otherwise companies should be dissolved unless such losses are offset either by direct contribution of the stockholders or partners, or through an increase of capital.

Investment funds should reach a net worth of at least US$52,578 within six months of starting operations provided they have at least 75 participants, otherwise they should be liquidated. Funds are under the control of the National Securities Council that works within the Superintendence of Corporations, which issues regulations for their operations.

Investment funds and complementary funds are tax-exempt, provided they withhold income tax, as applied to dividends, to participants.

ii Deduction of finance costs

In general, all finance costs are tax deductible except costs, including interest on foreign credit if the credit has not been registered with the Central Bank, or interest exceeding the tariffs established by the board of directors of the Central Bank, on the portion above the tariff. To deduct interest on foreign loans registered with the Central Bank, the amount of such loans should not exceed 300 per cent of a company’s net worth or 60 per cent of the total assets of physical persons.

iii Restrictions on payments

The general principle is that net profits should be distributed unless intended for other uses, such as capital contributions or the offset of losses. Stock corporations and limited liability companies should distribute at least 50 per cent of net profits unless there is a decision otherwise unanimously approved by the general meeting of stockholders or quota holders. Therefore, the payment of dividends on such 50 per cent of net profits is compulsory, unless otherwise approved unanimously by such general meetings. To overcome the objection to direct profits towards other objectives, after declaring dividends on the proportion established in the law, the general meeting may approve a capital increase by the offset of credits on the amount declared as dividends.

iv Return of capital

Reduction of capital is allowed if the remaining capital permits the company to continue the business. Such reduction of capital does not generate income tax.
VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition
Unless foreign companies already have a corporate entity in Ecuador, they acquire companies in Ecuador through a company incorporated abroad. Normally the business is created through an acquisition of shares, after due diligence, since such transfer does not generate any tax.

ii Reorganisation
Mergers do not generate any taxes. The surviving company is liable for all tax obligations of the merging companies. Only mergers between companies established in Ecuador are allowed.

Divisions of companies do not generate taxes. The agreement to split a company must determine how the companies will divide the profit and losses for the period the division is registered. Such agreement may provide that one of the companies will have the profits and losses of the original company. If the losses and profits are divided among the new companies, the profit and loss statement should establish an equitable allocation of the revenues with the costs.

iii Exit
A change of corporate domicile within Ecuador does not incur any tax penalties or effects. A change to a domicile abroad causes the dissolution of the company.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance
Companies established in tax havens or low-tax jurisdictions, when transacting with local companies, are deemed related companies and, therefore, the costs incurred in such transactions are tax deductible only if their value corresponds to the commercial principles of arm’s-length dealings.

Dividends received by companies established in tax haven jurisdictions or low-tax jurisdictions are not tax-exempt, and are therefore deemed taxable income.

An important decision was entered on 18 July 2013 by the Taxation Chamber of the National Court of Justice⁵ declaring as acceptable tax-deductible expenses the interest paid to related companies based on a contract between the Republic of Ecuador and a company operating an oil pipeline. However, through an action for extraordinary protection that under the Constitution is designed to guarantee due process of law, and to defend constitutional, human rights and civil liberties, the SRI obtained from the Constitutional Court vacation of the final decision⁶ and ordered the alternate judges of the Taxation Chamber of the National Court of Justice to enter a new decision, which was issued on 24 July 2014,⁷ by newly appointed associate judges, which considered that interest paid by the company operating the pipeline under a contract with the Republic was not a deductible expense, and established a new income tax with a surcharge of 20 per cent as a sanction for the taxpayer.

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⁵ Compañía Oleoductos de Crudos Pesados v. Servicio de Rentas Internas.
⁶ Servicio de Rentas Internas v. Taxation Chamber of the National Court of Justice, 26 December 2013.
⁷ Oleoducto de Crudos Pesados (OCP) Ecuador v. Servicio de Rentas Internas.
Ecuador

corporation. Previously, the Council of the Judiciary, without granting the judges that issued the 18 July 2013 decision the right to a hearing, had suspended and dismissed these judges.\(^8\)

The Council of Citizenship Participation and Social Control dismissed all the Constitutional Court judges that rendered the decision.

### ii Controlled foreign corporations

No special tax rules exist with respect to companies established in Ecuador that are controlled by foreign corporations.

All companies under the control of the Superintendence of Banks or the Superintendence of Companies having foreign companies as share or quota holders should remit to such entities the list of the partners of such foreign companies or a certificate providing evidence that they are public companies whose shares are registered on a stock exchange.

### iii Transfer pricing

The transfer pricing regime is established with the purpose of ensuring that prices between related parties are established under the same parameters as prices between independent parties. Therefore, such prices should reflect principles of competition and comparability, and a methodology for establishing such prices is submitted for the approval of the SRI.

However, the transfer pricing regime is not applicable if the taxpayer pays income tax equivalent to at least 3 per cent of total gross revenues, does not conduct business with residents in tax havens or low-tax jurisdictions and does not have contracts with the state for the exploration and exploitation of non-renewable resources.

### iv Tax clearances and rulings

It is possible to consult the SRI or other tax authorities on the interpretation and application of tax laws. The answers to such consultations are compulsory for both the tax authorities and the taxpayer, which constitutes a risk for the taxpayer. There are no cases of legal requirements to have such tax ruling in advance with respect to acquiring local business or in other cases linked to income tax.

### X YEAR IN REVIEW

Since 2009, all physical persons having a patrimony higher than US$200,000 have been required to present each year a declaration concerning their assets and liabilities. Purportedly, this information will permit the establishment of a tax on the patrimony of physical persons in the future – a tax that has the support of the SRI’s main officers as a means to reduce alleged inequalities. Regulations enacted during 2012 have established that physical persons not having the obligation to bear accounting books but with a certain level of gross revenues should report (in online form) all their expenses on a monthly basis to the SRI.

The Organic Law for Productive Development, published on 21 August 2018, re-established the rate of 25 per cent for corporate income tax, but this rate was increased to 28 per cent for companies having stockholders, partners, participants, incorporators,

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\(^8\) Disciplinary action Servicio de Rentas Internas v. Judges José Suing and Gustavo Durango, 20 December 2013.
beneficiaries or similar physical persons regarding whom the companies have not informed to the regulator authority and to the SRI or if within the channel of ownership there are residents linked with a tax haven.

Such law also provided for a progressive capital gain tax of 2 per cent to 10 per cent on the sale of shares or other participation titles on companies.

As a consequence of the complete reorganisation of the judicial system during 2012, constantly ongoing, the judges appointed for the majority of the tax courts are former officers of the SRI, which has led to suspicion regarding their impartiality.9

The surcharges on imports were eliminated as a consequence of a formal proceeding initiated by the Secretary General of the Andean Community.

The organic Law to avoid the evasion of taxation on inheritances is still in force. Thereunder, beneficiaries of trusts are subject to progressive taxation of between 5 per cent and 35 per cent.

A Public and Private Alliance Act establishing tax exemptions or benefits for energy and mining investment projects, supported by government planning, entered in force on 18 December 2015. Such law aims to encourage public projects in association with private investors by avoiding the rules for public contracting for specific projects.

VAT returned to 12 per cent from mid-2017. A special law on capital gains derived from sale of real property was enacted on 31 December 2016 establishing a rate of 75 per cent on the difference of the price at the time of acquisition after 1 January 2017 and the price of the first sale thereafter. Under the plebiscite called by president Moreno such law was abrogated.

The Organic Law on Reactivation of the Economy, in force since 1 January 2018, exempted microenterprises from income tax for three years, eliminated the exemption of income tax on reinvestment of corporate profits, increased personal income tax for professionals, granted the SRI authority to establish presumptive profits, returned to the old income tax rate of 25 per cent for corporate income, except for microenterprises and exporting companies, established special tax reductions of value added tax if payment is made electronically, increased the term for the expiry of customs duties and other taxes based on statute of limitations, created a special gazette destined to inform taxpayers of audits and observations, and increased the powers of the Superintendence of Banks.

The Organic Law for Productive Development, in force since 21 August 2018, created special tax incentives exempting from income tax for 12 years new companies devoted to listed activities and businesses, granted a tax amnesty for payment of taxes owed condoning fines and interest, permitted the submission to international arbitration under specific rules controversies between the state and foreign investors investing tens of millions of dollars or more under investment contracts, and established additional tax incentives and benefits to private parties entering into alliances with public entities for conducting joint projects in specific areas. The Law also eliminated the subsidy to high-octane fuel, but maintained the subsidies for low-octane fuel and diesel.

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9 In Juan Quevedo v. Servicio de Rentas Internas, the tax court of first instance ruled that even companies not having net worth and that only represent individuals are subject to anticipate income tax, which applied to double tax individuals. The National Tax Court refused to hear the case.
XI OUTLOOK AND CONCLUSIONS

A new trend to develop private investment, including foreign investment, has been implemented since 24 May 2017, when president Lenin Moreno was sworn in. Certain actions against corruption have been taken mainly through the Council of Citizenship Participation and Social Control, which dismissed all the members of the Council of the Judiciary to try to support the independence of the judicial system. The Council also dismissed, as said above, all the judges of the Constitutional Court because of allegations of corruption. It is expected that the new constitutional judges to be appointed will not be linked with the Executive Branch.

The former government had appropriated and confiscated the revenues of private pension funds, and had used funds destined to cover the social security benefits of retired persons in the public healthcare sector. The retirement pensions of members of the armed forces and of members of the national were also reduced. The net worth and the cash flow of companies devoted to prepaid medical care has been affected by a law ordering that such companies should reimburse the amounts covered by the Social Security Institute.

A new Criminal Code, in force since 10 August 2014, considers as criminal offences subject to imprisonment several acts connected with accounting books and supporting documents triggering a reduction in taxes. Criminal liability is also established for juristic persons and corporations subject to the sanction of extinguishing their legal existence. Criminal cases under these new provisions may be brought even without sufficient evidence.

A new Organic Monetary and Financial Code, in force since 12 September 2014, contains provisions that may ease the elimination of the dollar as the country’s legal currency and the introduction of a new local currency, but the Organic Law for Productive Development, in force since 1 January 2018, has strengthened the dollarisation in force in Ecuador since January 2000.
I INTRODUCTION

Although still on the high tax side, France remains generally favourable to inward investment, especially where it creates or maintains jobs on French territory. A government agency, Business France, has been created to promote and facilitate international investment. It publishes a brochure, named *Invest in France*, that provides most of the relevant legal, regulatory and tax information. Another publication, the *France Attractiveness Scoreboard*, examines the indicators that position France among several Western countries to enable foreign investors to compare and make judgements between European countries competing to attract job-creating investment projects.

Certain new tax compliance and anti-avoidance provisions are being implemented especially in view of the Anti-Tax Avoidance Directive (ATAD) by 1 January 2019. Certain provisions of more than 80 double tax treaties signed by France could also be altered as a result of France’s signature and reservations on the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the MLI). At the time of writing, no substantial further changes are expected after the Finance Act for 2019 has been enacted on 28 December 2018.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate

French law provides for several forms of corporate entities for business activities:

- the joint-stock corporation (SA), the shares of which may be offered to the public;
- the limited liability private company (SARL);
- the *société par actions simplifiée* (SAS), which is examined further below;
- the limited partnership with stock (SCA); and
- the *société européenne* (SE or European company).

For French tax purposes, all these entities are subject to French corporation tax (except where a SARL or an SAS is closely held by individuals and has elected to be treated as a partnership). An SA must have at least two shareholders (seven if publicly traded) and three directors, and an SCA must have at least a general partner and three shareholders, who may be the three members of the supervisory board. Boards of directors (in an SA) or supervisory boards (both
in an SA and SCA) must be composed with a balanced representation of men and women. Where a business employs more than 1,000 persons, the board must include representatives of the employees. SARLs and SASs may have a single shareholder. For US tax purposes, only the SA is deemed a *per se* corporation; other French corporate vehicles may be regarded as partnerships or, if held by a single shareholder – which may be the case for a SARL or an SAS – as disregarded entities.

**SAS**

The SAS is a limited liability company that is often used as a corporate vehicle for wholly owned subsidiaries, intermediary holding companies and joint ventures, regardless of the nationality of the parties. One of the major advantages of the SAS is its flexibility and the wide latitude it offers to its shareholders in shaping corporate governance. The only major downside to this corporate form is that since the SAS is in essence a closely held company, it is prohibited from making public offerings of its shares. Should the investors contemplate an initial public offering of their French corporate vehicle at a later stage, the SAS would need to be converted into a public limited company (SA) to be floated on the stock market.

Subject to a limited number of legal requirements, the SAS is primarily governed by the terms and conditions of its articles of association. The articles govern matters such as the organisation of the management, and the amount and type of equity. Where an SAS is used as a joint-venture company, the articles may determine the allocation of the voting rights among the shareholders. A unanimous vote of the shareholders is also required with respect to certain matters.

Great flexibility is granted to the form that shareholders’ decisions may take and the conditions applicable to making such decisions. In particular, the articles determine the manner in which decisions that require shareholder approval are to be taken.

While the articles can determine the persons competent to make decisions (e.g., they may provide that veto power be given to certain persons within or outside the company, such as a banker or important customer), decisions relating to certain essential matters may only be made by the shareholders.

**ii Non-corporate**

**French law partnerships**

Most French law partnerships are legal entities that are registered as such with the Business and Companies Registrar (RCS). Generally, the partners have unlimited liability, and are personally liable for income or corporation tax on their share of the income or profits of the partnership as if they had generated it themselves. Unless they have elected to be subject to French corporation tax, French partnerships are not subject to any income or corporation tax on their profits, but they are required to maintain separate accounts and file tax returns; they may be subject to tax audit procedures. As a result of such audit procedures, some taxes may be assessed on the partnership (VAT, local taxes including the local economic contribution, payroll taxes, etc.), while other taxes may be assessed upon the partners only (income or corporation tax). Some withholding taxes are assessed on both and may be challenged both by the partnership (viewed as a paying agent) and by the beneficiary of the relevant income.

For international tax purposes, where a French partnership is liable to or has elected to be subject to corporation tax, it may be regarded as a hybrid entity. In other situations, a
French partnership can become a reverse hybrid where it is deemed to be a corporation in the country of (some of) its partners. Accordingly, French partnerships may cover the full spectrum from transparent to opaque via hybrid or reverse hybrid.

The most common forms of French partnership are:

1. General partnership (SNC), in which all partners must qualify to carry out a trade in France and are jointly liable for the SNC’s debts;
2. Non-trading partnership, which may not engage in commercial activities and which is mainly used for real estate investment and leasing, certain asset management activities such as portfolio holding and certain (regulated) professional activities;
3. Limited partnership (SCS), where the share of the profits accruing to limited partners is subject to corporation tax and deemed as dividends as and when distributed to them; and
4. Economic interest groupings (either French ‘GIE’ or European ‘GEIE’).

The société en participation is an unregistered partnership that does not enjoy separate legal personality. Generally, it is subject to the same tax treatment as a partnership provided the names and addresses of its members are disclosed to the French tax authorities. Sociétés en participation are commonly used as joint-venture vehicles in the construction industry, the performing arts and the publishing sector, and also to a certain extent in the financial sector.

iii Other French entities

Assets may be held and activities may be carried out through the French equivalent of common trusts, which are tax-transparent in most income and corporation tax aspects.

Certain investment trusts are tax-exempt, such as funds for collective investment in transferable securities or securitisation vehicles. Foreign trusts also may hold assets in France – either directly or indirectly through French or foreign entities – and accordingly be subject to certain disclosure obligations.

An investment vehicle akin to a limited partnership, the société de libre partenariat, has been introduced. Like other investment funds, it is tax-exempt in France and partners may be taxable upon distribution, if and when this occurs. Debt investment vehicles, such as organismes de financement spécialisés, are liable to corporation tax on their net income (including unrealised exchange gains and losses on assets and liabilities).

Liaison offices: a presence without commercial activity

Liaison offices may conduct only a very limited range of non-commercial operations, such as prospecting, advertising, providing information, storing merchandise, or other operations of a preparatory or auxiliary nature. Such offices are not separate legal entities. Invoices must be issued by the head office, where any contracts must be signed.

Liaison offices are not permanent establishments for tax purposes. They are not subject to corporate tax or VAT, but they must pay certain local taxes and social security contributions on the payroll. However, where commercial activities are conducted in France, in particular where any employee signs contracts on behalf of the foreign company and employer, where a full manufacturing cycle is completed in France, or where a fixed place of business is maintained in France through which the company conducts all or part of its trade, the foreign company may be deemed to have a branch or permanent establishment in France. Companies wishing to ascertain their tax position may ask the tax authorities to
In advance whether their establishment qualifies as a permanent establishment in France (the tax authorities are deemed to have given tacit consent if no reply is received within three months).

**Distribution through sales intermediaries**

A foreign company may also develop commercial activities in France through a variety of sales intermediaries without being deemed to be established in France, notably through individual sales representatives, independent sales agents (i.e., a self-employed individual or a company that acts on its behalf) and independent distributors.

A commissionaire (i.e., an undisclosed agent acting on behalf of the principal but in its own name) may have more important functions, risks and costs. The French Supreme Administrative Court held as a rule that a commissionaire cannot constitute a permanent establishment of its principal, unless the contractual provisions or the circumstances differ from a true commissionaire agreement. This rule will be reconsidered following the adoption of the new clauses inserted by the MLI. Article 12 of the MLI provides that an enterprise shall be deemed to have establishment where a person habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification for the transfer of goods or the provision of services by that enterprise. This would apply when the person is closely related to that enterprise and acts exclusively on its behalf.

France is promoting the project of a digital service tax that would apply at the rate of 3 per cent to the revenue generated in France by certain major digital services firms. It is anticipated that France might implement such a digital services tax if a global solution is not reached within the OECD.

**French branch or permanent establishment**

Branches of foreign companies may generally carry out all the operations of an industrial or commercial company in France subject to certain professional regulations. They must be registered with the RCS and must be headed by a legal representative entitled to do business in France and whose identity and particulars must also be published with the RCS. In certain situations, the French tax authorities are inquisitive upon undisclosed permanent establishments, including where a French subsidiary performs certain duties of a related foreign company or where a foreign company is managed out of France. Many contentious issues have arisen in this respect.

Branches are permanent establishments with regard to tax laws and must pay corporation tax, VAT, local taxes (including the local economic contribution) and social security contributions. The subsequent conversion of a branch into a separately incorporated subsidiary is possible and must comply with the rules governing the sale or transfer of a business or going concern. Such transfer is generally subject to taxation except where some form of rollover relief applies.
III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

French corporation tax

French corporation tax is assessed on the earnings determined by commercial accounts established under French generally accepted accounting principles (GAAP), subject to specific tax adjustments. Income and expenses are recognised on an accrual basis. Some financial instruments, and any outstanding foreign currency debts and receivables, are taxed on a mark-to-market basis.

Favourable tax adjustments include accelerated depreciation of equipment, certain immovable fixtures, and full and immediate depreciation of some IP acquisition costs; and participation exemption on dividends received (95 or 99 per cent exempt) and on capital gains realised (88 per cent exempt) upon a substantial (i.e., at least 5 per cent) participation in French and foreign companies or partnerships (unless established in a non-cooperative state or territory (NCST)).

Unfavourable tax adjustments include:

a no deduction for amortisation of goodwill, trademarks and land;

b no deduction for most penalties;

c restricted or deferred deduction of net financial expenses, generally capped at the higher of 30 per cent of EBITDA or €3 million;

d further restricted or deferred deduction of financial expenses by thinly capitalised entities;

e conditional deduction of financial expenses on hybrid debt instruments and certain acquisition financing;

f restricted deduction of payments for services, including interest and royalties, to any entity domiciled or established in a low-tax country or in an NCST; and

g limited deduction for company cars and certain other expenses.

Territorial scope of corporation tax

Generally, French corporation tax applies to earnings from business enterprises carried out in France or the taxation of which is attributed to France under a double taxation treaty. French corporation tax also applies to any profits generated by controlled foreign corporations (CFCs) established in a low-tax country unless a bona fide commercial purpose test is satisfied. Different tests apply depending upon whether the CFC is located inside or outside the EU and, if outside, in an NCST (see Section IX.ii). ‘Low-tax country’ is defined as a country where corporate income tax is lower than one half of French corporation tax with surcharges (i.e., lower than 14 per cent or 18 per cent).

Capital and income

Income and capital gains are taxed at the same rate (currently 31 per cent plus surcharges) and can be aggregated, except for capital gains and losses realised upon the disposal of substantial participations, which are exempt or subject to special tax rates. A special lower rate (15 per cent, lowered to 10 per cent under the 2019 Finance Act, plus surcharges) also may apply to a portion of the net amount of royalties and other proceeds from the licensing or sale of patents, know-how, software and similar intangible property rights.
**Losses**
Losses may be carried forward indefinitely and survive a change of ownership, but not a cessation or substantial alteration of business. Each fiscal year, carried-forward losses may shelter the sum of €1 million plus 50 per cent of the current year’s profits. Losses may be carried back for one year up to €1 million.

**Rates**
The standard rate of corporation tax currently is 31 per cent and will be gradually reduced to 25 per cent by 2022. For financial year 2019, a 28 per cent rate will apply to the first €500,000 of profits for all companies (with the remaining profits subject to the 31 per cent standard rate). In 2020, the standard rate of 28 per cent will apply to the full profit in 2020. It will drop to 26.5 per cent in 2021 and 25 per cent in 2022. In addition, a 3.3 per cent surcharge applies where the annual revenue (turnover) of a company exceeds €7.63 million, thus resulting in an effective rate peaking at 28.924 per cent in 2019.

Subject to certain anti-avoidance rules, qualifying dividends received and profits made on the sale of substantial participations are exempt, except for a recapture of costs equal to respectively 5 (or 1) per cent of the dividend or 12 per cent of the gain, thus resulting in an effective tax charge of 1.7 (or 0.33) per cent on dividends and 4.56 per cent on capital gains.

Special tax rates apply to profits generated by the sale of shares in listed real estate companies (19 per cent); to a portion of the net income arising out of certain royalties (15 per cent, to be lowered to 10 per cent); and the gain on certain venture capital funds where they do not qualify for the participation exemption.

For any financial year closed between 31 December 2017 and 30 December 2018, a temporary surcharge applied to companies with revenue (turnover) above €1 billion, and a further additional surcharge applied above €3 billion (subject to adjustments for the first €100,000 over each threshold). Each surcharge is equal to 15 per cent of the gross amount of corporation tax, before any tax credit or tax reductions. The resulting effective tax rate for these companies (approximately 320) amounted respectively to 39.43 per cent and 44.43 per cent.

**Tax credits**
Under French domestic law, many incentives take the form of tax credits, the most important of which is the R&D tax credit, which amounts to 30 per cent of the qualifying expenditure not exceeding €100 million per year and 5 per cent for expenses in excess of such amount.

Except where CFC income is taxable in France, there is no unilateral relief for foreign tax. To the extent foreign-source income is taxed in France, and only where a double taxation treaty applies, foreign withholding taxes may be credited against French corporation tax pursuant to the relevant double taxation treaty (except for foreign withholding taxes on inbound dividends, which may be applied only on withholding taxes on outbound dividends, where the participation exemption applies). Where and to the extent the foreign tax credit cannot be credited against French corporation tax, for instance because of a net loss or insufficient taxable profits, it cannot be deducted. Whether excess foreign tax credits may be carried forward is currently litigated and has been referred to the European Court of Justice.
Administration

Tax returns are due annually and must be filed electronically. Corporation tax returns filed by major companies must include certain information on the activities, assets and transfer pricing policy of the group, and certain information on major intra-group transactions. Country-by-country reporting is required from corporate groups that publish consolidated accounts and realise consolidated revenues in excess of €750 million per year.

Corporation tax is payable in quarterly instalments, the balance being payable upon filing of the tax return prior to the 15th day of the fourth month following the fiscal year end (or 15 May for corporations whose fiscal year coincides with the calendar year).

Generally, tax returns may be audited and taxes reassessed by the tax authorities up until the end of the third calendar year following the year when a tax was payable. Longer periods of limitation apply in certain cases. In certain situations, where the tax authorities are time-barred from reassessing an element of income or disallowing an expense, the tax may be reassessed on the first non-barred taxable year.

The tax authorities may challenge and set aside any tax avoidance scheme that is either a sham or exclusively tax-driven and seeks to benefit from an advantage contrary to the purpose of the law (general anti-avoidance rule) (see Section IX.i). Substantial penalties apply in such cases (80 per cent or 40 per cent). Where tax savings are the principal (but not exclusive) purpose of a scheme, the above general anti-avoidance rule may also apply but the penalties become conditioned upon the circumstances.

Guidance and comfort may be sought from the tax authorities both on points of legal interpretation and how particular facts will be treated. Where formally given, such guidance or clearance is binding upon the tax authorities and the tax courts. Apart from a judicial review of administrative regulations and certain individual tax rulings, there is no effective way to challenge a tax position announced by the tax authorities that a taxpayer finds unsatisfactory.

Tax grouping

French tax laws enable corporate taxpayers belonging to the same group to elect for group taxation, resulting in the top French parent company becoming the sole corporate taxpayer for all members of the group on the aggregate net income of the group.

Definition of a French tax group

The group can include only companies that are liable to corporation tax in France, and that are at least 95 per cent owned by the parent company, either directly or indirectly through intermediate companies that are members of the group or established in an EU jurisdiction. The 95 per cent-plus ownership condition must be satisfied for the full 12-month taxation period. Parent companies and qualifying subsidiaries may elect whether to be included in the integrated tax group, which may be modified each year.

Group taxable income

Under the French tax integration or consolidation, the group’s taxable income is not the consolidated income of the group (where intra-group profits and losses would have been eliminated), but rather an adjusted combined or amalgamated income of the companies composing the group. Basically, it consists of the algebraic sum of the taxable income or losses
of all the group members determined as if each of them were independent taxpayers, subject to certain adjustments. Certain intra-group distributions of dividends trigger a 1 per cent recapture of costs (resulting in a 0.33 per cent tax charge).

As such, there are no transfers or surrenders of losses from one company of the group to another on terms to be mutually agreed. By operation of the law, all the tax losses shown by the members of the group are escalated – together with other tax attributes such as tax credits, either domestic or foreign – to the parent company of the group and sole taxpayer. The parent company may enter into a tax contribution agreement with each of its tax-integrated subsidiaries to determine the contribution of each subsidiary, and whether the subsidiary is compensated for the losses, tax credits and other tax attributes transferred to the parent company.

Exit charges

Some adjustments to group income tend to temporarily neutralise the tax effect of certain intra-group transactions or situations but, following the exit of a subsidiary or the termination of the group (including following the acquisition of the parent company, or a merger or demerger where the parent company does not survive), all relevant neutralised items are de-neutralised and become taxable or deductible, as the case may be. They must be added to or deducted from the group taxable income for which the parent company is liable to corporation tax. Generally, exits from and termination of the tax group have a retrospective effect on the beginning of the current fiscal year. Where the group terminates as a result of a merger or acquisition of the parent company, the surviving companies of the group may be included in the tax group of the acquirer. Tax losses of the terminated group may be carried forward under certain conditions and restrictions. It is not uncommon for the target company and its ex-parent company to enter into an exit agreement to set certain consequences of the exit of the subsidiary from the tax group, especially with respect to tax losses and credits or other tax attributes.

ii Other relevant taxes

Business contribution on value added

As a partial substitute for the notorious and now removed local business tax, this business contribution on value added of 1.5 per cent is part of the local economic contribution (CET) and applies annually to the value added by any business established in France. This tax is deductible for corporation tax purposes.

Local taxes

Businesses established in France must also pay a business contribution on property, which forms the other part of the CET and is calculated, at local authority rates, on the rental value of all properties used for the business.

French or foreign owners of a property located in France are also subject to the real estate tax, based upon the rental value of the property. All such local taxes are deductible for corporation tax purposes.

Wealth taxes

Wealth tax on natural persons has been substantially narrowed by the Finance Act for 2018 to real property and shares in real property entities, except where such property is applied to a
business activity of the taxpayer. Non-residents and certain residents are liable to such annual French net wealth tax either on their worldwide assets or on their French assets only. The taxable threshold remains at €1.3 million of taxable assets and the rate escalates from 0.5 to 1.5 per cent where the total net assets exceed €10 million. Pre-existing favourable tax regimes (e.g., the ‘Dutreil’ regime and regime applicable to investment in small or medium-sized businesses) have been abolished and replaced by new ones, such as exclusion from the taxable basis of shareholding of less than 10 per cent. Assets held through a foreign trust are included in the taxable base and must be specially reported annually by the trustee.

Legal entities are not subject to a general net wealth tax in France. Potentially, a 3 per cent annual tax may apply to the fair market value of properties directly or indirectly owned by certain foreign entities. Where applicable, the tax is not deductible for corporation tax purposes. Most investors benefit from one or more of the many exceptions applicable, as the tax rule’s aim is to discourage anonymous investment in France by presumed tax evaders.

Miscellaneous taxes

Many other taxes are applicable in France. Some have a very wide scope, such as the apprenticeship tax, based upon payroll in any industry or business sector, and the tax on corporate cars.

Other taxes are specific to certain industries (e.g., the payroll tax imposed at rates escalating from 4.25 to 13.6 per cent on businesses that are wholly or partially exempt from VAT such as insurance, banks, etc.) or certain forms of investment.

Value added tax

French VAT applies substantially in line with EU rules on VAT. The standard rate is 20 per cent. Reduced rates are 10, 5.5 and 2.1 per cent.

There are currently no grouping rules in France for VAT purposes except for consolidated payments.

Digital services tax

France does not currently operate any such tax but is contemplating doing so.

Stamp duties, capital duties and registration taxes

Generally, French stamp duty applies at fixed flat rates on most corporate documents. There is no capital duty on the issuance of shares or other corporate instruments either for cash or for valuable property.

Registration taxes apply at proportional rates on most transfers of certain assets for a consideration or for the assumption of liabilities:

- real property: 5.09 per cent, possibly increased up to 5.8 per cent at local level;
- goodwill and equipment of a going concern, trademarks: 5 per cent;
- shares in unlisted real estate companies: 5 per cent; where made outside of France, the transfer of such shares must be reported by a notarial deed made in France;
- interest in an SNC, SARL: 3 per cent;
- shares in an unlisted SA, SAS: 0.1 per cent; and
- no tax is due on listed shares when no deed is established or executed in France.
A financial transaction tax applies at a rate of 0.3 per cent on the acquisition of shares and other equity instruments of listed French companies where the market capitalisation of the issuer exceeds €1 billion on 1 December of the preceding year. The list currently contains approximately 120 names. The tax currently does not apply to operations that do not result in an acquisition of shares (such as derivatives or contract for difference).

Where a deed is made to record a partition of assets among multiple owners who jointly owned them, a partition duty applies at a rate of 2.5 per cent uncapped.

**Gift and inheritance taxes**

France operates a very wide-reaching gift and inheritance tax system. Subject to the provisions of few double taxation treaties, French gift and inheritance taxes apply on assets worldwide where the donor or deceased is or was a resident of France, or where the heir or beneficiary is a resident of France. Where none of the donor, deceased, heir or beneficiary is a resident of France, French gift and inheritance taxes apply on assets located in France only, including French real property indirectly held through companies, trusts and partnerships, and also including shares in unlisted real estate companies.

There is no inheritance tax on transfers to a surviving spouse, but transfers *inter vivos* between spouses and any transfers to children and other descendants may be taxed at escalating rates of up to 45 per cent. Transfers to third parties are taxed at 60 per cent. Both formal and informal transfers are taxable.

### IV TAX RESIDENCE AND FISCAL DOMICILE

Since French corporation tax is assessed on a territorial basis (i.e., on the net income generated by businesses carried out in France), and since there is no French net wealth tax on corporate bodies, corporate residence as such is of little relevance for French tax purposes, and there is little guidance and limited case law on the point. Corporate residence could be relevant for dividend withholding tax purposes.

Corporate residence was – and to some extent still is – relevant for certain stamp duties, distribution taxes or miscellaneous discriminatory tax provisions. These are fairly limited, since the French tax judges tend to interpret legislative provisions targeting the head office of an entity as concerning not the actual corporate head office but instead any permanent establishment in France. As a result, the French tax authorities traditionally have not argued that a corporation organised outside France is resident in France as a permanent establishment in France is sufficient to trigger corporation tax in this country. Recently, the French authorities have undertaken to challenge the residence of foreign letter box companies and claim that they have an effective place of management in France. Corporate residence is relevant mainly for double taxation treaty purposes. Corporate residence is essential for determining the law applicable to a corporate entity, as French law applies to entities with a corporate head office in France. The migration of corporate entities out of or into France may be organised under certain conditions (see Section IV).

Despite a mid-19th century statute apparently still in force but now of no practical effect, foreign corporate entities and certain foreign partnerships are entitled to enter into contracts and acquire assets in France, and also to appear and act before French courts. Subject to certain direct investment restrictions, they may also open and maintain branches or other forms of permanent establishment in France (see Section IV).
i Corporate residence

French corporate laws apply to corporate bodies with a head office in France. As a matter of law, the corporate seat is presumed to be located at the place indicated in the articles of association or, if proven different, at the place where the senior person or group of persons (shareholders’ meeting, board of directors) effectively make strategic and other major decisions for the company, including wherever the operations of the company and its current management are carried out in any other location or jurisdiction.

In substance, the test is similar to the place of effective management referred to in the OECD model for double taxation treaties and the commentaries thereof (at least before the 2008 revision), and to the centre of main interests under the EU regulation on insolvency proceedings.

Although there is no law, court precedent or administrative guidance on the issue, a single (or few) board meetings in France should not characterise a corporate head office in France, provided most other meetings are held and decisions made outside France. However, decisive board meetings in France could result in a permanent establishment in France. Similarly, a few board meetings held outside France should not be sufficient to characterise a corporate head office outside of France when most meetings are held and decisions made in France.

Inbound transfers of the corporate head office of a foreign entity into France are recognised under French civil, corporate and tax laws, and do not amount to the formation of a new entity provided the continuation of the migrating entity is also recognised under the corporate law of the jurisdiction of origin.

Outbound transfers of corporate head offices are less common and, except for companies organised as European companies, such transfers require the unanimous consent of all shareholders. As a domestic tax rule, the transfer of the corporate seat outside France generally triggers the consequences of a cessation of business, including the immediate taxation of profits and potential gains, and the deemed distribution of all profits. However, a transfer to another Member State of the European Union does not trigger such consequences: gains are recognised upon the assets effectively transferred outside France only and corporate tax may be spread over five years. No gains are recognised or taxed on assets that remain part of a French permanent establishment.

There are just a few examples of French listed companies that converted into a European company and moved their corporate seat to another EU Member State (e.g., Eurofins Scientific). A few other corporate migrations or inversions have resulted from cross-border statutory mergers (where the French target company disappeared) within the European Union, with the benefit of a conditional rollover relief of the actual or potential gains on the transferred assets (e.g., Stallergenes/Greer in 2015, Technip/FMC in January 2017).

ii Branch or permanent establishment

Under French domestic tax laws, French corporation tax is assessed on the earnings from any enterprises operated in France, and on the income and gains arising from properties located in France or from investment in real estate companies or entities.

There is no statutory definition of an enterprise operated in France, and the tax courts hold that this implies a business activity:

a either conducted by an establishment, which includes the equivalent of a permanent establishment under the OECD model double taxation treaty and could extend to some fixed business installations that are excluded under the OECD model (see Section II for the exclusion of liaison offices);
carried out by a dependent agent, also in terms similar to those of the OECD model (see Section II for the situation of independent intermediaries); or

c which consists of a full commercial cycle of operations, such as the purchase and sale of merchandise in France, even in the absence of any physical presence in France. The reverse could not be verified where the decisions are made and the financial movements originate in France. In such cases, the tax authorities and courts consider the decision centre in France to be a place of management in France and, accordingly, a permanent establishment to which the operations of the company must be allocated.

Where a foreign entity realises earnings in France, these are deemed distributed abroad at the end of each fiscal year, and (unless the foreign entity is effectively managed from an EU Member State) they trigger a 30 per cent withholding tax, unless excluded or reduced by a double taxation treaty.

Where corporation tax does not apply under the above terms, withholding taxes apply in France to payments for services by French debtors to foreign residents (see Section VI).

If a double taxation treaty applies, protection from French taxation may be obtained where the presence in France either does not fall within the definition of, or benefits from an exception to, the relevant treaty provisions on permanent establishment and branch profits tax.

A subsidiary is not supposed to be a permanent establishment of its parent, but in some cases, it can be considered as a dependent agent and then triggers the issue of whether it has the legal authority to conclude contracts in the name of its parent. The Paris lower tax court ruled in favour of the taxpayer, namely Google, in a July 2017 ruling on the grounds that although a Google French subsidiary was a dependent agent of Google Ireland Limited, it lacked the legal authority to conclude contracts and, therefore, could not be characterised as a permanent establishment. The Paris Court of Appeal decided similarly in other cases.

**Taxable base**

Under both domestic law and the relevant treaty provisions, profits taxable in France are limited to the earnings attributable to the French operations or permanent establishment. There are few court precedents and little administrative guidance on the allocation of income between the French and the foreign establishment. It is commonly assumed that the OECD guidelines on the allocation of profits to a permanent establishment should apply. A legislative provision to include a ‘diverted profit’ taxation was quashed by the Constitutional Court a couple of years ago.

**V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT**

There is no French tax incentive especially designed to encourage inward investment, and only a few French tax measures of a rather limited impact – such as the temporary deduction of losses made abroad by medium-sized enterprises or the now-terminated global consolidated tax regime – tend to favour operations outside the home jurisdiction. However, certain features of the French tax system – which apply to both domestic and inward investors – compare reasonably well with similar measures in other jurisdictions.
i Holding company regimes

There is no special tax regime for holding companies; however, as mentioned above, there is no capital duty and, for corporation tax purposes, both the participation exemption and the tax consolidation provide substantial benefits to companies – including French permanent establishments of foreign companies – holding a substantial participation in French and (as far as participation exemption is concerned) foreign entities.

Participation exemption

Qualifying participations include shares in French and foreign corporations, and interest in certain French and foreign partnerships. However, shares in entities established in an NCST are excluded from the exemption, and interest in low-tax jurisdiction entities may also be excluded in certain circumstances.

Dividends that receive the 95 per cent exemption are subject to a minimum 5 per cent fully paid shareholding (including without voting rights), which is conditional on a two-year holding period (potentially extending either side of the dividend date).

An 88 per cent capital gains exemption applies under similar but not identical circumstances. The decisive criterion is the accounting treatment as ‘investment in subsidiaries’ under French GAAP or the 5 per cent minimum shareholding (with voting rights).

The participation exemption does not prevent an acquiring company from deducting both acquisition costs for the shares (which may also be amortised over a period of no more than five years) and financial expenses related to acquisition financing, subject to the general limitation of net financial charges at 30 per cent of EBITDA. Under a specific provision known as the Carrez amendment, now repealed, any deduction of financial expenses related to acquisition finance was conditioned upon demonstration that the decision-making and control of the acquired company was carried on in France or in a company subject to corporation tax in a European Union Member State or a Member State of the European Economic Area with which France has a tax treaty with full exchange of information. The 2019 Finance Act should repeal that provision for the future.

Tax grouping

Where the acquiring company is a member of a consolidated tax group, the dividends received from other consolidated companies within the group are fully exempt, even when the conditions for the dividend received exemption are not satisfied. Tax deficits resulting from the deduction of acquisition costs and interest on acquisition financing may shelter the taxable profits of any consolidated operating company, including the target, an essential feature for leveraged acquisitions by financial investors such as private equity funds. Thin capitalisation rules – and anti-hybrid provisions – would apply as previously indicated where (part of) the acquisition finance is provided by the shareholders or related entities.

Further care should be taken to avoid the ‘Charasse amendment’ when the acquisition is made from investors who control the consolidated group. This special anti-abuse provision disallows group financial charges in proportion to the purchase price of shares in subsidiaries that were acquired from persons who control the group, subject to certain exceptions. Since control can result from a concert, it could also apply in circumstances where the vendors of the target receive an interest in the parent company giving them rights in the management
of the group. A minority interest with clauses preserving their financial interests only should not result in such concert, and accordingly should not trigger the application of the Charasse amendment.

ii IP regimes
There is no special tax regime, such as ‘patent box’ companies, in France, but the standard provisions of French tax laws contain several incentives for R&D and IP.

R&D costs are deductible expenses. Acquisition costs of patents are not deductible but may be amortised over five years, even where the protection extends over a longer period.

R&D equipment is exempt from CET, the local business tax. There is also an R&D tax credit, which generally equals 30 per cent of the qualifying expenses up to €100 million, and 5 per cent for the portion of expenses that exceeds the limits.

As mentioned above, a reduced corporation tax rate (15 per cent plus surcharges) applies to a portion of the net income arising out of the transfer or licensing of patents, patentable inventions, certain software and know-how.

iii State aid
There is a variety of state aid available in France. Generally, the French authorities support investment projects that entail:

a investment and job creation by large companies in economically disadvantaged regions and regions undergoing industrial redevelopment, as are indicated on a map approved by the European Commission (the regional aid zones map);
b business R&D projects;
c professional training programmes for employees;
d job creation for defined populations;
e investment and job creation by small and medium-sized enterprises in all parts of the country; and
f protection of the environment.

iv Temporary tax credit on lower wages
As part of a plan to boost ‘competitiveness’, a tax credit applied on lower wages (below 2.5 times the legal minimum salary – currently at €1,480.27 per month). Although this measure was aimed at boosting the manufacturing industry, the credit applied to any economic sector and benefited mainly retail and postal services. The tax credit rate was reduced from 7 per cent to 6 per cent in 2018; it will be abolished in 2019 and be replaced by a decrease of employers’ contributions.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)
There are no withholding taxes on interest, except where it is paid either in an NCST or to an entity established or domiciled in an NCST. An NCST is blacklisted when it is outside the EU and does not meet international standards of exchange of information on tax matters. The blacklist is updated from time to time, and currently includes seven territories. New territories may become included, as the French tax administration is currently testing the
effectiveness of information exchange with former NCSTs. Such was the case of Bermuda, Jersey and the British Virgin Islands in 2013. Bermuda and Jersey rapidly amended their legislation and practice and were removed from the blacklist in early 2014. The British Virgin Islands took similar measures and was removed in 2015. Panama was reintroduced in 2016 with effect on 1 January 2017. Where applicable, withholding applies at 75 per cent of the gross amount, except where the payer demonstrates bona fide commercial reasons for the transaction. An administrative regulation has created a safe harbour for notes and other negotiable debt securities. At present, there is no safe-harbour rule for interest payments on any other debt instrument.

Other withholdings include:

\[ \begin{align*}
  a & \quad 33.33 \text{ per cent withholding on royalties paid and other payments for services made to any non-resident with no establishment in France, 75 per cent withholding where paid in or to an entity established in an NCST;} \\
  b & \quad 12.8 \text{ per cent withholding on dividends paid to any non-resident individual or 30 per cent on dividends and other distributed income, including deemed dividends (at the grossed-up effective rate of 30:70) paid to other non-residents unless the payment is attributable to a permanent establishment, 75 per cent withholding on payments in an NCST;} \\
  c & \quad 30 \text{ per cent withholding on profits made in France by a foreign corporation and deemed to be distributed outside France;} \\
  d & \quad 33.33 \text{ per cent withholding on gains from the sale of any part of a substantial (25 per cent plus) participation in a French company by a corporation, 12.8 per cent withholding if made by a non-resident individual, 75 per cent withholding if paid to an NCST; and} \\
  e & \quad 33.33 \text{ per cent (or occasionally 75 per cent) withholding on gain from the sale of property in France, or from the sale of shares in companies whose principal assets consist directly or indirectly of property located in France by a corporation, 19 per cent (to be increased to 26 per cent under the 2019 Social Security Finance Act) withholding if made by a non-resident individual.}
\end{align*} \]

\[ \text{ii} \quad \text{Domestic law exclusions or exemptions from withholding on outward-bound payments} \]

**Interest and other exemptions**

Safe harbour regulations are applicable to notes and other negotiable debt securities. An EU parent company exemption applies to interest, dividends and royalties paid to a direct EU parent company owning at least 10 per cent of the French payer company. As regards dividends, the exemption also applies under the participation exemption where an EU parent company owns at least 5 per cent of the French distributing company and is conditional upon a two-year holding period.

**Reduced rates**

Withholding applies at a rate of 12.8 per cent on dividends paid to individuals, and 15 per cent (instead of 30 per cent) withholding applies on dividends paid to not-for-profit institutions in the EU or the EEA. Qualifying EU, and certain non-EU, investment funds are exempt from such dividend withholding tax.

No ‘branch tax’ applies on profits made in France by corporations having their place of effective management in an EU country.
The 19 per cent or 26 per cent (instead of 33.3 per cent) withholding rates apply on capital gains made by non-residents on real estate located in France.

Foreign governments, central banks and certain foreign public financial institutions are exempt from withholding taxes on interest, dividends and capital gains.

iii Double tax treaties

France has an extensive network of 126 double taxation treaties. Most of them follow the OECD model; however, there are a few notable exceptions, such as those with Belgium, Monaco and some Gulf states.

Although the solution may vary from treaty to treaty and should be checked accordingly, qualifying residents of a treaty country receiving income from French sources generally enjoy an exemption from or a reduction of withholding tax charged on such income.

According to recent case law, legal entities that are not liable to, or are exempt from, corporate income tax in their country of origin, such as offshore entities, pension funds and other investment funds may not qualify as residents of a treaty country and are excluded from tax treaty benefits except where a special clause applies.

VII TAXATION OF FUNDING STRUCTURES

French entities are commonly funded with an appropriate combination of equity (i.e., share capital, including preference shares) and debt (including convertible or exchangeable notes) from third parties and related parties. French tax courts have constantly ruled, subject to specific provisions that must be strictly construed, that enterprises can freely determine the manner in which they obtain their financing. In certain cases, the French tax authorities attempted to deny the tax deductibility of one part of the financial interest incurred on the grounds of the abnormal act of management, as they considered the gearing to be excessive and thought it was likely that the borrower would not be in a position to reimburse all its debts, and they argued that a more prudent debt-to-equity ratio should be retained. This argument has been rejected constantly by the highest court. As a result, a reassessment on the sole basis of an unbalanced debt-to-equity ratio is unlikely to succeed before French courts.

Debt financing remains tax-favoured to the extent that interest expense is largely deductible on an accrued basis and subject to the cap on net financial expenses equal to 30 per cent of EBITDA (see above and below). There is no withholding tax on outbound interest (unless at the 75 per cent dissuasive rate when paid in an NCST, or to a person domiciled or established in an NCST, in situations where the safe harbour on notes and other negotiable debt instruments does not apply).

i Thin capitalisation

There is no general thin capitalisation principle. Subject to dealings between related parties, French tax law does not impose any general debt-to-equity ratio on enterprises taxable in France.

Related-party loans limitation rules, and scope of the thin capitalisation and anti-hybrid rules

French thin capitalisation rules apply to all loans granted to any enterprise taxable in France either by a related enterprise or by a third party where they are guaranteed by a related
enterprise. Enterprises are deemed related where one enterprise directly or through any interposed entity holds the majority of the share capital of the other, or in practice exercises decision-making power; or both enterprises are under the control of another single enterprise.

According to the administrative regulations, the rules apply to any enterprise carrying out a business in France, including permanent establishments of foreign corporations, and French or foreign partnerships to the extent that they or their partners are subject to corporation tax in France on their share of profits.

**Impact of the thin capitalisation rules**

Interest accrued on amounts loaned to an enterprise by a related enterprise would be denied where it exceeds any of the following limitations. Within these limits, interest deduction would apply subject to other limitations, including the above-mentioned 30 per cent of EBITDA deduction limit on net financial charges.

**Interest rate limitation**

As far as loans granted directly by a related party are concerned, the rate of deductible interest is capped at the rate provided for in the French Tax Code (i.e., 1.8 per cent for fiscal years closed on or before 30 July 2018) unless it can be demonstrated that the borrowing could not have been obtained from independent financial establishments at a lower interest rate (documentary, benchmarking evidence is required); and the deduction in France is subject to a demonstration that the lender is taxable on the interest at income or corporation tax at a rate at least equal to one-quarter of the standard French corporation tax rate (i.e., approximately 7.8 per cent).

**Worldwide group debt ratio**

The above limits also do not apply if the borrower company can demonstrate that the consolidated leverage ratio of the group of companies to which it belongs is equal to or higher than its own leverage ratio for the relevant fiscal year. The worldwide group debt ratio is determined, for a group of companies (the group), through the comparison of the total amount of the debts of the enterprises within the group with the net equity of the group. Where applicable, international financial reporting standards may be relied upon.

**ii Anti-hybrid provision**

Interest paid with respect to a loan granted by a related company is deductible only if the debtor proves that the interest is subject to corporate income tax at least equal to one-quarter of the French corporation tax that would have been due had the lender been established in France (i.e., 7 per cent for the first €500,000, and thereafter 7.8 per cent).

**iii Acquisition finance**

Under two specific anti-abuse provisions – the aforementioned Carrez (now repealed) and Charasse (still in force) amendments – interest expenses related to the acquisition of participations may be disallowed in certain circumstances.
iv Deduction of finance costs

Capitalised interest deduction

The French Tax Code provides for specific deductibility rules in respect of loans comprising capitalised interest. These rules apply to redemption premiums, and the French tax authorities consider that the redemption premium includes capitalised interest. As a general principle, capitalised interest is tax-deductible on a yearly basis as and when it accrues; however, under these specific rules, when the aggregate of capitalised interest over the duration of the loan exceeds 10 per cent of the nominal amount of the loan, the capitalised interest must be apportioned and deducted on a yield-to-maturity basis.

Convertible bonds are explicitly excluded from such specific rules and deduction is allowed on a cash basis only.

v General limitation of net financial charges

After applying all the above rules, the excess, if any, of the deductible amount of financial charges over the total amount of financial income of the company (or the group in French tax consolidation) is fully deductible if lower than €3 million per year. Where this threshold is passed, then the net amount of financial charges in a given fiscal year is capped at 30 per cent of the EBITDA for the same fiscal year; the excess is not deductible but may be carried forward.

Tax treatment of other financing costs

Corporation tax

To the extent that they are incurred in the interest of the French enterprise, fees relating to the financing of the entity or any of its transactions are deductible for corporate income tax purposes during the fiscal year in which they are incurred. However, further to a global decision, bank fees may be activated and then amortised over the duration of the loans (either in proportion to the interest accrued or on a straight-line basis).

VAT treatment

Most acquisition and financing costs (e.g., auditors’ fees, lawyers’ fees, certain banks’ commissions such as arrangement fees, depending on the global election of the invoicing banks) are subject to VAT. Other fees, however – in particular the majority of bank commissions – are VAT-exempt (e.g., underwriting and commitment fees).

vi Restrictions on payments

Dividends

Under French corporate law, dividends are decided by shareholders at general meetings and may not exceed the total of all distributable profits and unrestricted reserves:

a distributable profits consist of the profits for the year, less prior-year losses and sums that the law or the articles request be reserved, plus the unallocated retained earnings; and

b the unrestricted reserves include capital surpluses such as issuance premiums and accumulated profits, except for the legal reserve (in SA, SAS, SCA, SE and SARL), the revaluation reserve and, where applicable, any reserves whose distribution is prohibited by the articles.
A second restriction is that no distribution may be made to shareholders when the net equity is or would become lower than the sum of the share capital and restricted reserves. Any dividend paid in excess of the limits described above would be deemed fictitious and would trigger both criminal sanctions against the corporate officers and the civil liability of the shareholders to repay dividends where they knew or could not ignore the irregular nature of the operation. Dividends are generally paid in cash but may be paid in specie where the articles of the company so provide.

vii Return of capital and share buy-backs

Corporate law

To return capital to some or all of the shareholders, a corporation may decide on a reduction of the share capital. Such a decision must be made by an extraordinary general shareholders’ meeting on the basis of a qualified majority and pursuant to a special report from the statutory auditors. It may be enforced only after creditors have been given 20 days in which to object to the reduction of capital following the filing of the decision’s minutes with the commercial court. A return of capital commonly results from a share buy-back followed by the cancellation of the acquired shares. A share buy-back programme may be carried out by the board of directors or the management board within a limit of 10 per cent of the share capital.

Taxation

A fixed stamp duty applies to a reduction in share capital; where shares are bought back, no transfer tax applies. Any sums paid to the shareholders are deemed a distribution of dividends up to the total amount of the tax reserves and retained earnings, and a return of original capital only if and to the extent all reserves have been depleted. Share buy-backs are not deemed a distribution of dividends, but a sale of shares that accordingly generates capital gains or losses to the shareholder. This tax treatment was enforced by the Constitutional Court of France in a decision of 20 June 2014 that found that the previous disparity of tax treatments that depended upon the legal form of share buy-backs was unconstitutional. Rollover relief is available to individual shareholders where shares are bought back in exchange for other shares under a public offer; a participation exemption applies to qualifying corporate shareholders.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Asset or share deal

Generally, the acquisition of a local business in France is organised as a sale of shares in the operating business (or any holding company owning it) rather than a sale of assets both for corporate, civil and administrative law reasons and for tax reasons. On the tax side, a sale of assets triggers a substantial proportional transfer tax on the value of equipment and intangible assets, and also, where applicable, on property. In contrast, a share deal triggers reduced transfer taxes (see Section III.ii). For corporation tax purposes, an asset deal generally triggers the recognition of taxable gains and deductible losses, the cost of which may be acceptable to the vendor only where taxable gains may be sheltered with deductible losses from prior years or from other retained businesses. A share deal generates no corporate taxation in France for the acquired company and reduced capital gains tax for the vendor. Most tax attributes of the
acquired company (including any losses carried over) survive the change of ownership. The major downside of a share deal for the acquirers is that this does not result in a stepped-up value for the corporate assets, and accordingly does not uplift the basis for depreciation or amortisation and future capital gains. Certain corporate reorganisations may overcome all or part of this encumbrance.

**Acquisition vehicle**

Generally, a foreign investor acquiring a French business by the means of a share (or an asset) deal would use a French entity in order to take advantage of the tax deduction in France of the acquisition costs and the financial expenses related to the acquisition. Even where the French business is only one part of a global transaction, the consideration for which consists of shares or other financial instruments issued by a foreign company, it is tax-effective in France to use a local entity to carry out a leveraged acquisition and become the top entity of a consolidated tax group. The decision must be made prior to the original acquisition in order to avoid the Charasse amendment mentioned above, and the acquired company must be controlled from France or a Member State of the EU or the European Economic Area with which France has a tax treaty with full exchange of information.

**Consideration for sellers**

When contemplating the acquisition of a business in France, an investor should also consider the tax impact of the transaction upon certain individuals, and especially vendors, and upon the business’s personnel, and especially the management, to offer tax-attractive terms for the transaction. Where the vendor is a corporate shareholder, it is to be expected that the capital gains would be 88 per cent exempt under the participation exemption irrespective of whether the acquisition price is paid in cash, shares or assumption of liabilities. Certain share-for-share – or assets-for-share – reorganisations qualify for rollover relief. Where the vendors are natural persons residing in France, a ‘flat tax’ applies at the rate of 30 per cent, being the total of income tax at 12.8 per cent and social taxes at 17.2 per cent, except where a rollover relief applies on certain share-for-share exchanges.

The personal taxation of the personnel also needs to be considered, especially on employee shareholding, restricted shares and stock-option schemes, which are considerably less tax-favoured in France than they used to be.

**ii Reorganisation**

**Tax-favoured reorganisations**

French tax law provides for rollover relief and stamp duty exemption on a series of corporate reorganisations substantially reflecting the provisions of EU Directive 2009/133 of 19 October 2009, as amended. As a result, the amalgamation of an acquired business with an existing French business can be achieved without adverse French tax consequences. The major restriction is that any existing losses within the disappearing companies cannot be transferred unless approved by a tax ruling to that effect. Tax-free reorganisations encompass the following:

- statutory mergers, including an upstream merger between a parent company and its wholly owned subsidiary, which may be carried out either under the merger laws (and accordingly may have a retroactive effect up to the first day of the current fiscal year) or under a Civil Code provision named ‘dissolution without liquidation’, the effect of which is delayed until the end of an objection period open to creditors and may not have a retroactive effect;
b split-up or scission, where the tax-favoured treatment is conditional upon administrative approval, unless the divided company had at least two business activities, with each of the surviving companies receiving at least one complete branch of activity and the shareholders of the divided company receiving a pro rata share of the surviving companies’ stock; and
c spin-off or partial division, where assets representing a complete branch of activity may be transferred in exchange for new shares on a rollover basis. Such shares may be distributed to the shareholders of the transferring company without triggering distribution taxes, but rather on a rollover basis. This exemption is subject to an administrative ruling.

Certain exchanges of shares may not be immediately subject to capital gains tax but rather may be taxed upon the subsequent sale of the shares received in exchange (on a rollover basis).

**Cross-border reorganisations**
The favourable tax regime applies in France where foreign companies are involved in the reorganisation, provided that all of them are established in countries that have entered into a treaty with full exchange of information with France. Where, as a result of the transaction, assets are transferred by a French company to a qualifying foreign company, the rollover relief is subject to the effective allocation of the transferred assets to a French permanent establishment of the foreign acquiring company. Together with its last corporation tax filing, the French disappearing company must file a special statement with the French administration describing the motivations and consequences of the transaction.

French companies may participate in triangular mergers on a tax-free basis in France. There are several examples where French companies have taken part in reverse triangular mergers, with the French acquiring company being the surviving entity in the transaction. Participation by French companies in forward triangular mergers is less common but not unknown. There are only very few precedents for triangular mergers in which a French public company is either the target or the disappearing company: the formation of EADS in 2000 was a notable exception. Despite the implementation of EU Merger Directive 2005/56/EC, to date there have been only a couple of French public companies completing an outbound cross-border merger. More commonly, French public companies may be acquired on a rollover basis in a cross-border transaction by means of a public exchange offer.

iii Exit
See Section IV.i regarding the conditions for and consequences of a transfer of the company’s head office.

**IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION**

i General anti-avoidance
The French tax system contains both very general anti-avoidance rules, commonly referred to as ‘abuse of the law’ and ‘acts of mismanagement’, and a series of specific anti-avoidance rules, some of which cover certain cross-border situations or transactions.
**General anti-avoidance rules: ‘abuse of the law’ and ‘act of mismanagement’**

Several statutory provisions enable the tax authorities to set aside any legal instrument or scheme that is either fictitious (a ‘sham’ transaction or corporate entity), or exclusively tax-driven and seeking to benefit from a literal construction of any applicable rule contrary to the objectives of the rule’s authors. This first provision applies to any French tax and covers any set of rules such as French laws and regulations or double taxation treaties. In the past, French tax courts held that this does not extend to administrative guidance that is binding upon the administration and the judge.

When abuse of law is declared, the avoided taxes may be reassessed with interest, and a proportional penalty of 80 per cent, or 40 per cent where the taxpayer was neither the main initiator nor the principal beneficiary of the scheme. All of the parties to the contract or the scheme are jointly liable with the taxpayer for the payment of the interest and penalties.

Two milder versions of this provision have been introduced in the 2019 Finance Act, aiming at transactions the principal purpose of which was tax saving and either seeking to benefit from a literal construction of any applicable rule contrary to the objectives of the rule’s authors or meeting the tests of the ATAD on corporation tax. None of them carry the automatic penalties of 80 per cent or 40 per cent.

The other general anti-avoidance rule is not statutory and applies to any ‘act of mismanagement’ defined by the courts as any action or omission contrary to the interest of a business and to the sole purpose of favouring another person. Typically the rule applies to any transaction with a related party at a significantly (20 per cent) higher, or lower, than market price without another reasonable consideration.

**Specific anti-avoidance provisions**

Among the many specific anti-avoidance provisions contained in French tax law, some specially cover outward situations such as transactions with low-tax jurisdictions that have not entered into an extensive exchange of information agreement with France. Other measures, such as a dividend withholding tax, apply to both domestic and cross-border transactions in ‘cumex’ circumstances.

Favourable tax provisions, such as the rollover relief of mergers and other corporate reorganisations, do not apply where non-French entities are concerned in the absence of an extensive exchange of information agreement.

Dissuasive or punitive measures apply in relation to transactions involving NCSTs. Also, payment for services made, or to a person established, in a low-tax jurisdiction (i.e., a jurisdiction where there is no income tax or where the tax is lower than one-half of French corporation tax). In such cases, the deduction is not allowed for corporation tax purposes (and a 30 per cent withholding tax grossed up to 30:70 applies on the related deemed dividend) unless the taxpayer demonstrates a *bona fide* commercial reason. The definition should be refined by a forthcoming ruling from the highest national court.

**Special disclosure requirements**

Although the French tax authorities and Parliament have considered introducing disclosure legislation in France on several occasions in the recent past, there is currently no general obligation for any type of transaction (other than asset holding by a foreign trust and certain tax-favoured overseas schemes) or uncertain tax position. Reporting requirements will be introduced to implement EU Directive 2018/822 on reportable cross-border arrangements.
French legal privilege rules prevent the authorities from accessing any correspondence between any individual or entity and its attorney. Other privileges could have the same effect, and no precedent indicates that the French tax authorities have tried to examine statutory auditors’ working papers.

ii Controlled foreign corporations (CFCs)
France has extensive CFC rules that may apply to any type of income generated by any branch or entity, including a trust, established or organised in a low-tax jurisdiction (as defined above).

The positive income generated by such branch or entity is taxable for the French corporate taxpayer that owns the branch or a controlling interest in the entity unless there is a *bona fide* commercial purpose.

‘Control’ generally means directly or indirectly holding more than 50 per cent of the share capital, financial rights or voting rights of the entity. A 5 per cent stake, however, would be deemed part of joint control where more than 50 per cent of the low-tax entity is held by other French enterprises or by related enterprises.

A safe-harbour provision applies for enterprises or entities established or organised in an EU Member State provided this is not part of an artificial scheme aimed at circumventing French tax legislation.

Where the entity is established outside the EU, the CFC legislation would not apply only where the profits are generated by an industrial or commercial activity carried out locally.

Further tests apply if the CFC is an intermediate holding company within a group or renders intra-group services.

Where CFC rules apply, the positive income of the entity is subject to French corporation tax in proportion to the direct and indirect interest of the French corporate taxpayer in the entity. Foreign tax credit is allowed for corporation tax in the jurisdiction where the entity is established, and for withholding taxes on interest, dividends and royalties from treaty countries.

iii Transfer pricing
France applies transfer pricing rules largely in line with the practices adopted in other major industrial countries and EU Member States.

The legal basis for this is a very short and general statutory provision. There are no detailed regulations or administrative guidelines and a limited but increasing number of case law precedents.

Documentary obligations have been increased over time, with penalties that may reach 5 per cent of the profits transferred abroad.

The French tax authorities may enter into advance pricing agreements with French corporate taxpayers either unilaterally, bilaterally or multilaterally with other jurisdictions. Approximately 10 to 20 advance pricing agreements are concluded each year.

In the event of reassessments of transfer pricing with treaty countries, the mutual agreement procedure may be enforced under the terms of the relevant treaty and may result in corresponding adjustments being made. At the end of 2017, 814 applications with 53 countries were outstanding; 251 procedures had been completed over the year. Most of them wholly or largely eliminated double taxation; less than 10 procedures failed entirely. An arbitration procedure is available within the EU and also under certain double taxation treaties, especially with the United States, but it has rarely applied.
iv Tax clearances and rulings
Several provisions of French law enable the tax authorities to deliver clearances and rulings that are binding both upon them and the tax courts. Some have a very general scope, but do not create an obligation for the authorities to take a position. Others are more specific and fix a deadline, after the end of which the administrative decision is deemed favourable. This applies, inter alia, to requests from foreign enterprises about whether a permanent establishment exists or not in France.

Specific rulings are also available on the taxable basis of international headquarters or logistics centres based in France.

No specific procedure exists in relation to the acquisition of a local business by a foreign investor, and it is not common practice to seek any.

X YEAR IN REVIEW
The French legal and fiscal landscape saw major changes in 2017. Overall, 2018 was less dramatic in terms of taxation and rather included marginal adjustments to business taxation and certain anti-avoidance provisions. Criminal provisions aiming at tax fraud, tax evasion and money laundering of tax misdemeanours have been amended with the view to expanding their scope and increasing the penalties.

The tax environment for business investment remains affected both by domestic rules (e.g., restricted use of net operating losses, general limitation of deductible net financial expenses and conditional deduction of acquisition financial expenses) and by measures inspired by the OECD base erosion and profit shifting initiative and the anti-avoidance package of the European Union. Compliance requirements constantly increase and the risk of criminal procedures has been widely extended.

XI OUTLOOK AND CONCLUSIONS
The French tax environment is heading in a new pro-business direction. Recent and anticipated tax cuts should bring France closer to the current average of European tax levels. However, owing to heavy budget and debt constraints, the French government still has not undertaken an attractive approach towards taxation.
I INTRODUCTION

As of July 2013, the Greek Income Tax Code (2238/1994) was replaced by Law 4172/2013. Therefore, as of 1 January 2014 onwards, income tax for individuals and legal entities is based on the provisions of Law 4172/2013 (the new Income Tax Code) (ITC) effective from 1 January 2014, as recently amended by many laws. The ITC has been simplified to become more transparent for taxpayers, as well as including updates following the international tax law rules and developments, especially in the areas of tax evasion and tax avoidance. In light of this, the ITC as well as the new Tax Procedures Code (Law 4174/2013 (TPC)) have made a number of significant changes to the tax rules, including measures designed to combat tax avoidance and tax evasion. These changes, indicatively, refer to:

a) the controlled foreign corporation (CFC) rules for taxation on the non-distributable profit of a legal entity established in a low-tax jurisdiction at the level of the Greek tax resident, which have been introduced for the first time into Greek tax legislation, as well as changes in the definition of ‘preferential tax regime’;

b) the introduction of a general anti-abuse provision applicable to any ‘artificial arrangement’ adopted by the TPC, also effective as of 1 January 2014. The TPC, which is a separate piece of legislation, attempts to establish a common legal framework for the procedure before the tax authorities concerning the filing of tax returns, tax audits, out-of-court petition procedures, collection of taxes and other procedural issues; and

c) the definition of tax evasion applicable to most tax objects. Specifically, under Article 66 of the TPC, tax evasion is committed by persons who intentionally avoid the payment of taxes such as income tax, tax on the real estate ownership (ENFIA), special real estate tax, VAT, turnover, premium tax, withholding taxes, shipping tax, etc., by hiding any taxable income or assets from the tax authorities. Moreover, the number of persons considered to be perpetrators or accomplices of tax evasion has been recently expanded.

The filing of an administrative (out-of-court) petition and a judicial petition does not affect criminal proceedings. A criminal court may decide to suspend criminal proceedings until the issuance of a final decision of an administrative court if this is considered as critical to its judgment.

All the measures and provisions under the above legislation, the ITC and the TPC as currently in force, have been recently adopted, and only a few interpretative advanced rulings...
have been provided by the Ministry of Finance for many of them. In this respect, there is no precedent; therefore, the application of the new provisions should be examined thoroughly and judged on a case-by-case basis.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

As per the provisions of Article 2 of the ITC, a taxpayer is defined as a person subject to income tax according to the provisions of the ITC.

A ‘person’ means an individual, legal person or legal entity. A ‘legal person’ means an entity with corporate status and legal personality. A ‘legal entity’ means an entity irrespective of whether it has been incorporated, is a legal personality and conducts a profitable activity, and that is not an individual or legal person. Following the above definition, the ITC provides a non-exhaustive list of taxable legal entities such as offshore companies, cooperatives or other entities of a similar nature, foundations, trusts, funds, joint ventures, civil societies, assets, inheritance, donation management companies, civil law companies, participatory or silent companies, and private investment companies.

i Corporate

The following legal persons, inter alia, are subject to the ITC:

- capital companies incorporated in Greece or abroad;
- partnerships incorporated in Greece or abroad;
- non-profit public or private entities, governed by private or public law, incorporated in Greece or abroad, including associations and foundations, with the exception of profits derived from the pursuit of their purpose, the latter not constituting tax objects;
- cooperatives and their unions;
- civil societies, civil (including non-profit) companies, and participatory or silent companies that conduct a business or a profession;
- foundations, trusts, funds, joint ventures; and
- the above-mentioned legal entities.

ii Non-corporate

Up to now, no special tax regime existed in Greece for non-corporate entities. However, recently, the Independent Authority of Public Revenue (IAPR) of the Greek Ministry of Finance issued a ruling with respect to the tax treatment of the foreign trusts and foundations, which are commonly used as vehicles for wealth and succession planning purposes, within the framework of Greek income, gift and inheritance taxation. In the income tax field, the Circular Pol. No. 1114/2017 examines the period after the introduction of the new Income Tax Code (ITC) and the period before it (the Old ITC).

Specifically, as of 1 January 2014, the ITC recognises trusts and foundations as taxable legal entities for corporate income tax purposes. On individuals’ taxation level, any distribution of profits, acquired by the settlor under his or her capacity as beneficiary of the foreign trust or foundation, falls within the definition of dividends, being that considered as taxable income, and is subject to Greek income dividend tax of 10 per cent with effect for payments performed up to the tax year 2016, and 15 per cent for the tax year 2017 onwards (plus solidarity tax contribution). In the event the settlor or founder and the beneficiary of the trust or foundation is not the same person, the transfer of the trust’s assets to the
beneficiary is treated as a gift or inheritance for tax purposes and is taxed according to the
gift or inheritance tax scale, which is applicable based on the relationship between the settlor
or founder and the recipient of the assets. Undistributed income, which arises in the trust
or foundation, could be treated pursuant to the provisions of CFC rules referred to above,
provided that all the conditions are cumulatively met. In case of the trust’s or foundation’s
dissolution and liquidation, the distributed amounts that exceed the initial capital transferred
to the trust or foundation are considered as dividends and are subject to Greek income
dividend tax of 10 per cent, with effect for payments performed up to the tax year 2016 and
15 per cent, for the tax year 2017 onwards (plus solidarity tax contribution). There is no
taxable event to the extent the distributed amounts do not exceed the initial capital since they
are considered as capital repayment. Finally, the transfer of assets into the trust or foundation
upon its settlement is not considered as taxable event.

Up to 31 December 2013, Greek Law 2238/1994 recognised only foundations as
taxable legal entities for corporate income tax purposes. On individuals’ taxation level, any
distribution of profits, acquired by the settlor under his or her capacity as beneficiary of a
foreign trust, is subject to income tax at the level of the settlor of the trust depending on the
source of income (e.g., interest, dividends, capital gains), while, as per the distribution of
profits from a foundation, acquired by the founder under his or her capacity as beneficiary
of the foreign foundation, is subject to income tax according to the tax scale applicable
on freelancers pursuant to Greek Law 2238/1994. In case the settlor or founder and the
beneficiary of the trust or foundation is not the same person, the transfer of the trust’s or
foundation’s assets to the beneficiaries is treated as a gift or inheritance for tax purposes
and is taxed according to the gift or inheritance tax scale that is applicable based on the
relationship between the settlor of the trust or foundation and the recipient of the assets. The
trust’s dissolution and liquidation is not considered a taxable event, while, in the event of
the foundation’s dissolution and liquidation, the distributed amounts that exceed the initial
capital transferred to the foundation are subject to income tax according to the tax scale
applicable on freelancers pursuant to Greek Law 2238/1994. There is no taxable event to
the extent the distributed amounts do not exceed the initial capital since they are considered
as capital repayment. Finally, the transfer of assets into the trust or foundation upon its
settlement is not considered as taxable event.

III DIRECT TAXATION OF BUSINESSES

As of 1 January 2016, the corporate income tax rate is 29 per cent, while as of 1 January 2019
for any corporate income profits for legal entities keeping ‘double-entry’ or ‘single-entry’
accounting books deriving during the tax year 2019, corporate income tax rate is 28 per cent,
which is gradually decreasing to 27 per cent as regards corporate income profits deriving
during the tax year 2020, to 26 per cent as regards corporate income profits deriving during
the tax year 2021, and finally to 25 per cent as regards corporate income profits deriving
during the tax year 2022. According to the ITC provisions, any source of income of taxable
legal entities shall be deemed business income subject to corporate taxation.

i Tax on profits

Business income is defined as the sum of the global total income from business activity
after the deduction of business expenses, depreciation and bad debt provisions. Moreover,
capitalisation or non-distributable profits that have not been taxed shall be deemed, under
conditions, as business income.
Greece

The ITC adopts a dual system for the deductibility of business expenses. All business expenses are deductible, subject to some general conditions, with the exception of some explicitly enumerated expenses. Specifically, an exhaustive list of non-deductible expenses, irrespective of their purpose, is provided by law (Article 23 of Law 4172/2013). Expenses that do not fall within the ambit of the aforementioned provision are, in principle, deductible as long as the following requirements are cumulatively met:

a the expenses are incurred in the interest of the business or in the ordinary course of the business;
b the expenses correspond to an actual transaction, and the value of the transaction is not deemed lower or higher than the market value, based on elements available to the tax administration; and
c the expenses have been recorded in an enterprise's books along with the supporting documentation.

Special reference is provided in the ITC as to the deductibility of expenses made for scientific and technological research. Specifically, the ITC provides that expenses of scientific and technological research are deductible from gross income of enterprises at the time of their realisation increased by 30 per cent.

The total expenses paid to a legal person or a legal entity who is a tax resident in a ‘non-cooperative state’ or is subject to a ‘preferential tax regime’ are not deductible for tax purposes unless the taxpayer proves that these expenses relate to real and ordinary transactions, and do not result in transfer of profits, income or capital for tax avoidance or tax evasion. Exceptionally, deduction of expenses paid to an EU or EEA Member State tax resident is not precluded if a legal basis for the exchange of information between Greece and the Member State in question exists.

Adjustments for tax purposes may occur in cases such as where thin capitalisation rules apply, in the event that audit verifications are impossible due to infringements of the tax legislation, when the accounting books are not duly kept or when differences are incurred owing to the implementation of certain transfer pricing methods.

**Depreciations**

Depreciations have been introduced in the ITC. Depreciation rates vary from 4 to 40 per cent depending on the asset in question. The income tax legislation provides for depreciation either in favour of the owner of the assets or of the lessee on the occasion of a financial leasing agreement. Some basic categories that can be mentioned are the depreciation of intangibles at a rate of 10 per cent, while buildings are depreciated at a rate of 4 per cent.

For fixed assets valued up to €1,500, a one-off depreciation may be opted for in the year when the assets are acquired.

Newly established companies are eligible to postpone their depreciation claim for all their fixed assets for the first three years.

**Income acquisition time**

In principle, any taxable income, including business income, is taxed on an accrual basis. In that respect, the income acquisition time is considered to be the time when the right to collect the income is acquired; thus, the exact time that the right to collect the income is born is critical. By derogation from the main rule, only individuals’ income from their employment and pensions shall be taxed upon receipt.
Capital and income

Capital income is a distinct category of income and includes income, in cash or in kind, from dividends, interest, royalties and immovable property.

As mentioned above, any source of income of taxpayers, in the form of legal entities, and the capital income as well, is considered business income and taxed with the applicable corporate tax rate.

On the other hand, individuals (taxpayers) are subject to income tax at various tax rates, depending on the classification of their taxable income in question.

In general, the applicable withholding tax rates per category of capital income are as follows:

a. dividends distributions are subject to withholding tax at a rate of 10 per cent, with effect for payments performed up to tax year 2016, and 15 per cent for tax year 2017 onwards, exhausting any further tax liability for individuals (final tax);

b. interest payments are subject to a withholding tax rate of 15 per cent, exhausting any further tax liability for individuals (final tax); and

c. royalties payments are subject to withholding tax at a rate of 20 per cent, exhausting any further tax liability for individuals (final tax).

However, the imposition of withholding tax on the payment of capital income exhausts the tax liability only for individuals and foreign legal persons or entities without a permanent establishment in Greece, while capital income is added to Greek legal persons’, entities’ or foreign legal persons’ (with permanent establishment in Greece) total income, and will be taxed as business income, as analysed below.

Losses

According to the ITC, businesses can carry forward tax losses, offsetting them against business profits for five consecutive tax years. A new rule on the abuse of provisions for the transfer and set-off of losses is introduced if, during a tax year, the direct or indirect holding or voting rights of an enterprise are changed to a percentage exceeding 33 per cent while in the same or the following tax year, or both, the activity of the company in which the holding or voting rights are acquired is changed to a percentage exceeding 50 per cent of its turnover in relation to the immediately preceding tax year by the change of holding or voting rights.

Offsetting of losses incurred abroad is allowed only if they are carried over from another EU or EEA Member State, provided that they are not exempt on the basis of the double tax treaty (DTT) concluded and applied by Greece.

Rates

As of 1 January 2016, the corporate income tax rate is 29 per cent for any business income for legal entities keeping ‘double-entry’ or ‘single-entry’ accounting books, while as of 1 January 2019 for any corporate income profits for legal entities keeping ‘double-entry’ or ‘single-entry’ accounting books deriving during the tax year 2019, the corporate income tax rate is 28 per cent, which is gradually decreasing to 27 per cent as regards corporate income profits deriving during the tax year 2020, to 26 per cent as regards corporate income profits deriving during the tax year 2021, and finally to 25 per cent as regards corporate income profits deriving during the tax year 2022.
**Administration**

Income tax returns are filed during the period starting from 1 February to 30 June of the year following the tax year to which they relate. For legal entities, the tax prepayment (which is actually an advance payment for the following tax year) is 100 per cent of the tax corresponding to the profits of the tax year for which the return is filed. The corporate income tax prepayment is also increased to 100 per cent for partnerships, non-profit legal persons of public or private law, civil law societies, civil law profit or non-profit companies, joint-stock or undisclosed companies to the extent they exercise trade or business, as well as joint ventures or partnerships.

Audits and the collection of taxes are conducted by the competent tax authorities determined by the seat of the legal entity in question. By derogation of the main rule, SAs, irrespective of their seat, fall within the ambit of FAE, the central tax authority for SAs, registered in Athens, Piraeus and Thessaloniki.

A tax clearance may be granted by the tax administration to a taxpayer to proceed with acts and transactions only if it is established that the taxpayer does not have any due tax liabilities and has submitted all tax returns in the past.

The following types of tax audit are provided for in the TPC:

- a remote tax audit performed from the offices of the tax administration based on tax returns, financial statements, accounting books, documentation and other information; and
- an on-site tax audit, either a full on-site audit with prior written notice, unless there is evidence of tax evasion, and a partial on-site audit without prior notice.

The selection of the cases to be audited will be based on risk analysis criteria or other criteria that are specified by the Directorate of Independent Authority of Public Revenue.

Any enforceable tax assessment act issued by the tax administration is subject to an out-of-court procedure as provided under TPC. Taxpayers have the right, within a 30-day period from the notification of the act, to file an out-of-court petition requesting the review of the tax assessment act by the Dispute Resolution Directorate (Internal Review Unit) of the IAPR. It is provided that the direct filing of a petition before the competent administrative courts against acts of tax assessment is inadmissible, and therefore is rejected.

The relevant decision of the Dispute Resolution Directorate shall be issued within 120 days of the filing of the out-of-court petition. A summons to a hearing of the taxpayer before the Dispute Resolution Directorate (Internal Review Unit) is not mandatory unless it is considered necessary by the administration. If a decision is not issued within this time frame, it is considered that the petition has been implicitly rejected.

Taxpayers can submit interpretation queries to the Greek Ministry of Finance, which may revert with advance rulings applicable on an ad hoc basis.

**Tax grouping**

Company law only provides for a consolidated balance sheet for accounting purposes.

In principle, Greek tax law does not provide a special tax regime for tax grouping. Each member of the group has a separate tax liability. Profits and losses cannot be shifted between affiliated companies. Furthermore, pursuant to the transfer pricing provisions, intra-group transactions must be in compliance with the arm’s-length principle.
Foreign tax credit
Foreign-source income is usually taxable with a credit for foreign income taxes paid up to the amount of Greek tax corresponding to the foreign-source income. The credit cannot exceed the amount of Greek tax payable on the same amount.

ii Other relevant taxes
Business activity in Greece (consisting of taxable supplies of goods or services for VAT purposes) is subject to VAT. The standard VAT rate amounts to 24 per cent. Special provisions for VAT grouping are not applicable according to the Greek VAT legislation. Legal entities belonging to a group should register for VAT numbers individually.

Capital duty is payable on the nominal capital increase of legal entities, plus an additional 0.1 per cent surcharge for the benefit of the Competition Committee.

Save for the provisions of Greek VAT law, stamp duty at a rate of 1.2, 2.4 or 3.6 per cent may apply, depending on the transaction. Stamp duty is imposed on the relevant contractual agreement or transaction since it qualifies as transaction duty. In this respect, each transaction may be burdened either with VAT or stamp duty, but not both at the same time. Thus, the characterisation of the transaction is crucial for the imposition of indirect taxation, and each case should be examined on a case-by-case basis so as to determine whether it falls within the scope of VAT or stamp duty.

Foreign legal entities or companies are burdened with an annual special real estate tax rate of 15 per cent of the objective value of their real estate property unless they disclose their shareholders up to the level of the individual, ultimate beneficial owner, who is obliged to acquire a tax registration number in Greece.

Many additional exemptions are also available.

IV TAX RESIDENCE AND FISCAL DOMICILE
Greece (a member of the OECD since 1961) has signed and ratified 57 bilateral conventions for avoiding double taxation with third countries. See Section VII.iii for further information.

i Corporate residence
Legal entities of any type, as long as they are considered to be Greek tax residents, are subject to corporate tax in Greece on their worldwide income.

A legal entity is considered to be a Greek tax resident in the following cases: it is incorporated or established under Greek law; it has its registered office in Greece; or the place of its effective management is in Greece at any time during the tax year. The ‘effective place of management’ concept should be reviewed on an ad hoc basis as per the factual background of each case. To this end, indicative criteria are listed (such as the place of the day-to-day management of the company, place of strategic decision taking, place where the annual general meeting of shareholders or partners or the board of directors takes place, place where the accounting books of the company are held, residence of the members of the board of directors) without, however, excluding additional factors that, while they might not on their own substantiate the existence of tax residence in Greece, are taken into account when determining the place of effective management (such as the residence of the majority of shareholders or partners). It has been clarified that these provisions do not apply to companies subject to tax under Law 27/1975 and Legislative Decree 2687/1953 (shipping entities).
ii Branch or permanent establishment
The definition of PE in the ITC is compliant with Article 5 of the OECD Model, with the only exception of technical projects for which a three-month period is provided for the substantiation of a PE, as compared with the 12 months provided in the Model.

In the past, the domestic provision (under the previous ITC) was interpreted by the tax authorities in a manner that resulted in the substantiation of a PE for the provision of services in many cases (such as the dependency element regarding dependent, independent or undisclosed commission agents, judged each time on the factual background) and consequently for such PE to be burdened with Greek taxation. In this respect, the provision of services on technical projects in Greece has always been challenged by the Greek tax authorities. Recently, it has been established by the Supreme Administrative Court that the crucial element is whether the services provided are essential for the completion of the project and subsequently the substantiation of a PE for the foreign provider.

In any case, the provisions of various DTTs override the provisions of domestic law, which is applicable in the absence of any DTTs.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes
In principle, as per the provisions of the ITC, holding companies are taxable legal entities for corporate income tax purposes.

Shipping companies operating under the special regime of Law 27/1975
Owing to the beneficial tax regime for shipping companies operating under Law 27/1975, Greece attracts Greek and foreign ship-owning companies with vessels flying a Greek flag and foreign ship-owning companies with vessels flying a foreign flag if their management is exercised by Greek companies or foreign companies established in Greece (operating under a special regime of offshore companies) that are subject to tonnage tax.

The Greek tonnage tax regime applies to category ‘A’ and ‘B’ vessels. Category ‘A’ vessels includes cargo vessels, tankers, steel hull vessels for dry or liquid cargo that ply to or between foreign ports, passenger vessels and drilling platforms. Category ‘B’ vessels include small boats and any other motor vessels not listed under category ‘A’. The gross tonnage is calculated by multiplying coefficient rates by each scale of gross registered tonnage. This taxable tonnage is then multiplied by an age-corrected rate. A credit for the tonnage tax paid abroad is provided.

A shipowner, whether an individual or a legal entity, who is the registered owner of the relevant ship on the first day of each calendar year is liable to pay the ship’s tonnage tax. The person managing the ship and collecting the hire fee as well as the manager’s representative, subject to the latter having accepted the relevant appointment in writing, are also jointly and severally liable to pay the ship’s tonnage tax.

Various exemptions to and reductions of the tonnage tax apply; for example, vessels built in shipyards in Greece, under a Greek flag, are exempt from tax for the first six years. A 50 per cent reduction for vessels operating regular routes between Greek and foreign ports or solely between foreign ports is also provided.

The payment of the tonnage tax exhausts all income tax liability of the ship-owner with respect to income derived from the ship’s operation. The exhaustion of tax liability also applies to the shareholders or partners of a (Greek or foreign) shipping company; it also

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covers all capital gains arising out of the sale of the vessel realised at the level of the shipowner, the shipping company or its shareholders. If a company that owns a Greek-flagged ship also has other commercial activities than the operation of the ship, exemption from income tax applies to the net profits that correspond pro rata to the gross income the owner derives from ships subject to the tonnage tax regime.

In addition, the shareholders of the above-mentioned companies are exempt from any tax, duty, contribution or withholding, up to a natural person, for income acquired from dividends or distribution of net profits, whether such profits are acquired directly or through holding companies. An exemption from any taxation of the transfer of shares or parts of Greek or foreign shipowner companies under Greek or foreign flags applies regardless of the reason for the transfer. On the contrary, a 10 per cent withholding tax is applicable on dividend distributions to Greek tax residents by offices that are engaged in activities such as chartering, insurance and brokerage, other than the management and exploitation of Greek or foreign-flagged ships.

According to Article 29 of Law 27/1975, exemption from inheritance tax applies with respect to transfers of vessels, stocks or shares of Greek or foreign companies that own vessels flying a Greek or foreign flag with gross tonnage of over 1,500, and of stocks or shares of holding companies that hold stocks or shares of shipping companies, whether directly or through holding companies.

Finally, an annual contribution at a rate of 5 to 7 per cent from 2016 to 2019 is imposed on offices or branches of foreign enterprises that have been established in Greece by virtue of Article 25 of Law 27/1975, and that are engaged in the chartering, insurance, average (damage) settlement, purchase, chartering or shipbuilding brokerage, or chartering of insurance of ships under the Greek or a foreign flag whose capacity exceeds 500 gross registered tons, as well as on the representation of shipowner companies or undertakings whose object is identical to one of the above-mentioned activities. Greek and foreign companies that have established an office or branch under Law 27/1975 and are engaged in the management of vessels flying the Greek or a foreign flag, as well as in other activities approved by their licence of operation, are exempt from the above-mentioned annual contribution.

ii IP regimes

The ITC provides no special IP tax regime. However, income from royalties, which is defined as income gained in exchange for the use or the right to use any kind of intellectual property rights, is considered as capital income and is subject to withholding tax according to the general provisions. Specifically, royalties paid by Greek individuals or legal persons to foreign legal persons or entities with no establishment in Greece are subject to withholding tax at a rate of 20 per cent unless the legal persons or entities are tax residents of countries with whom Greece has entered into DTTs, which will prevail over the domestic law. The withholding tax of 20 per cent exhausts the tax liability of foreign legal persons and entities without a PE in Greece. On the other hand, foreign-source royalties paid to legal persons or entities that are Greek tax residents or have an establishment in Greece shall be included in their annual income tax return to be taxed as business income.

iii State aid

Over the years, the state traditionally introduced tax-incentive laws to motivate Greek companies either to set up a new business or expand their existing business activities. These tax incentives varied from time to time based on specific legislation. The basic state aid criteria
differed basically on the requirements that were set, for example, according to the business sector contemplated and the region in Greece where the business would be established. The state used to provide incentives to Greek companies in the form of a subsidy or in the form of tax deductions to their annual corporate tax liability. Owing to the recession, there have been significant cuts to subsidies granted by the state, and the legislative framework on tax incentives has changed rapidly over the past few years.

iv  General
The rationalisation of the applicable rates for legal persons (flat rate for taxable legal persons with both double-entry and single-entry accounting books) along with the deductibility of any expense incurred for business purposes under the conditions provided by law have formed a neutral tax regime.

VI  WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i  Withholding on outward-bound payments (domestic law)
ITC provides the imposition of withholding tax on capital income, which is introduced as a distinct category of income and includes the income, in cash or in kind, from dividends, interests, royalties. Specifically:

- dividends distributions made by Greek legal persons are subject to withholding tax at a rate of 10 per cent with effect for payments performed up to tax year 2016 and at a rate of 15 per cent for tax year 2017 onwards, exhausting any further tax liability for foreign legal persons or entities with no establishment in Greece;
- interest payments made by Greek legal persons are subject to withholding tax at a rate of 15 per cent, exhausting any further tax liability for foreign legal persons or entities with no establishment in Greece; and
- royalties payments made by Greek legal persons are subject to withholding tax at a rate of 20 per cent, exhausting any further tax liability for foreign legal persons or entities with no establishment in Greece.

If the recipient of the above-mentioned payments is a Greek legal person or entity, or a foreign legal person or entity with a PE in Greece, the capital income is added to the total taxable business income, and the withheld tax is offset against the income tax.

Withholding tax may be reduced or eliminated according to the provisions of the available DTTs or the provisions of the domestic legislation.

On the other hand, foreign-source dividends, interest and royalties paid to legal persons or entities that are Greek tax residents or have their PE in Greece shall be included in their annual income tax return to be taxed as business income.

ii  Domestic law exclusions or exemptions from withholding on outward-bound payments
As regards intra-group dividends received by Greek legal entities or Greek PEs of EU legal entities, a broad tax exemption provision is provided, subject to conditions. Specifically, the recipient taxpayer must hold at least a minimum participation of 10 per cent of the value or the quantity of the share or principal capital or voting rights of the distributing legal entity,
the minimum participation percentage should be held for at least 24 months (although the exemption may be provided prior to the completion of 24 months secured by a guarantee), and the legal entity proceeding to the distribution of profits should not have its registered seat in a state characterised as a non-cooperating state. As of 1 January 2016, a new condition has been introduced by virtue of which intra-group dividends are exempt from taxation to the extent that the respective dividends have not been deducted by the subsidiary. Moreover, a general anti-abuse rule is introduced by virtue of which the tax exemption in the case of the collection and payment of dividends is alleviated if it is considered that a ‘non-genuine arrangement’ exists as regards the intra-group structure. A ‘non-genuine arrangement’ is an arrangement that has not been put into place for valid commercial reasons reflecting the economic reality. The above-mentioned general rule is open to interpretation by the tax authorities, and there is no indication which party shall have the burden of proving that the arrangement is genuine.

In addition, dividends paid by or to legal entities that are taxpayers in an EU Member State are not subject to Greek withholding tax if the above-mentioned conditions are cumulatively met. The same exemption from Greek withholding tax applies for payments of interest or royalties between affiliated companies pursuant to EU Directive 2003/49/EC if the EU recipient taxpayer holds at least a minimum participation of 25 per cent of the value or the quantity of the share or principal capital or voting rights of the distributing legal entity. The minimum participation percentage should be held for at least 24 months (although the exemption may be provided prior to the completion of 24 months if secured by a guarantee), and the legal entity proceeding to the distribution of profits should not have its registered seat in a state characterised as a non-cooperating state.

iii Double tax treaties
Greece has entered into DTTs that provide beneficial income tax provisions compared to Greece’s internal income tax legislation with the following countries: Albania, Armenia, Austria, Azerbaijan, Belgium, Bosnia-Herzegovina, Bulgaria, Canada, China, Croatia, Cyprus, the Czech Republic, Denmark, Egypt, Estonia, Finland, France, Georgia, Germany, Hungary, Iceland, India, Ireland, Israel, Italy, Korea, Kuwait, Latvia, Lithuania, Luxembourg, Malta, Mexico, Moldavia, Morocco, the Netherlands, Norway, Poland, Portugal, Qatar, Romania, Russia, San Marino, Saudi Arabia, Serbia, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Tunisia, Turkey, Ukraine, the United Arab Emirates, the United Kingdom, the United States and Uzbekistan.

DTTs, through their integration into Greek (domestic) law, have increased legislative power over the domestic legislation according to Article 28 of the Greek Constitution. As such, the withholding tax amount differs if the recipient of a payment is resident in a tax treaty state, resulting in the application of the beneficial rate provided in the applicable DTT.

iv Taxation on receipt
Dividends, interest and royalties payments that are taxed on receipt and are not exempt under the above-mentioned conditions are attributed to the beneficiary legal persons and entities as taxable business income, while the tax withheld will be credited against the final tax liability in respect of such income at the level of the shareholder.
VII TAXATION OF FUNDING STRUCTURES

i Thin capitalisation
The thin capitalisation rules have been radically amended.

The rules under the ITC apply to all loans irrespective of their origin (whether intercompany or not, banking, etc.).

The amount of redundant interest is now taken into account for the tax-deductibility of interest rather than the equity and loans of the borrower as per the previous regime.

In principle, as of 1 January 2017, surplus interest expenses (debt interest expenses minus interest income) are not recognised as deductible business expenses to the extent that they are over 30 per cent of the taxable earnings before interest, taxes, depreciation and amortisation (EBITDA) after tax adjustments. Under the condition that the amount of net interest expenses registered in the accounting books does not exceed an annual threshold of €3 million (for tax years 2016 and 2017 onwards) although the surplus interest expenses exceed 30 per cent of EBITDA, it is fully recognised as a deductible business expense. In the meantime, there will be a transitional period under which thin cap rules will be calculated likewise (interest on debt minus interest income) but with different percentages for each year (e.g., for FY 2014, 60 per cent, for FY 2015, 50 per cent and for FY 2016, 40 per cent). In the transitional period (i.e. tax years which commence from 1 January 2014 up to 31 December 2015) the threshold for interest expenses is €5 million.

Subject to conditions, interest expenses can be carried forward in subsequent years without a time limit.

Credit institutions are excluded from these provisions.

ii Deduction of finance costs
As per the provisions of the ITC, there are certain restrictions in relation to the deductibility of interest expenses (excluding bank loans, bond loans, etc.). Specifically, the aforementioned interest expenses are not deducted if these amounts exceed a certain predetermined interest rate defined by the Bank of Greece (the crucial time period is the conclusion or execution of the loan).

iii Restrictions on payments
From a corporate perspective, whether there are restrictions on dividend payments should be addressed on a case-by-case basis.

iv Return of capital
There are specific rules on the distribution of tax-free reserves implemented by the ITC. Since these tax-free reserves have been formed for various reasons either provided by tax, corporate or incentives legislation, the tax treatment should be determined based on the characterisation of the reserve.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition
Owing to the tax neutrality approached through the entry into force of the ITC, there is no particular vehicle for tax purposes for conducting a business in Greece unless the activity
falls within the scope of Law 27/1975 or Law 89/1967. In addition, there are certain special purpose companies that may be subject to a special tax regime, such as real estate investment companies.

ii Reorganisation
Under the ITC, a provision of ‘business restructurings’ has been introduced. In particular, the ITC includes provisions on company restructuring and specifically on the contribution of assets in return of shares, exchange of shares, mergers and spin-offs, and transfers of the registered seat of a Societas Europaea.

Moreover, a business restructuring should be effected in accordance with the arm’s-length principle. Specifically, it is stated that in the case of an intercompany business restructuring, either local or cross-border, in which goodwill or intangible assets are transferred or their use is assigned, then such transfer should be performed at a price that will be in compliance with the arm’s-length principle. In addition, the reallocation of risks and functions in the context of this restructuring should be performed in accordance with the arm’s-length principle by taking into account other comparable cases.

iii Exit
Once a business moving abroad has fulfilled its tax obligations in Greece, there is no particular exit tax regime regarding movement of the business abroad. It is worth mentioning that the ITC has certain provisions in relation to the EU Merger Directive.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION
i General anti-avoidance
In Greece, a general anti-abuse rule has been introduced for the first time in Greece (Article 38 of Law 4174/2013) as part of the new measures to combat tax evasion, allowing the tax authorities to disregard artificial arrangements set up for tax evasion purposes. Upon assessing an ‘artificial arrangement’, the tax authorities should refer to the substance and business purpose of the arrangement, or lack thereof, and compare the tax burden triggered in the context of the potentially ‘artificial arrangement’ to the tax burden that would arise in the absence of such an arrangement.

An arrangement is considered artificial if it lacks commercial or economic substance. To determine whether an arrangement is artificial, various characteristics are examined. For the purposes of this provision, the goal of an arrangement is to avoid taxation in the event that, regardless of the subjective intention of the taxpayer, it is contrary to the object spirit and purpose of the tax provisions that would apply in the other cases. In order to determine the tax advantage, the amount of tax due, taking into consideration such arrangement, is compared to the tax payable by the taxpayer under the same conditions in the absence of such arrangement.

Finally, by virtue of specific tax provisions, transactions (e.g., expenses) between domestic entities and entities of non-cooperative states or states with beneficial tax regimes (e.g., offshore entities) are not recognised for income tax purposes.

On an EU level, ECOFIN adopted Council Directive 2018/822/EU, amending Directive 2011/16/EU as regards mandatory information on automatic exchange of reportable cross-border arrangements. The main purpose this framework, known as DAC6,
is to provide a mechanism that will enhance and increase tax transparency throughout the EU as regards tax-aggressive cross-border arrangements, which effectively result in tax avoidance. Each Member State (and, therefore, Greece) must implement DAC6 into their domestic laws and regulations by 31 December 2019 and be in position to apply the new mandatory disclosure rules by 1 July 2020.

On a global level, according to the provisions of the Multilateral Convention to Implement Tax Treaty related measures to prevent BEPS (MLI) and Action 6 OECD/BEPS, separate rules are proposed to address situations of treaty abuse (treaty shopping for technical tax avoidance), as follows:

a A general anti-abuse rule based on the principal purpose of transactions or arrangements, according to which contracting states could deny the application of the preferential provisions of a bilateral treaty when transactions or arrangements entered into the application of a treaty in order to only obtain the tax benefits of these provisions in inappropriate circumstances (technical arrangements).

b A principal purpose test (PPT), according to which, having regard to all relevant facts and circumstances, obtaining that tax benefit is one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that tax benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the covered tax agreement. The benefit under this convention could not be granted if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit. In this case, a case-by-case analysis is required, based on what can reasonably be considered to be one of the principal purposes of transactions or arrangements.

c A simplified limitation on benefits (LOB) provision. The MLI does not include a detailed LOB provision given the substantial customisation required by contracting jurisdictions. Instead, the MLI allows parties that prefer to address treaty abuse by adopting a detailed LOB provision to opt out of the PPT and agree to ‘endeavour to reach a bilateral agreement that satisfies the minimum standard’. In addition, the MLI allows parties preferring a detailed LOB provision to express their intention to incorporate the PPT as an interim measure while the detailed LOB is being bilaterally negotiated. For SPVs, funds or holding companies especially, the above limitation could arise if a significant percentage of UBO could not qualify for the tax relief for which the legal entity seems to qualify.

Greece seems to opt for the PPT rule. If the other jurisdiction chooses LOB but Greece chooses PPT, the PPT rule shall apply if the source country (place of payment) is Greece. The MLI will apply after being ratified and incorporated in the domestic legal framework of each jurisdiction. Greece has not incorporated or implemented the MLI framework. At present, the Greek tax administration is not yet familiar with the MLI framework, as it is not yet applicable in everyday practice.

ii Controlled foreign corporations (CFCs)

CFC rules have been recently introduced in the ITC with the aim of dealing with the tax avoidance of Greek companies through shifting revenues to subsidiaries in low-tax jurisdictions. Basically, these rules provide for the inclusion in the taxable income of Greek
companies of undistributed ‘passive’ income of foreign subsidiaries under the conditions stipulated in law. As a general rule, EU entities fall outside the scope of the Greek CFC rules (unless the legal entity is deemed to be an artificial arrangement generated for the purpose of tax avoidance – in line with EU case law). If deemed a CFC, all undistributed income would be considered as taxable income of its Greek tax-resident shareholder, taxed at the rates applicable to income derived from business activities, as they are provided above.

The undistributed income of a foreign legal entity will be considered the taxable income of a Greek resident who controls the foreign entity if all of the following requirements are cumulatively met:

\( a \) the taxpayer, on his or her own or jointly with related persons, holds, directly or indirectly, shares, parts, voting rights or participations in the capital at a percentage exceeding 50 per cent, or is entitled to receive a percentage exceeding 50 per cent of the profits of the said legal entity or other entity;

\( b \) the above legal entity or other entity is subject to taxation in a non-cooperative state or a state with a preferential tax regime, namely a special regime allowing for a substantially lower level of taxation than the general regime;

\( c \) a percentage exceeding 30 per cent of the net income before taxes realised by the legal entity or other entity falls into one or more of the following categories:

- interest or any other income generated from financial assets;
- royalties or any other income generated from intellectual property;
- income derived from dividends and the transfer of shares;
- income derived from movable assets;
- income derived from real estate property, unless the Member State of the legal entity or other entity taxpayer would not be entitled to tax such income according to an agreement concluded with a third country; or
- income derived from insurance, bank and other financial activities; and

\( d \) it is not a company with a principal category of shares that are traded on an organised market.

Under Law 4337/2015, new provisions on the ‘tax evasion’ definition have been provided. In particular, tax evasion is committed by persons who intentionally avoid payment of taxes such as income tax, ENFIA, VAT, premium tax and shipping tax by hiding any taxable income or assets from the tax authorities. Moreover, under the new regime, the number of persons who are considered accomplices in tax-evasion crimes has been expanded. The persons falling under the said definition are those engaged with a company’s effective management, administration and representation.

It should also be noted that under the new tax regime, the filing of an administrative out-of-court petition as well as a judicial petition before an administrative court does not affect criminal proceedings. However, the criminal court may suspend criminal proceedings until the issuance of a final decision of the administrative court if it decides that the decision of the administrative court is substantive.

### iii Transfer pricing

The ITC provides that legal entities and other entities, when realising transactions with associated persons, should comply with the arm’s-length principle. The arm’s-length principle states that the terms concluded between associated persons for the performance of any
transaction (supply of goods or services) must be the same as if the parties were not associated, otherwise the profits that would have arisen in the absence of the above-mentioned terms are considered as taxable profits.

The ITC defines the term ‘associated person’ to extend to legal persons, individuals and any other body of persons. Two persons or entities are regarded as ‘associated’ where:

a. every person or entity holds, directly or indirectly, shares or parts of the quota in the other of at least 33 per cent estimated on the basis of the total value or number, or equivalent profit participation rights or voting rights;
b. two or more persons or entities if one of them holds, directly or indirectly, shares or parts of the quota in the other of at least 33 per cent estimated on the basis of total value or number, or equivalent profit participation rights or voting rights; or
c. every person or entity with which there is direct or indirect management dependence or control, or every person or entity that exercises or is able to exercise decisive influence over the other or a third person that has the possibility of direct or indirect management dependence or control or decisive influence over the other two.

The TPC provides the option of obtaining an advance pricing arrangement (APA) from the General Secretary of Public Revenues, as regards the methodology of specific future cross-border transactions with associated parties. An APA will cover any relevant criteria used for determination of the intra-group pricing. An APA term cannot exceed four years, and retroactive effect will not be possible.

Under Law 4337/2015, the penalties imposed for the delayed filing or non-filing or filing of an inaccurate summary information table as well as of the transfer pricing documentation file are calculated based on the value of intra-group transactions (as 1/1,000th of the value of the transaction).

iv Tax clearances and rulings

A tax clearance, valid for two months, may be granted by the tax administration to a taxpayer to realise acts and transactions only if it is established that the taxpayer does not have any due tax liabilities and has submitted all tax returns in the past.

If the issuance of a tax clearance is not possible, liability certification, valid for one month, may be granted to realise acts and transactions where the taxpayer has been included in a debt regulation programme.

A prohibition on granting a tax clearance or liability certification is provided for cases of state safeguarding measures for financial crimes or in the event of assessed due liabilities in the name of the taxpayer.

In cases of real estate property transactions (transfers, etc.), there is a certain type of liability certification that is issued for that particular reason.

In principle, Greek tax legislation does not provide a general framework for the acquisition of advance tax rulings. Under certain circumstances, the state issues an official approval decision – for example, for setting up an office under Law 89/1967 or the implementation of an APA procedure as referred to above.

X TAX COMPLIANCE

In the context of the continuous improvement of international tax compliance, Greek Law 4493/2017 ratified the Memorandum of Understanding and the Agreement between the
Government of the Hellenic Republic and the Government of the United States of America on the improvement of international tax compliance, and the implementation of the Foreign Account Tax Compliance Act (FATCA) on preventing tax evasion. Based on the Agreement for the implementation of FATCA legislation, Greece and the United States agreed on the automatic exchange of information on financial accounts held by Greek tax residents in US financial institutions and financial accounts held by US tax residents in Greek financial institutions.

In addition, in the context of mutual administrative assistance and cooperation in tax matters on an international and EU basis (OECD, EU) for the automatic exchange of information, Greece has adopted the global standard for the automatic exchange of information of financial accounts (Common Reporting Standard (CRS)). By virtue of law 4378/2016 (Government Gazette A’ 55/106), amending Law 4170/2013, Greece implemented Council Directive 2014/107/EU ‘amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation’, adopting the use of the CRS at European level. By virtue of Law 4428/2016 (Government Gazette A’ 190/2016) Greece ratified its participation in the Multilateral Competent Authority Agreement (MCAA) on Automatic Exchange of Financial Account Information. According to the new provisions, financial institutions that are tax resident in Greece must adopt specified due diligence procedures for the purpose of identifying bank accounts of individuals and legal entities and report their findings annually to the Ministry of Finance.

XI YEAR IN REVIEW

The entry into force of a new tax procedural code as of 1 January 2014, along with the introduction of CFC rules and general anti-avoidance rules as currently in force, brought about significant changes to the concepts of tax evasion and tax avoidance. In view of the new tax legislation, the Greek tax authorities have been adopting a stricter attitude towards legal entities and individuals upon a tax audit to prevent techniques that lead to a tax advantage. However, another aspect that should be addressed is the type of measures against individuals representing or participating (participation in partnerships) in a company that has tax liabilities owing to financial crimes. In particular, it is explicitly provided in the TPC that the state will impose safeguarding measures cumulatively on the company, and at the same time against the general partners of partnerships and any person who is appointed for any reason to the administration or management or representation of any legal entity or other entity as from the time the liability to attribute the taxes was born or the time the tax evasion was committed until the time the measures have been activated, irrespective of whether they have ceased to act under said capacity by any way or by any reason.

With reference to the joint liability of executives, the number of persons who are considered as perpetrators or accomplices of tax evasion crimes has been expanded to include those engaged in the effective management, administration and representation of legal entities, directly by law, by private consent or by a court decision.

The option of taking enforcement actions prior to the legal deadline for the payment of taxes or default notice, or the lapse of 30 days starting from the notification of the default notice, is provided in the case of a suspicion of fraud that endangers the collection of taxes.
XII OUTLOOK AND CONCLUSIONS

Since 1 January 2014, our tax legislation has been trying to keep up with new trends, taking into consideration the fact that tax evasion in Greece has been a major and unsolved issue. In particular, for the first time in Greece, tax avoidance and CFC rules have been introduced, and the transfer pricing legislation has been updated to a great extent. Greece, being a member of the OECD, will have to follow the changes launched by the OECD in terms of base erosion and profit shifting and the global initiative to abolish BEPS.

The main burden on Greek taxpayers during this period is over-taxation both on income and on real estate property. Moreover, in view of the new tax legislation, Greek tax authorities have adopted a stricter attitude towards legal entities and individuals upon a tax audit to prevent mechanisms that lead to a tax advantage.

Notwithstanding the above, and owing to the recession in Greece, the government is not taking the necessary measures to provide tax relief and tax incentives that would attract new investment into the country. In view of this, it is imperative that the tax burden is reduced, since Greece is suffering from both high unemployment and much higher tax rates than other EU Member States.
I INTRODUCTION

With a maximum corporate tax rate of 16.5 per cent, and no tax on sales, dividends or capital gains, Hong Kong is one of the most tax-friendly economies in the world. Foreign investments are not subject to any specific approval process, and the Hong Kong tax regime does not differentiate between foreign and domestic investors, except in relation to the acquisition of residential property. Hong Kong also promotes shariah investment, with the Hong Kong Monetary Authority indicating its aspiration for Hong Kong to be an Islamic finance hub. Since 2014, a number of banks have begun offering shariah-compliant funds. Coupled with its close proximity to and connection with Mainland China, Hong Kong is a popular gateway for inward investment into Mainland China by multinational corporations.

Although not an OECD member, Hong Kong is committed to supporting international efforts on base erosion and profit shifting (BEPS) and the Common Reporting Standard (CRS). Hong Kong joined the inclusive framework for implementation of the package of measures against BEPS (BEPS Package) on 20 June 2016 as a BEPS Associate. Following public consultation on the proposed measures, legislative amendments to implement CRS and automatic exchange of information were passed back in 2016 and amendments to implement the four minimum standards of the BEPS Package on 13 July 2018.

The principal tax legislation in Hong Kong is the Inland Revenue Ordinance (IRO).  

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

The most common business entities used in Hong Kong are companies, partnerships and trusts.

Companies

A company incorporated under Hong Kong law may be limited by shares, limited by guarantee or unlimited, with a company limited by shares being the most common corporate form. If a company is limited by shares, the liability of the shareholders is limited to the amount unpaid on their shares. A company limited by shares may either be a public or a private company. Public and private companies mainly differ in their ability to offer their shares to the public for subscription. Private companies must also cap the number of shareholders

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1 Steven Sieker is a partner and Wenwen Chai is an associate at Baker McKenzie.
3 Inland Revenue Ordinance (Chapter 112 of the laws of Hong Kong).
at 50. Both types of company are required to appoint a company secretary who is a Hong Kong-resident individual, or a company with a registered office or place of business in Hong Kong. However, a private company only needs to have one director, and at least one director must be an individual. Public companies, on the other hand, need at least two directors.

**Taxation**

Profits tax is charged on every person carrying on a trade, profession or business in Hong Kong. A 'person' under the IRO is defined to include individuals, corporations, partnerships and bodies of persons. Profits tax would be charged on the assessable profits that arose in or were derived from Hong Kong during the basis period.

Corporations were previously taxed at a flat rate of 16.5 per cent on their profits arising in or derived from Hong Kong. Beginning from the year of assessment 2018/19, a two-tiered profits tax system will apply to corporations as well as other entities chargeable to profits tax in Hong Kong. Under the two-tiered system, the first HK$2 million of profits will be chargeable to a reduced profits tax rate of 8.25 per cent and any profits in excess of HK$2 million will be chargeable at the previous rate of 16.5 per cent.\(^4\)

As the two-tiered system was introduced primarily for the benefit of small and medium-sized businesses, if an entity has one or more connected entities at the end of the basis period for a relevant year of assessment, then the two-tiered profits tax rate would only apply to one entity nominated by the group. An entity is connected to another entity if (1) one of them has control over the other; (2) both of them are under the control of the same entity; or (3) in the case of the first entity being a natural person carrying on a sole proprietorship business, the other entity is the same person carrying on another sole proprietorship business.\(^5\)

In this context, control means directly or indirectly owning more than 50 per cent in aggregate of the issued capital of another entity, or an entitlement to exercise or control the exercise of more than 50 per cent of the voting rights in another entity, or an entitlement to more than 50 per cent in aggregate the capital or profits of another entity.

The two-tiered system applies to a natural person, a body of persons, as well as corporations, partnerships and trusts. Persons other than corporations were previously taxed at a flat rate of 15 per cent on their assessable profits. Under the two-tiered system, the first HK$2 million of profits would be taxed at the reduced rate of 7.5 per cent and the remaining at 15 per cent.

**ii Partnerships**

Under the Partnership Ordinance\(^6\) a partnership is established when a group of persons carry on a business in common with a view to profit. Generally, no formalities are required to establish a partnership. However, a written partnership agreement is usually used to govern the relationships between the partners.

Limited liability partnerships are permitted under Hong Kong law. They must be registered with the Companies Registrar under the Limited Partnership Ordinance.\(^7\)

\(^4\) Section 14(2), IRO.
\(^5\) Section 14AAB, IRO.
\(^6\) Partnership Ordinance (Chapter 38 of the laws of Hong Kong).
\(^7\) Limited Partnership Ordinance (Chapter 37 of the laws of Hong Kong).
**Taxation**

The assessable profits of a partnership are charged as though the partnership is a single entity.\(^8\) A partner's individual tax liability is calculated by apportioning the partnership's assessable profits between each of the partners in the ratio in which the profits or losses of the basis period were divided. Thereafter, losses carried forward from previous years are deducted before applying the tax rate applicable to the individual partner to that partner's share of the assessable profits.

**iii Trusts**

Trusts are commonly used in Hong Kong as an investment vehicle. A trust comes into existence when one person transfers a specific property to the trustee with the intention that it will be applied for the benefit of another person (i.e., the beneficiary).

**Taxation**

A trustee is subject to profits tax on its own profits arising from the provision of trustee services. Due to the separation of legal and beneficial ownership, a trustee will not be personally liable for tax charged on profits of the underlying entities of the trust. To the extent that the trustee itself carries on business, those profits will be subject to tax. A corporate trustee will, therefore, be subject to tax at a rate of 8.25 per cent on the first HK$2 million of profits (subject to the connected-entity rules) and at 16.5 per cent on the remaining profits.

**III DIRECT TAXATION OF BUSINESSES**

**i Tax on profits**

**Determination of taxable profit**

Hong Kong has a territorial system of taxation. Three conditions must be satisfied before a charge to profits tax can arise:

- **a** the taxpayer must carry on a trade, profession or business in Hong Kong;
- **b** profits to be charged must be from the trade, profession or business carried on by the taxpayer in Hong Kong; and
- **c** the profits must be profits arising in or derived from Hong Kong.

Whether a person is carrying on a trade, profession or business in Hong Kong is a question of fact.

Six factors have emerged from case law in determining whether a taxpayer has engaged in trade, which collectively are referred to as the 'badges of trade', namely:

- **a** the subject matter of the transactions;
- **b** the length of ownership;
- **c** whether there have been successive or frequent similar transactions;
- **d** whether supplementary activities have been performed to make the assets marketable or to attract purchasers;
- **e** the reason for the disposal or realisation of the subject matter; and
- **f** the taxpayer's motives.

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\(^8\) Section 22(1), IRO.
In addition, the taxpayer’s intention to trade and the existence of a commercial purpose for the transaction are also relevant to such a determination. It is not necessary for all badges of trade to be present before a taxpayer will be found to be trading.

The definition of ‘business’ is much wider than ‘trade’. A company incorporated for the purpose of making profits for its shareholders that puts any of its assets to any gainful use is presumed to be carrying on a business. Business can be more passive than trade, with the receipt of share profits and fixed annuities having been held to be business. Similarly, the receipt of income by a holding company and the mere activity of depositing have been held to be carrying on a business as well. One-off transactions may also fall under the definition of ‘business’ under the IRO. Having a registered office in Hong Kong of itself will not necessarily amount to carrying on a business in Hong Kong.

A ‘profession’ is not defined in the IRO. Case law indicates that it refers to work requiring either purely intellectual skill or manual labour dependent upon purely intellectual skill. If a person practices a profession but is an employee, he or she is not considered to be carrying on a profession for the purpose of profits tax.

On the source of profits, the IRO defines ‘profits arising in or derived from Hong Kong’ to include ‘all profits from business transacted in Hong Kong, whether directly or indirectly through an agent’. According to Commissioner of Inland Revenue v. Hang Seng Bank Limited, the process of determining the source of profit involves examining the gross profit of the transaction and what the taxpayer has done to earn the profit in question. However, the test outlined in this case is not consistently followed in subsequent case law, many of which revert back to an operations test (i.e., an examination of the operations of the taxpayer that contributed to the generation of net profits).

To provide some guidance and clarity in this area, the Hong Kong Inland Revenue Department (IRD) issued Departmental Interpretation and Practice Note (DIPN) No. 21. DIPNs are not legally binding, but are indicative of the IRD’s views on various legal issues. According to DIPN No. 21, transactions must be looked at separately and the profits of each transaction considered on their own. Where the gross profit from an individual transaction arises in different places, they can be apportioned as arising partly in and partly outside Hong Kong. Further, the place where day-to-day investment decisions are undertaken does not generally determine the locality of profits. The absence of an overseas permanent establishment (PE) of a Hong Kong business does not of itself mean that all the profits of that business arise in or are derived from Hong Kong. However, practically, the IRD is less likely to accept an offshore profits claim in the absence of an offshore presence of the taxpayer.

All outgoings and business expenses incurred in the production of profits are deductible in the basis year in which they are incurred. Such expenses include:

- interest on borrowings for the purpose of producing profits, and other sums payable in connection with such borrowings, subject to the limitations outlined in Section VII.ii;
- rent paid by tenants for buildings or lands occupied for the purpose of producing profits;

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10. IRC v. Korean Syndicate Ltd (1921) 3 KB 258; South Behar Railway Co Ltd v. IRC (1925) AC 476.
12. IRC v. Masse (1919) 1 KB 647.
13. Section 2, IRO.
e. foreign tax paid by a Hong Kong taxpayer where they were incurred in the production of profits;
d. bad debts;
e. expenditure incurred in the repair of premises, plant, machinery, implements, utensils or articles in the production of profits;
f. expenditure incurred on the replacement of any implement, utensil or article, provided that no depreciation allowances are made;
g. expenditure for the registration of trademarks, designs or patents used in the trade, profession or business that produced the assessable profits; and
h. contributions made by individual taxpayers to mandatory provident funds in Hong Kong.

As a general rule, capital expenditures are not deductible. However, there are certain exceptions. For example, expenditure on research and development related to a taxpayer’s trade, profession or business is deductible provided that the expenditure is not on land or buildings, and that the payment is to an approved research institute for research and development related to that trade, profession or business or that the payment is to an approved research institute, the object of which is the undertaking of research and development relating to that particular class of trade, profession or business. To promote technological progress in local industries, the purchase of patent rights and rights to know-how are also deductible. In addition, payments for technical education and approved charitable donations may also be deducted from the assessable profits.

Depreciation is allowed for qualifying industrial and commercial buildings, and plant and machinery. For industrial buildings, a taxpayer who has incurred capital expenditure on the construction of an industrial building or structure is allowed a 20 per cent initial deduction of the capital expenditure. Thereafter, a 4 per cent deduction of the original capital expenditure is allowed annually.

A taxpayer with an interest in a commercial building or structure who has incurred construction costs can claim a deduction of 4 per cent annually. No depreciation deduction is available for commercial buildings that are more than 25 years old.

Capital expenditure on plant and machinery is allowed an initial deduction of 60 per cent in the year in which the expenditure is incurred. Thereafter, depending on the type of asset, depreciation is allowed on a reducing-value basis at 10, 20 or 30 per cent.

A super tax deduction scheme for research and development (R&D) expenditure was introduced on 2 November 2018. Under this new scheme, a 300 per cent tax deduction will be offered for the first HK$2 million of qualifying R&D expenditure and for expenditure in excess of HK$2 million, HK$6 million plus a 200 per cent tax deduction.

Capital and income

Hong Kong does not impose tax on capital gains. However, the issue as to whether income constitutes trading profits or non-taxable capital gains arises frequently in relation to the disposal of real property. Relevant factors include the frequency of the transactions, the accounting treatment adopted by the taxpayer, how long the property was held, how the property was financed and developed, and the reason for its sale. Profits obtained from properties acquired, developed and then sold are generally regarded as trading profits.
Losses
Hong Kong allows losses to be carried forward indefinitely.

Rates
The profits tax rate for companies is 8.25 per cent for the first HK$2 million of profits and 16.5 per cent for profits in excess of HK$2 million, subject to restrictions on connected entities discussed in Section II.i. If a company is a partner in a partnership, profits tax for its share of assessable profits is also charged according to the same two-tiered system of 8.25 per cent and 16.5 per cent. The rate for unincorporated businesses is 7.5 per cent for the first HK$2 million of profits and 15 per cent for profits in excess of that amount, subject to restrictions on connected entities as well.

Administration
A single tax authority – the IRD – exists in Hong Kong, and is responsible for administering the IRO.

  Tax is charged on the assessable profits for the year of assessment. The assessable profits for a business that makes up annual accounts are calculated on the profits of the year of account ending in the year of assessment. Generally, profits tax returns should be filed within one month of the date of issue. However, under the IRD’s Block Extension Scheme, this may be extended depending on the accounting date of the company. If a business objects to a tax assessment issued by the IRD, it has the right to file an objection within one month of the issuance of the assessment with the IRD, which will then render a determination that is subject to appeal to the IRD Board of Review as well as the Hong Kong courts.

Tax grouping
No group loss relief is available to companies that are members of a group in Hong Kong.

ii Other relevant taxes

Stamp duty
Hong Kong imposes stamp duty on instruments of transfer rather than the transaction itself. Instruments relating to the sale and lease of real property are subject to stamp duty, as are instruments relating to the sale of Hong Kong stock. Hong Kong stock is defined to include equity and debt instruments registered on a Hong Kong register. Therefore, if an offshore company maintains its share register in Hong Kong, any transfer of shares will be subject to stamp duty. Stock also includes units in unit trusts that maintain their registers in Hong Kong.

  Hong Kong bearer instruments such as promissory notes and bills of exchange are also subject to stamp duty. However, owing to the range of exemptions applicable to these instruments, they are rarely subject to stamp duty in practice.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence
Owing to the territorial tax system of Hong Kong, whether profits tax is chargeable under domestic law depends on whether the source of profits is in Hong Kong. As part of the amendments of the IRO to introduce comprehensive transfer pricing rules passed on
13 July 2018, there are further provisions to clarify what constitutes a permanent establishment in Hong Kong, especially with regard to entities resident in jurisdictions with which Hong Kong has not concluded a double taxation agreement (DTA). However, it is important to bear in mind that the territorial principle continues to apply despite the introduction of detailed rules on the definition of permanent establishment.

Whether a person resident in a territory with which Hong Kong has concluded a DTA has a permanent establishment in Hong Kong is to be determined in accordance with the relevant provisions of the DTA concerned.

For a non-DTA territory resident person, it has a permanent establishment in Hong Kong if it has a fixed place of business in Hong Kong through which the business of the enterprise is wholly or partly carried on. Carrying out certain preparatory or auxiliary activities would not constitute having a permanent establishment in Hong Kong. However, the fact the activities carried on does not reach the threshold of a permanent establishment does not necessarily mean that it would not be chargeable to tax in Hong Kong. If the activities carried out constitute carrying on a trade, profession or business within the definition of Section 14 of the IRO, any profits derived from such activities sourced from Hong Kong would nevertheless be taxable profits.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

In general, and as a matter of policy, Hong Kong does not offer tax incentives. However, this principle has been relaxed in recent years with the result that four industries currently enjoy lower statutory tax rates.

i General

Corporate treasury centres (CTCs)

In addition to the general allowance for deductions discussed in Section III.i, the IRO allows the deduction of interest payable on money borrowed by a corporation carrying on an intra-group financing business in Hong Kong as long as the following conditions are satisfied:

a the deduction claimed is in respect of interest payable by a corporation (i.e., the borrower) on money borrowed from a non-Hong Kong associated corporation (i.e., the lender) in the ordinary course of an intra-group financing business;

b the lender is, in respect of the interest, subject to a similar tax (i.e., such tax has been paid or will be paid) in a territory outside Hong Kong at a rate that is not lower than the Hong Kong’s profits tax rate (i.e., 16.5 per cent); and

c the lender’s right to use and enjoy that interest is not constrained by a contractual or legal obligation to pass that interest to any other person, unless the obligation arises as a result of a transaction between the lender and a person other than the borrower dealing with each other at arm’s length.

In addition, there is a reduction in the profits tax rate to 8.25 per cent for qualifying CTCs, which are dedicated CTCs, multifunction CTCs and CTCs by determination. A dedicated CTC is one that carries out one or more corporate treasury activities that stands alone. It would generally be prohibited from carrying out other activities. Multifunction CTCs can engage in a certain level of income-generating activities but still qualify for the profits tax concession on qualifying profits. A CTC by determination is a CTC that does not meet

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the conditions of either a dedicated CTC or a multifunction CTC, but may obtain a
determination from the IRD stating that it is a qualifying CTC. Qualifying profits include
lending transactions, corporate treasury services and corporate treasury transactions with
non-Hong Kong associated corporations.

These CTC incentives became effective from 1 April 2016.

Captive insurers
Captive insurers enjoy a 50 per cent reduction in profits tax on their business of insuring
offshore risks, thereby also reducing the effective corporate tax rate to 8.25 per cent.

Open-ended fund companies
From 30 July 2018, the profits tax exemption previously enjoyed by publicly offered
open-ended fund companies and certain offshore funds was extended to onshore privately
offered open-ended fund companies (Private OFCs).

In order to enjoy the exemption, a Private OFC must satisfy the following conditions:

a. be resident in Hong Kong, with its central management and control located in Hong
   Kong;

b. not be closely held, namely not owned by only a few individuals or corporate investors;

c. all transactions generating profits must be carried out or arranged by corporations or
   authorised financial institutions licensed or registered under the Securities and Futures
   Ordinance; and

d. only invest in permissible asset classes, which should largely involve securities and
   futures contracts, with a 10 per cent de minimis limit for investing in non-permissible
   asset classes.

Aircraft lessors and managers
Through legislative amendments passed in July 2017, Hong Kong now offers a tax concession
to qualifying aircraft lessors and aircraft leasing managers.

Qualifying aircraft lessors enjoy an 8.25 per cent tax rate on their assessable profits. In
addition, the assessable amount of leasing income of a qualifying aircraft lessor is deemed to
be 20 per cent of the gross leasing income less deductible expenditure. Effectively, the profits
tax payable on the assessable profits of a qualifying aircraft lessor is reduced to 1.65 per cent
of its net profit (ignoring depreciation). An 8.25 per cent profits tax rate also applies to the
assessable profits of aircraft leasing managers providing management services (which also
include aircraft financing activities) to qualifying aircraft lessors. These tax concessions apply
to all profits derived on or after 1 April 2017.

Any aircraft lessor or manager who wishes to take advantage of the regime must make
a written election with the IRD. The election is irrevocable.

To qualify for the reduced profits tax rate, the aircraft lessor or manager must satisfy
the following conditions:

a. the lessor or manager must have its central management and control in Hong Kong;

b. the entity must not carry on any aircraft leasing or management activities from a
   permanent establishment outside Hong Kong;

c. the aircraft lessor must not carry on any activities other than aircraft leasing activities; and
an aircraft leasing manager must ensure that at least 75 per cent of its profits are derived from the aircraft leasing management business, and at least 75 per cent of its assets are deployed for such business.

If an aircraft lessor or manager fails to satisfy any of the conditions above, it will automatically be disqualified and cannot opt back into the regime. No grace period is allowed.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)
Hong Kong has no withholding tax. However, sums paid as royalties to non-residents for the right to use intellectual property are subject to a tax similar to withholding tax. The withholding tax rate is 4.95 per cent if the recipient is a corporation and 16.5 per cent if the two parties are associates. However, even if the recipient is an associate, as long as no person carrying on a trade, profession or business in Hong Kong has at any time held an interest in the ownership of such intellectual property, the normal 4.95 per cent rate would apply. For payments to unincorporated businesses, the rates are 4.5 and 15 per cent respectively.

There is no withholding tax on interest or dividends.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments
There are no exclusions or exemptions applicable.

iii Double tax treaties
Traditionally, as Hong Kong adopts a territorial basis for taxation, Hong Kong residents generally do not suffer from double taxation. However, in recent years, Hong Kong has negotiated and entered into numerous DTAs with its trading partners, recognising that DTAs provide certainty to investors on the taxing rights of the contracting parties, helping investors to better assess their potential tax liabilities and providing an added incentive to do business in Hong Kong.15

Jurisdictions with which Hong Kong has concluded comprehensive DTAs include Austria, Belgium, Belarus, Brunei, Canada, the Czech Republic, Finland, France, Guernsey, Hungary, India, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Luxembourg, Mainland China, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Pakistan, Portugal, Qatar, Romania, Russia, Saudi Arabia, South Africa, Spain, Switzerland, Thailand, the United Arab Emirates, the United Kingdom and Vietnam.

iv Taxation on receipt
Dividends from a company subject to Hong Kong profits tax are not included in profits. No part of the profits or losses of a trade, profession or business carried on by a person subject to profits tax is included in ascertaining profits on which any other person is subject to profits tax.

VII TAXATION OF FUNDING STRUCTURES

i Thin capitalisation
There are no thin capitalisation rules in Hong Kong.

ii Deduction of finance costs
Interest payable upon money borrowed by a person for the purpose of producing assessable profits is deductible, subject to certain restrictions. In general, interest will be deductible if borrowed from a foreign or domestic financial institution or if borrowed from a person subject to tax in Hong Kong on the interest received. Generally (aside from the CTC rules discussed in Section V.i), interest paid to a corporation outside of Hong Kong will not be deductible.

In addition, legal fees, procuration fees, stamp duties and other expenses in connection with the borrowed money are also deductible.

Borrowing expenses that are of a capital nature are not deductible. In making this determination, the relevant consideration is the purpose of the loan, namely whether money was borrowed for capital expenditure purposes. For example, where interest was paid on money borrowed for the purpose of acquiring a redevelopment site, intended ultimately to generate rental income, the interest expenses was of a capital nature and deduction should not be allowed.\(^{16}\)

iii Restrictions on payments
A company must not make a distribution except out of profits available for the purpose, where 'distribution' is defined to include every form of distribution of a company's assets to its members.\(^{17}\) Profits available for distribution are the company's accumulated realised profits less accumulated realised losses.

iv Return of capital
Return of capital is permitted under the CO for a company limited by shares through a reduction of share capital.\(^{18}\) This is generally used when changes in a company's business result in excessive capital in the company. A reduction of capital is tax-neutral in Hong Kong.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition
As Hong Kong does not impose tax on the sale of capital assets, capital gains on the sale of shares are not taxable. It is a question of fact as to whether shares are capital or trading assets. As discussed previously in Section III.ii, instruments of transfer of Hong Kong stock are subject to stamp duty.

\(^{17}\) Sections 297(1) and 290, Companies Ordinance (CO) (Chapter 622).
\(^{18}\) Section 210, Companies Ordinance (Chapter 622).
Reorganisation

The CO introduced a court-free amalgamation scheme on 3 March 2014 for intra-group mergers. Under this scheme, two or more Hong Kong-incorporated, wholly owned companies within the same group could amalgamate and continue as one. However, neither the CO nor the IRO itself currently contain provisions on the tax consequences of such amalgamation. These rules are under development.

Exit

There is no exit tax for Hong Kong.

ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

General anti-avoidance

Anti-avoidance measures under the IRO include the following:

a. Use of artificial or fictitious transactions under Section 61 of the IRO. A fictitious transaction is one that was never intended to be carried out by those who were ostensibly parties to it. An artificial transaction includes transactions that have been carried out but are commercially unrealistic. Commercially realistic transactions with incidental tax benefits could not be struck down under this provision.

b. Implementation of transactions with the sole or dominant purpose of producing a tax benefit under Section 61A of the IRO. This section aims to strike down blatant or contrived tax-avoidance schemes. If a transaction is found to have the sole or dominant purpose of obtaining a tax benefit, then the transaction as a whole or a part of it will be disregarded.

c. Sale of loss companies under Section 61B of the IRO. If a change in the shareholding of a company has been effected, and the sole or dominant purpose of the change in shareholding was to use a tax loss to obtain a tax benefit, then the set-off of a loss may be disallowed.

Controlled foreign corporations

Hong Kong has no controlled foreign corporation legislation.

Transfer pricing

Hong Kong introduced its first ever transfer pricing legislation in 2018 through substantial amendments to the IRO. These amendments codify the arm’s-length principle, which, until recently, has been applied in Hong Kong through informal practice rules rather legislative provisions. This means that all transactions with associated parties must be conducted on arm’s-length terms. In addition, the amendments introduce transfer pricing documentation requirements, namely local and master files, and country-by-country reporting.

A Hong Kong entity entering into transactions with associated persons is required to prepare and keep on record a local file and a master file, unless such entity meets any of the

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19 Section 61, IRO.
21 Cheung Wah Keung v. Commissioner of Inland Revenue (2003) HKRC.
22 Section 50AAF, IRO.
two conditions below: (1) the total revenue of the entity does not exceed HK$400 million; (2) the total value of the entity’s assets does not exceed HK$300 million; and (3) the average number of the entity’s employees does not exceed 100.23

The master file should contain information on the group’s structure, the location of all the group entities, high-level information about the group’s global business operations, the group’s transfer pricing policies and consolidated financial statements. The local file should describe the business of the relevant entity, record information and transfer pricing documentation on each material category of related-party transactions and contain the entity’s financial statements. However, if a certain transaction falls below the relevant monetary thresholds, then it would not be necessary to cover the transaction in the local file.

Country-by-country reporting is now also required for multinational corporations, which generally follows the OECD’s requirements on the same. If a multinational corporation’s ultimate parent entity is a tax resident in Hong Kong for each accounting period beginning on or after 1 January 2018, then it should prepared a country-by-country return in a form specified by the IRD.24 A Hong Kong entity that is not the ultimate parent entity may also be required to file a return if, for example, the ultimate parent company is not required to file a return in its tax residence jurisdiction, where there is no exchange arrangement in place between Hong Kong and the other jurisdiction, or where there has been a systemic failure to exchange country-by-country report by the other jurisdiction.25

Advance pricing agreements are available under the new legislation, allowing entities to reach prior agreement with the IRD on the application of transfer pricing rules to material transactions during specified years of assessment.26

iv Tax clearances and rulings

Under Section 88A of the IRO, the IRD is empowered to make advance rulings upon an application made by a person. An advance ruling may relate to how any provision of the IRO applies to the applicant or to the arrangement described in the application. However, it must not relate to the imposition or remission of a penalty, the correctness of a return supplied by a person, the prosecution of a person or the recovery of any debt owing by any person.27 The IRD will not entertain applications for arrangements that are hypothetical or speculative, and a ruling will only be given for a seriously contemplated arrangement.

Where a ruling has been made, such ruling applies to the arrangement for the period specified in the ruling. Each ruling is confined to its specific terms and cannot be relied on as a precedent for similar arrangements in the future.

Advance ruling applications are subject to a charge calculated on the basis of cost recovery.

X YEAR IN REVIEW

The most significant development in 2018 would be the enactment of the first transfer pricing legislation in Hong Kong. Substantial amendments were made to the IRO not only

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23 Section 58C, IRO.
24 Section 58E, IRO.
25 Section 58F, IRO.
26 Section 50AAP, IRO.
27 Section 1, Part 1 of Schedule 10, Inland Revenue Ordinance.
to codify the arm's length but also to introduce measures for Hong Kong to comply with the four minimum-standards of the BEPS Package. This is a culmination of Hong Kong's commitments to support international efforts on BEPS.

Throughout 2018, Hong Kong continues to expand and strengthen its automatic exchange of information (AEOI) network. Whereas Hong Kong first adopted the OECD CRS by way of an amendment to the IRO back in 2016, by 1 January 2017, all Hong Kong financial institutions were required to comply with the due diligence and reporting obligations under the legislation. However, by June 2017, Hong Kong had expanded the list of reportable jurisdictions significantly from less than 10 to 75. Given the number of information exchange partners, in February 2018, the Hong Kong government further amended the IRO to allow entry into the international multilateral treaty for automatic exchange of information. The Hong Kong government has indicated its plan to add another 51 jurisdictions to the information exchange network; as such, the number of reportable jurisdictions may increase well beyond the current 75 jurisdictions to 126 jurisdictions. Starting from 6 September 2018, an arrangement between Mainland China and Hong Kong for conducting AEOI came into effect. Information exchange with Mainland China as well as 49 other jurisdictions began at the end of September 2018.

On the profits tax front, as discussed in Section II.i, Hong Kong has introduced a two-tier profits tax system for enterprises, by reducing the profits tax rate to 8.25 per cent on the first HK$2 million of profit for companies and 7.5 per cent for non-incorporated bodies, subject to the connected-entity rules. The standard 16.5 per cent would apply to profits in excess of the first HK$2 million (15 per cent in the case of non-incorporated bodies). The introduction of a two-tier profits tax system will likely bring about significant complexity to the tax system in Hong Kong, both in terms of provisions for implementation of the system and provisions for anti-avoidance.

XI OUTLOOK AND CONCLUSIONS

Hong Kong prides itself on maintaining a simple tax system with a low effective tax rate, a principle that was enshrined in the Basic Law, the quasi-constitutional document governing the operation of the Hong Kong Special Administrative Region. In general, the government continues to satisfy this objective, but the system's complexity has increased significantly in recent years, largely as a result of international pressure. Tax treaties, once unknown to Hong Kong, have become part of the tax landscape and, while providing some taxpayers with additional certainty, have introduced additional complications. Similarly, concepts such as transfer pricing and exchange of information were once unknown, but have now become part of domestic law.

Notwithstanding such development, Hong Kong retains an enviable competitive position with respect to taxes, as complexity has increased in most other jurisdictions at an even faster pace. Moreover, the absence of any sales taxes, significant duties, withholding taxes on dividends and interest, or tax on capital gains makes it an attractive investment location, particularly as a gateway to Mainland China, with which Hong Kong enjoys a privileged relationship.

28 Article 108, Basic Law.
INTRODUCTION

A host of reforms have made it easier for entities to start, operate and exit businesses in India. Some of the initiatives, including ‘Make in India’, improving the ease of doing business in India, ‘Start up India’ and ‘Digital India’, will further pave the way for growth. Over the past few years, the government has delivered landmark structural reforms (including the Insolvency and Bankruptcy Code, Indian Accounting Standards, and the Goods and Service Tax), which are expected to foster the next phase of economic growth of India. A testament to this is India having jumped 30 spots to secure a place among the top 100 countries on the World Bank’s ‘ease of doing business’ ranking list of 2018.

COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

There are several types of business vehicles that operate in India. Broadly, these include sole proprietorships, partnership firms or limited liability partnerships (LLPs), private limited companies and public limited companies. However, the options available to a non-resident intending to set up a business in India are more specific.

Corporate

One of the more preferred business vehicles in India is a private company limited by shares, which is incorporated under the Companies Act 2013 (the Companies Act).

The key differences between a private company and a public company are set out below:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Private company</th>
<th>Public company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic characteristics</td>
<td>Preferred by small to mid-sized companies</td>
<td>Preferred by large companies,</td>
</tr>
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<td></td>
<td>Cannot invite the public to subscribe to its</td>
<td>Can invite the public to subscribe to its</td>
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<td></td>
<td>shares or make deposits</td>
<td>shares or make deposits</td>
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<tr>
<td>Corporate governance and disclosure requirements</td>
<td>Less compared to public companies</td>
<td>More compared to private companies</td>
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<tr>
<td>Potential listing on stock exchanges</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Transferability of shares</td>
<td>Not freely transferable</td>
<td>Freely transferable</td>
</tr>
<tr>
<td>Shareholders</td>
<td>Minimum two, and not exceeding 200</td>
<td>Minimum seven, with no upper limit</td>
</tr>
</tbody>
</table>

1 Bijal Ajinkya is a partner and Nilanshu Pandya is an associate at Khaitan & Co. The authors would like to thank Surajkumar Shetty, Raghav Kumar Bajaj and Ishani Kundu for their contributions to the chapter.
<table>
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<tr>
<th>Particulars</th>
<th>Private company</th>
<th>Public company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Directors</td>
<td>Minimum two, and maximum 15; unless special resolutions are obtained</td>
<td>Minimum three, and maximum 15; unless special resolutions are obtained</td>
</tr>
<tr>
<td></td>
<td>Requirement to have one director who has stayed in India for a period of at least 182 days in the previous calendar year</td>
<td></td>
</tr>
<tr>
<td>Foreign Shareholders</td>
<td>Permitted subject to foreign investment laws</td>
<td></td>
</tr>
<tr>
<td>Foreign Directors</td>
<td>Permitted</td>
<td></td>
</tr>
<tr>
<td>Timeline for Incorporation</td>
<td>Two to three weeks from name approval</td>
<td>Three to four weeks from name approval</td>
</tr>
</tbody>
</table>

**ii  Non-corporate**

A non-resident may contribute to the capital of a general partnership firm, or a proprietorship concern in India, only with the prior approval of Reserve Bank of India (RBI).

Foreign investment in LLPs is permitted under the automatic route in sectors that are open to 100 per cent FDI under the automatic route. Unlike partnership firms, LLPs are body corporates and have a legal existence that is separate from their partners. An LLP can be incorporated with a minimum of two partners, and unlike partnerships, there is no restriction on the maximum number of partners. The liability of partners in LLPs is limited to the provision of their capital contribution and any other contribution as agreed in the partnership agreement. As a result, a significant benefit that an LLP has over the partnership structure is that a partner of an LLP is not personally liable for an obligation of the LLP or the wrongful act or omission of other partners of the LLP.

Under the IT Act, neither Indian general partnerships nor LLPs are accorded a tax pass-through status, and both qualify as a separate taxpayer category.

**III  DIRECT TAXATION OF BUSINESSES**

**i  Tax on profits**

*Determinaion of taxable profit*

Taxable income from business is required to be computed in accordance with either the cash or mercantile system of accounting regularly employed by the taxpayer. Taxable profits are based on accounting profits but are adjusted for specific allowances and disallowances. All revenue expenditure expended ‘wholly and exclusively’ for the purposes of the taxpayer’s business is generally allowed as a deductible expense.

Further, while computing its taxable income, a taxpayer is entitled to claim certain deductions and industry-specific tax concessions, subject to the fulfilment of specific conditions. Adjustments on account of depreciation are available to all categories of taxpayers on an annual basis, where depreciation is to be reduced from the written down value of each ‘block of assets’, namely buildings, furniture and fittings, machinery and plant, intangible assets, etc. It is important to note that depreciation for the purposes of the IT Act is different from depreciation as computed under accounting principles.

Residents are subject to income tax on their worldwide income, whereas non-residents are subject to tax in India only on income that is sourced in India, namely income that: (1) is received or is deemed to be received in India; or (2) accrues or arises or is deemed to accrue or arise in India.
Capital and income

The IT Act is schedular in nature and provides for different heads of taxable income. The general rule under Indian domestic law is that all revenue receipts are taxable unless a receipt is specifically exempt and all capital receipts are exempt from taxation unless there is a specific provision to tax it. While calculating taxable business income, only revenue receipts after deducting revenue expenses are considered. The IT Act provides a separate head of ‘income from capital gains’ for levying tax on certain capital receipts. Income from such capital gains is usually taxed at special rates, depending on the nature of the capital asset, and the period of holding. The IT Act also provides a residual category of income, namely ‘income from other sources’, which also taxes certain capital receipts as ordinary income of the taxpayer.

Taxpayers that use the mercantile system of accounting are required to follow the Income Computation and Disclosure Standards for computation of income chargeable under the headings ‘profits and gains of business or profession’ and ‘income from other sources’.

Losses

The IT Act provides for intra-head and inter-head adjustment of losses. If in any year, a taxpayer incurs a loss from any source under a particular head of income, then such taxpayer is allowed to adjust such loss against income from any other source falling under the same head (intra-head adjustments). Only after such intra-head adjustments are made can a taxpayer adjust losses from one head against income from another head (inter-head adjustments). However, there are certain rules for such adjustments. For instance, losses from speculative business can only be set off against income from speculative business, although non-speculative business losses can be set off against income from speculative business; long-term capital losses cannot be set off against any income other than income from long-term capital gains, although short-term capital losses can be set off against short or long-term capital gains, etc.

Losses are usually permitted to be carried forward for a period of eight years immediately succeeding the year in which such loss is incurred.

A taxpayer that operates as a private limited company is not permitted to carry forward any tax losses of the years prior to the relevant financial year, unless shareholders beneficially holding 51 per cent of the voting power as on the last day of the year in which the loss was incurred, and the year in which the loss is desired to be set off, remain the same. However, such losses are allowed to be carried forward in case of certain eligible start-ups and companies under insolvency proceedings.

Rates

Rates as prescribed under the IT Act and as mentioned hereinafter are required to be increased by applicable surcharge and education cess (unless otherwise stated). Surcharge is payable as a percentage of the income-tax payable. For domestic companies, the rate of surcharge is 7 per cent (if income > 10 million rupees but ≤ 100 million rupees), and 12 per cent (if income > 100 million rupees). For foreign companies, the rate of surcharge is 2 per cent (if income > 10 million rupees but ≤ 100 million rupees), and 5 per cent (if income of > 100 million rupees). For general partnerships and LLPs, the rate of surcharge is 12 per cent (if income > 10 million rupees), and nil (if income ≤ 10 million rupees). Further, a health and education cess of 4 per cent is also payable on the aggregate of income tax and surcharge.
Corporate
Domestic companies are liable to tax on their business income at the rate of 30 per cent. Certain domestic companies can choose to avail of a concessional tax rate of 25 per cent, subject to certain conditions. Non-resident companies having a permanent establishment in India are subject to tax on their business income at the rate of 40 per cent.

Domestic companies declaring, distributing, or paying dividends are required to pay an additional dividend distribution tax (DDT) at an effective rate of 20.56 per cent (including applicable surcharge and education cess of 4 per cent) on the dividends distributed. Such dividends are tax-exempt in the hands of all non-resident shareholders and resident corporate shareholders. However, a holding company does not have to pay DDT on dividends paid to its shareholders to the extent that it has received dividends from its Indian and foreign subsidiary company on which DDT has been paid by the subsidiary, subject to fulfilment of conditions.

If the income-tax payable by a domestic company is less than 18.5 per cent of its adjusted book-profits, then such company would be required to pay a minimum amount of tax, known as minimum alternate tax (MAT) at the rate of 18.5 per cent. MAT credit can be utilised over a period of 15 years.

Non-corporate
General partnerships and LLPs are taxed at the rate of 30 per cent. No additional tax is required to be paid by a partnership firm or an LLP at the time of distribution to the partners. Shares of profits received by partners of a general partnership or an LLP are tax-exempt in their hands.

An LLP is not subject to MAT. It is subject to an alternate minimum tax (AMT) at the rate of 18.5 per cent, when income tax on its total income is less than 18.5 per cent on its adjusted total income. However, this is applicable only if the LLP claims specified tax holidays or deductions under the IT Act.

Administration
Unlike some other nations, income tax in India is a central (federal) levy, and not a state-specific levy.

The Ministry of Finance governs and administers the IT Act through the Central Board of Indirect Taxes and Customs, which from time to time issues notifications, circulars and instructions, etc., to clarify or interpret the provisions of the IT Act. In addition to this, every year, the Finance Minister of India proposes amendments to the IT Act and revises the applicable rates of taxation annually through the Finance Bill for that year. Once the Indian Parliament approves the proposed amendments, the Finance Bill is enacted and the relevant changes or amendments get incorporated into the law.

The Indian tax year runs from 1 April to 31 March. Certain taxpayers having business income are required to get their account books audited for tax purposes. All companies are required to electronically file income tax returns on or before 30 September of the year following the tax year. In the event transfer pricing provisions are applicable, the due date for filing tax returns is extended to 30 November.

Further, quarterly returns have to be filed for withholding taxes in the prescribed form and manner.

On filing of tax returns, details furnished by the taxpayer are assessed by the tax authorities, and accordingly, an ‘assessment order’ is passed by the ‘assessing officer’ after
giving an opportunity of being heard to the taxpayer. A detailed appeal process is provided in the IT Act, which allows taxpayers to challenge an order passed by the tax authorities. The Supreme Court of India (i.e., the apex court of India), and the various High Courts provide a ruling on the law and do not engage in a fact-finding exercise.

Further, an advance ruling may be obtained from the Authority for Advance Rulings (AAR) on any question of law or fact in respect of a transaction undertaken or proposed to be undertaken by a non-resident or with a non-resident. Such a ruling obtained from the AAR is then binding on the revenue authority and the applicant in respect of the concerned transaction.

**Tax grouping**

India does not recognise group taxation, and each company in a group (or otherwise) is taxed as a separate company.

**ii Other relevant taxes**

**Indirect taxes**

The goods and services tax (GST) legislation has been enacted by the Indian government with effect from 1 July 2017. GST overhauls much of the indirect taxation framework in India, and has subsumed most of the erstwhile indirect taxes such as sales tax or VAT, service tax, excise duty, entertainment tax (unless levied by local bodies), entry tax, additional customs duty (countervailing duty), special additional duty of customs, surcharges and cesses. Basic customs duty on import of goods into India remains outside the GST ambit. Further, certain tobacco, petroleum and alcohol products remain outside GST, and will continue to be taxed as per the earlier system. As opposed to the multiple taxable events under the erstwhile indirect tax regime, such as manufacture, sale, provision of service, etc., the GST law imposes tax on a single taxable event, ‘supply’ which covers all kinds of transactions such as sale, transfer, barter, lease, provision of service, etc., unless specifically exempted. Both the centre and the states simultaneously levy GST across the value chain.

While problems of immediate migration costs are posed by it, the overall economy is expected to benefit from a more seamless movement of goods and service, and a less burdensome indirect tax credit and compliance regime. GST allows for seamless credit flow throughout the value chain with fewer restrictions to mitigate the cascading effect of taxes.

**Stamp duty/registration fees**

Separately, all legal documents are required to be stamped in India, and documents that have the effect of transferring immovable property are mandatorily required to be registered. Documents that have not been duly stamped cannot be introduced as evidence in any court. Stamp duty rates differ from state to state across the country, as stamp duty is a state subject. However, central government fixes the stamp duty rates for certain instruments.

**IV TAX RESIDENCE AND FISCAL DOMICILE**

**i Corporate residence**

A company is said to be resident in India in a financial year, if (1) it is an Indian company (i.e., incorporated in India), or (2) its place of effective management (POEM) is in India. The phrase ‘place of effective management’ has been explained to mean ‘a place where key
management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made. With effect from 1 April 2018 the concept of ‘significant economic presence’ (as defined) has been introduced into the definition of ‘business connection’. Also, transactions or activities (yet to be prescribed) undertaken by the non-resident shall constitute ‘significant economic presence’ in India, irrespective of whether the non-resident has a residence or place of business in India or renders services in India. The CBDT has issued guidelines for the determination of POEM of a company. POEM is, however, not applicable to companies having turnover or gross receipts of 500 million rupees or less in a financial year. If a foreign company’s POEM is considered to be in India, its global income shall be chargeable to tax in India at the rate of 40 per cent.

As per the Guidelines, (based on the average data of the relevant year and two years prior to such relevant year) in case of a company that is engaged in ‘active business outside India’, its POEM shall be presumed to be outside India, if the majority of meetings of the board of directors of the company are held outside India and the board of directors of the company exercise their powers of management and do not stand aside enabling either their holding company or such other person resident in India to exercise the said power. However, if the company is not ‘engaged in active business outside India’, then the determination of POEM for such company shall be to:

a identify or ascertain the person or persons who actually make the key management and commercial decisions for conduct of the company’s business as a whole; and

b identify the place where these decisions are in fact being made.

ii Branch or permanent establishment

A non-resident entity may set up branch, liaison or project offices in India. While a liaison office acts as a representative office of its parent company in India, a branch office is an establishment of the parent entity and can carry out the same or substantially the same activities as its parent company. A project office is permitted for specific projects to be undertaken in India, by the person resident outside India. Although these vehicles may be used by a non-resident, their use is not particularly popular given that the activities that such offices may undertake are heavily regulated and restricted by the RBI.

A branch of a foreign company is taxed as a foreign company in India at the rate of 40 per cent.

Activities carried out by foreign companies should be carefully examined to determine the existence of a permanent establishment (PE) of the foreign company in India. In the case of a PE, income of the foreign company that is attributable to the activities of the PE in India will be subject to tax at the rate of rate of 40 per cent.

Typically, the kinds of PEs common to India’s tax treaties are fixed place PE, service PE and dependent agent PE.

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2 Section 6(3) of the (Indian) Income-tax Act 1961.
3 The Guidelines define a company to be engaged in ‘active business outside India’ if: (1) the company’s passive income is not more than 50 per cent of its total income; (2) less than 50 per cent of its total assets are situated in India; (3) less than 50 per cent of total number of employees are situated in India or are resident in India; and (4) the payroll expenses incurred on such employees is less than 50 per cent of its total payroll expenditure. The Guidelines define ‘passive income’ of a company shall be the aggregate of: (1) income from the transactions where both the purchase and sale of goods is from or to its associated enterprises; and (2) income by way of royalty, dividend, capital gains, interest or rental income.
For the purpose of attribution of profits, the Indian PE is considered as a fictional entity separate from the foreign enterprise dealing with the latter on an arm’s-length basis. No specific rules for attribution of profits are provided under Indian laws, and such attribution is a complex determination.

Further, in keeping with Action Plan 1 on tax challenges of the digital economy, India introduced an equalisation levy of 6 per cent in respect of certain specified digital services in the online marketing and advertising space rendered by non-residents who do not have a PE in India. However, such income shall not be taxable in the hands of the recipient.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes
India does not have any participation exemption or qualifying dividend regime.

ii IP regimes
By way of the Finance Act 2016, the government put in place a concessional taxation regime for income from patents. Following Action Plan 5 of the OECD’s BEPS Project, the government has adopted the nexus approach, which prescribes that income arising from the exploitation of IP should be attributed and taxed in the jurisdiction where substantial R&D activities are undertaken, rather than the jurisdiction of legal ownership only.

Accordingly, the IT Act was amended to provide that, where the total income of an ‘eligible taxpayer’ includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10 per cent on the gross amount of royalty.

iii State aid
As a welfare economy, the Indian government offers subsidies in various sectors, such as agriculture, small and medium enterprise industry, railways, and infrastructure.

Separately, under the Special Economic Zones Act 2005, the government has identified certain zones in the country, where through favourable economic policies, business incentives and tax breaks, a conducive environment has been sought to be created for export-oriented businesses. In addition to the deductions otherwise available, the IT Act also provides for profit-linked deductions to certain taxpayers, such as units established for export in special economic zones.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)
Tax is to be withheld by the payer on all payments to non-residents that are chargeable to tax in India. The withholding rate is prescribed and depends on the nature of payment, and is subject to any relief under the relevant tax treaty between India and the country of residence of the payee. Set out below are the withholding tax rates in terms of India’s domestic laws:
<table>
<thead>
<tr>
<th>Income stream</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>Nil</td>
</tr>
<tr>
<td>Interest</td>
<td>5 per cent to 40 per cent (depending on currency of loan, etc)</td>
</tr>
<tr>
<td>Royalty</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Fees for technical services</td>
<td>10 per cent</td>
</tr>
</tbody>
</table>

### ii Domestic law exclusions or exemptions from withholding on outward-bound payments

India does not have a parent–subsidiary or participation exemption regime. However, capital gains arising from the transfer of certain instruments may be subject to a reduced rate of withholding in terms of India’s domestic law. For instance, long-term capital gains arising on transfer of listed equity shares (including units of an equity-oriented fund) executed on a recognised stock exchange in India, where securities transaction tax (STT)\(^4\) has been paid, is exempt from tax in India subject to certain conditions.

Section 90(2) of the IT Act provides that where India has entered into a double taxation avoidance agreement with any country, the provisions of the IT Act or the double taxation avoidance agreement, whichever are more beneficial to the taxpayer, shall apply. Accordingly, the withholding tax rates under India’s domestic law are subject to the provisions of the applicable tax treaty.

### iii Double tax treaties

India has a vast tax treaty network and has signed DTAs with over 80 countries across the globe. While the rates may vary from treaty to treaty, set out below are some of the common reduced withholding rates across most treaties:

<table>
<thead>
<tr>
<th>Income stream</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest</td>
<td>7.5 per cent to 15 per cent</td>
</tr>
<tr>
<td>Capital gains</td>
<td>Generally, sale of shares is taxable in India at domestic tax rates</td>
</tr>
<tr>
<td>Fees for technical services or royalty</td>
<td>10 per cent</td>
</tr>
</tbody>
</table>

### iv Taxation on receipt

Foreign dividends received by an Indian resident are taxed as ordinary income, namely at the rate of 30 per cent in the case of an Indian company, and at the applicable slab rate in the case of an individual. However, credit for foreign taxes paid (on dividends or otherwise) should be available to the Indian resident. Foreign dividends may be subject to a reduced rate of 15 per cent in the hands of an Indian company, if the Indian company holds 26 per cent of shares in the foreign company.

However, DDT, being an additional corporate tax on the Indian distributing company, is generally not affected by tax treaties. As a result, the availability of credit for DDT in the home country of the non-resident shareholder is doubtful.

\(^4\) STT is payable on certain on-market transactions (sale and purchase) ranging from 0.001 per cent to 0.2 per cent on the value of the transaction.
VII  TAXATION OF FUNDING STRUCTURES

i  Thin capitalisation
Following the BEPS Action Plan 4, the Finance Act 2017 introduced limited thin capitalisation norms in India’s extant transfer pricing regime, according to which, the Indian ‘associated enterprise’ would not be permitted a deduction of interest (payable to its non-resident ‘associated enterprise’) exceeding 30 per cent of the earnings, before interest, taxes, depreciation and amortisation, if the total amount of such interest exceeds 10 million rupees per year. If the interest is not eligible for deduction in a particular year, the same can be carried forward for eight years, and the same shall be allowed to the extent of maximum allowable interest expenditure for the relevant year.

ii  Deduction of finance costs
Interest payments by an Indian company to a non-resident shall be eligible to be deducted as an expense by the Indian company, if the loan is for its business purpose. However, if the Indian company and the non-resident are regarded as ‘associated enterprise’ in terms of the (Indian) transfer pricing regulations, such interest payments shall be subject to the arms’-length requirement, and also thin capitalisation norms as set out above.

iii  Restrictions on payments
In terms of the Companies Act, dividends can be declared by a company out of profits of the current financial year or any previous year, only after providing for depreciation in accordance with the provisions of the said Act. In the case of inadequacy of profits in any financial year, a company may declare dividends out of the accumulated profits earned by it in previous years, and transferred to the reserves in accordance with the prescribed rules. However, such dividends can only be declared from the free reserves of the company.

iv  Return of capital
A company may undertake a scheme of buy-back to purchase its own shares from its free reserves, securities premium account, or the proceeds of the issue of any shares. For a company to be able to undertake a buy-back, the same should be authorised by its charter documents. Further, generally, buy-back requires shareholder approval by way of a special resolution.

There are certain other restrictions on a company undertaking a scheme of buy-back, including, inter alia, that a company cannot issue fresh shares (of the same kind as those bought back) for a period of six months since the date of buy-back, there has to be a cooling off period of at least one year between two consecutive buy-backs, and only fully paid-up shares can be bought back.

Buy-back of unlisted shares is subject to tax at the rate of 20 per cent in the hands of the company on the amount of buy-back price that is in excess of the amount received by it for the issue of such shares. There are specific rules prescribed to determine the amount received for the purpose of computing this tax. Once such tax is paid by the company, no further tax shall be payable on such amount by the shareholders.

Buy-back of listed shares result in capital gains tax for the shareholders.

In capital reduction, to the extent of accumulated profits, the company is required to pay DDT on the amount returned to the shareholder. Although the rate of buy-back tax is slightly higher than the rate of DDT, in case of a buy-back, the company is allowed to reduce
the amount that it had received at the time of share issuance from the buy-back consideration to arrive at the buy-back tax. This is not permitted in case of DDT, as DDT is payable on the gross amount of dividend.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Acquisitions may be structured at: (1) the entity level, by acquisition of shares in a fresh issue or share buyout or merger/amalgamation; or (2) the business level, by acquisition of the entire business (referred to as slump sale in the Indian context), cherry-picking certain assets or demerger. A foreign investor looking to acquire certain Indian assets or businesses would need to have an Indian entity that acquires the business or assets.

The preferred mode of acquisition would depend on various considerations, such as the commercial objective sought to be achieved, tax efficiency, ability of the target to carry forward past tax losses, regulatory aspects, etc.

Other structuring considerations include the choice of intermediate holding jurisdiction to acquire or set up the Indian target, and choice of instrument for investing into the Indian target. Further, with ‘substance’-driven taxation and evolving tax laws aimed at protecting the source country’s tax base, aspects such as valuations and transaction documentation assume significance and tend to become major negotiation points.

Recently, India’s tax treaties with Mauritius and Singapore have been revised, in terms of which, capital gains arising to tax residents of such jurisdictions from the sale of shares of Indian companies acquired on or after 1 April 2017 shall be taxable in India. The amendments do not impact the beneficial capital gains tax treatment in relation to investment in instruments other than shares (regardless of the time of investment), and in relation to shares acquired prior to 1 April 2017 (regardless of when the exit occurs).

The choice of instrument for investment, that is, shares (equity or preference shares) or debt, would primarily depend on the commercial objectives, regulatory considerations and rights sought to be acquired by the investor, and would entail different tax implications for the investor as well as the investee.

Further, it is important to ensure that appropriate valuations are undertaken at the time of the investment, failure of which can lead to adverse tax consequences for both the seller as well as the acquirer. It is worth noting that the IT Act has prescribed certain minimum fair market value norms, which are applicable at the time of transfer of unquoted shares, and acquisition or subscription of shares and securities. According to these provisions, transfer of unquoted shares, or receipt of shares or securities, at a price that is less than the fair market value (to be computed in line with the prescribed guidelines) could attract adverse implications in the hands of the transferor and recipient. Note that similar fair market value requirements are also applicable in the case of a transfer of property.

Where Indian assets are indirectly acquired at an offshore level through the acquisition of shares in a foreign entity, an Indian tax charge will be triggered if the foreign target derives ‘substantial value’ (as defined) from India. Thus, prescribed valuations should be carried out to assess the Indian tax impact in such a case.

ii Reorganisation

Amalgamations and demergers are tax-neutral in India, provided certain specified conditions are satisfied.
The Indian government in April 2017 enacted certain provisions of the Companies Act that permit cross border mergers. However, there has been no corresponding amendment to the IT Act. Accordingly, only inbound mergers are tax-neutral, subject to conditions.

iii Exit
The sale of equity and debt instruments, specific assets or the entire business on a going-concern basis by a non-resident investor will entail capital gains tax in India that could vary from nil to 40 per cent (depending on the nature of the instrument and the period of holding), subject to relief under the applicable tax treaty.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance
The General Anti-Avoidance Rules (GAAR) included in the IT Act came into effect on 1 April 2017. GAAR may be invoked, where the main purpose of an arrangement is to obtain a tax benefit. GAAR provisions empower the tax authorities to investigate any such arrangement as an ‘impermissible avoidance arrangement’, and consequently disregard entities in a structure, reallocate income and expenditure between parties to the arrangement, alter the tax residence of such entities and the legal situs of assets involved, treat debt as equity and vice versa, and the like. By doing so, the tax authorities may even deny tax benefits conferred under a tax treaty. Accordingly, it must be ensured that there is justifiable commercial substance in the structure in order to avail of any beneficial taxation under the IT Act or a tax treaty.

ii Controlled foreign corporations (CFCs)
India does not have any rules for CFCs.

iii Transfer pricing
Transfer pricing regulations are applicable to ‘international transactions’ carried on between two or more ‘associated enterprises’ (AEs), where either both or at least one party to the transaction is a non-resident. The term ‘AE’ has been defined in the IT Act to include, inter alia, any enterprise that participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of another enterprise. The transfer pricing regulations provide that any income arising from such an international transaction would be computed having regard to the principle of an arm’s-length price (ALP). The transfer pricing regulations also prescribe the methods that a taxpayer can adopt to arrive at an ALP, and the documentation that is required to be maintained by the taxpayer to demonstrate that the ALP adopted by it is in accordance with the transfer pricing regulations.

5 Transfer pricing regulations are included in the Income Tax Act 1961 itself as Chapter X (comprising Sections 92–94B), and the rules framed thereunder (i.e., Rules 10A–10THD of the Income-tax Rules, 1962).

6 Further, two or more enterprises would be deemed to be AEs under specific circumstances by virtue of shareholding, borrowing, guarantees, licensing of trademarks, purchase, sales or where enterprises have any relationship of ‘mutual interest’ as may be prescribed by the government.
The transfer pricing regulations also provide for ‘secondary adjustments’, which essentially mean that an AE (being a non-local entity) will have to make a secondary adjustment in its books as a consequence of a primary adjustment to the taxpayer in India.

Safe harbour rules that prescribe conditions and circumstances under which the transfer price adopted by parties to a transaction would be immune from questioning by the Indian tax authorities have been prescribed.

The government has introduced an advance pricing agreement scheme and transfer pricing documentation requirements that are in line with the standards outlined in BEPS Action Plan 13. Taxpayers are required to maintain a master file, local file and country-by-country report. The CBDT has notified the final rules for maintaining and furnishing of transfer pricing documents in the master file and country-by-country report.

iv Tax clearances and rulings

As set out earlier, an applicant may approach the AAR for an advance ruling for transactions with a non-resident.

Further, if during pendency of any tax proceedings, a taxpayer transfers certain specified assets (such as land, building, plant, machinery, shares, securities, etc.), then the tax authorities are empowered to treat such transfer of assets as void against taxes for recovery of any tax claims arising pursuant to conclusion of such proceedings. However, such transfer will not be treated as void, if: (1) a no objection certificate had been obtained by the seller from the tax authorities prior to such transaction; or (2) the transfer is done for adequate consideration and without notice of the pendency of any proceedings or tax payable by the transferor. Therefore, such a tax clearance is important as it protects the buyer with respect to outstanding tax demands of the seller, or tax proceedings which are pending at the time of transfer of assets.

X YEAR IN REVIEW

Over the past couple of years, the government has re-negotiated tax treaties with countries such as Singapore, Cyprus and Mauritius to ensure that the right to tax capital gains comes to country of source (i.e., India and not to the country of residence, i.e., Singapore or Mauritius). The government had also simultaneously reduced the rate of tax on sale of unlisted securities (held for more than 24 months) to 10 per cent to ensure that foreign investors were not burdened with a high tax liability. An exemption was, however, provided in respect of transactions undertaken on the stock exchange for long-term capital gains (LTCG) and the transactions are only subject to a nominal STT. This was to encourage portfolio investors to access the Indian securities market. With significant movement of stock prices, the government has realised that it has brought a significant opportunity to bring a wider set of investors into the tax net. Therefore, with effect from 1 April 2018, the existing exemption on LTCG arising out of sale of listed equity shares of an Indian company on a stock exchange is withdrawn and a new provision is introduced to levy a 10 per cent tax on LTCG arising from the transfer listed equity shares, units of an equity-oriented mutual fund, or units of a business trust. However, gains accrued until 31 January 2018 are grandfathered.

As a part of India’s commitment to the OECD’s BEPS initiative, the scope of the definition of ‘business connection’ has been expanded to harmonise it with the changes to the tax treaties due to the MLI and include situations where a person plays a principal role in the conclusion of contracts in India.
Further, in the market of job-seekers, India needed job-creators and start-ups appeared to be ray of hope. With the intention to promote these job-creators and to facilitate their growth in the initial phase of business, a deduction of 100 per cent of the profits of the start-up engaged in innovation, development, deployment or improvement of products or processes or services or a scalable business model with a high potential for employment generation or wealth creation would be available for a period of three consecutive years out of seven years, starting from the year the start-up was incorporated.

XI OUTLOOK AND CONCLUSIONS

While in recent times the Indian economy has been facing challenges such as the depreciating rupee, increasing current account deficit, rising inflation and so on, the government has attempted a set of reforms. India’s endeavour is to become one of the most attractive investment destinations in the world, and it understands very well that the need of the hour is to simplify its tax regime and reduce corporate tax rates in the country.
I INTRODUCTION

Indonesia is a unitary state consisting of 34 provinces, and 514 regencies and municipalities. In addition to national taxes such as income tax\(^2\) and value added tax\(^3\), others are taxes imposed by the regional governments, such as taxes on land and buildings (except for areas used for plantation, forestry and mining, which are still maintained as national taxes), motor vehicles, restaurants, entertainment and advertising\(^4\).

Under Article 23A of the Indonesian Constitution, every tax and other impositions that are compelling in nature for the needs of the state must be regulated by law. In many cases, the tax laws delegate to lower regulations, such as government regulations or even ministerial regulations, as implementing regulations to further regulate the subject matter. The Director General of Tax also issues many circular letters on certain subjects to subordinates as internal direction or guidelines. While these circular letters are not regulations and are technically non-binding on taxpayers, the tax offices very often follow these. However, problems arise when the provisions in lower regulations or these circular letters of the tax authority conflict with those provided in the tax laws. As a general principle of Indonesian law, a regulation higher in hierarchy will take precedence over a regulation lower in hierarchy (\textit{lex superior derogat legi inferiori}). It has been more than three decades since Indonesia adopted a self-assessment system to replace the official assessment system in its tax legal system (except for tax on land and buildings, which still uses the official assessment system). Under the self-assessment system, taxpayers must themselves calculate, pay and report their own tax obligations in accordance with the prevailing laws and regulations.

In 2002, Indonesia enacted Law No. 14 of 2002 on the Tax Court (Tax Court Law), and also established a Tax Court (replacing the Board of Tax Dispute Settlement) to examine and decide tax disputes between taxpayers and the tax authorities. Under the Tax Court

\(^1\) Mulyana is a partner and Sumanti Disca Ferli, Bobby Christiano Manurung and Ratna Mariana are associates at Mochtar Karuwin Komar. The authors also thank Astrid Emmeline Kohar, an associate at the firm, for her research assistance in updating this chapter.


\(^3\) Set out in Law No. 8 of 1983 on Value Added Tax on Goods and Services and Luxury-goods Sales Tax as amended by Law No. 11 of 1994, Law No. 18 of 2000 and Law No. 42 of 2009.

\(^4\) Set out in Law No. 28 of 2009 on Regional Taxes and Dues. Note also decision of the Constitutional Court No. 46/PUU-XII/2014, dated 26 May 2015, which annuls the elucidation of Article 124 of this Law with respect to the regional dues for telecommunication tower control and decision of the Constitutional Court No. 15/PUU-XV/2017 dated 10 October 2017, which annuls a number of articles in Law No. 28 of 2009 with respect to taxation of heavy equipment treated as motor vehicles.
Law, based on limited grounds, taxpayers and the tax authorities, if not satisfied with a Tax Court decision, also have the right to request a civil review application to the Supreme Court against such Tax Court decision. Many tax disputes have been brought by taxpayers before the Tax Court regarding transfer pricing issues as a result of the price adjustment of or non-recognition by the tax authorities of the expenses in transactions between taxpayers and their foreign shareholders or affiliated companies. Tax disputes can also arise owing to different interpretations of laws and regulations between taxpayers and the tax authorities, or a conflict between laws and regulations affecting the rights and obligations of taxpayers.

To increase business activities in Indonesia, the government has also maintained certain tax incentives and facilities for companies doing business in Indonesia in specific business sectors and regions. There is also a tax incentive for publicly listed companies meeting certain requirements as regards the rate of income tax.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

The types of business entity commonly used in Indonesia take the form of sole proprietorship, general partnership, firm partnership, limited partnership (CV), limited liability company (PT) or cooperative.

A sole proprietorship is carried out by a natural person in his or her personal capacity. This form is typical for small to medium-sized businesses such as stores, restaurants and small repair shops.

A general partnership is the most basic form of partnership under Indonesian law. The general partnership is an association of persons for the carrying out of a joint enterprise. The members of the general partnership are not personally liable for the liabilities of the general partnership, and each member cannot bind the other member unless specifically authorised by the other member or unless the transaction is of benefit to the general partnership. A general partnership is the form of organisation that is typically used by professional experts, such as law firms or accounting firms.

A firm partnership is the form used by commercial partnerships, such as trading or commercial services firms. Each partner in the firm partnership has the right to act in the name of the partnership within the scope of its business. Liability of the partners in the firm partnership with third parties is on a joint and several basis.

A CV differs from a firm partnership; while all partners are active partners in a firm partnership, in a CV there is also a non-active or ‘sleeping’ partner (limited partner). The liability of the limited partner is only to the extent of the sum he or she has pledged to contribute to the CV.

Major companies in Indonesia mostly take the form of a PT. The main characteristic of a PT is that it owns its assets and holds liabilities separately from its shareholders. Generally speaking, the shareholders of a PT have no liability for acts carried out for and on behalf of the PT. Their liability is limited to the shares they have subscribed. However, under certain circumstances, the court may ‘pierce the veil’ or disregard the corporate entity, and hold that the shareholders are personally liable for acts carried out in the name of the PT. Those circumstances are:

- where the requirements for the PT to be established as a legal entity have not been made or are not met (e.g., approval of the Minister of Law and Human Rights has not been obtained);
b the shareholders in question, directly or indirectly, in bad faith exploit the PT for their personal interest;

c the shareholders in question are involved in an unlawful act committed by the PT; or

d the shareholders in question, directly or indirectly in an unlawful act, make use of the assets of the PT in such a way that the PT assets become insufficient to settle the PT’s debts.

The Indonesian Company Law (Law No. 40 of 2007) also provides that if there is only one shareholder in the PT for a period of not more than six months, the shareholder must transfer a part of its shares to another party. Otherwise, the sole shareholder becomes personally liable for all of the obligations and losses suffered by the PT.

A cooperative is an association of persons, and its objective is the enhancement of the welfare of its members through engagement in a specific business as authorised in its charter. A cooperative has the status of legal entity after it is legalised by the relevant minister.

Generally, the basic tax treatment for all forms of businesses, except for the sole proprietorship, is the same (i.e., a flat tax rate of 25 per cent of the net income). In the sole proprietorship, the person’s tax rates are calculated on a progressive basis ranging from 5 per cent up to 30 per cent. To calculate the tax obligation, in addition to the permissible deductible expenses, the natural person must also deduct a non-taxable income threshold for himself or herself, his or her spouse and up to three dependants.

i Corporate

Most large companies adopt a corporate form. Like its predecessor, the 1967 Foreign Investment Law, the Indonesian Investment Law of 2007 requires business entities engaged in almost all business sectors (including manufacturing and trading of goods and services) to take the form of a PT if there is a foreign ownership participation in that entity in the framework of foreign direct investment (a PMA company). The same requirement also applies to the financial sector (except for banking). For the oil and gas sector, a foreign corporation can be used. Banking business can take the form of a branch office of the foreign bank, but the banking authority no longer issues new business licences to a branch office of a foreign bank. Based on the foregoing, the discussion below focuses on the PT corporate form.

ii Non-corporate

Non-corporate entities such as a general partnership, firm partnership and limited partnership are not permissible for foreign-owned equity. Generally, the Indonesian Income Tax Law treats all entities, regardless of whether they are incorporated, in the same manner.

III DIRECT TAXATION OF BUSINESSES

Generally, the flat tax rate of 25 per cent of net income applies for all businesses that take the form of an entity (regardless of whether they are incorporated). There are some exceptions, including:

a a public company that satisfies a minimum listing requirement of 40 per cent and other requirements can obtain a 5 per cent reduction from the standard rate;

b corporate taxpayers with gross revenue up to 50 billion rupiah are entitled to a 50 per cent reduction of the standard tax rate imposed on the taxable income for gross revenue up to 4.8 billion rupiah;
companies engaged in upstream oil and gas and geothermal industries must calculate their corporate income tax pursuant to the terms of their production-sharing contracts; and

government must calculate their corporate income tax pursuant to the terms of the contract of work.

There are also businesses that have deemed profit margins for tax purposes. For such businesses, their respective deemed profit on gross revenue and effective income tax rate are, *inter alia*, domestic shipping operations (4 per cent; 1.2 per cent) and foreign shipping and airline operations (acting through a permanent establishment (PE) in Indonesia) (6 per cent; 2.64 per cent).

### Tax on profits

#### Determination of taxable profit

Indonesian tax residents are taxed on their worldwide income, and foreign tax credits are available for the foreign income of tax residents subject to certain criteria. The taxable profit is calculated based on the gross income deducted with allowed expenses. Pursuant to the Income Tax Law, deductible expenses are expenses for the purposes of earning, collecting or maintaining income, including:

- expenses that are directly or indirectly related to the business activities, such as material expenses, salaries, wages, allowances, interest, royalties, travelling expenses, waste management expenses, insurance premiums, promotion and selling expenses, administration expenses and taxes (except income tax);
- depreciation and amortisation expenses;
- contributions to the pension fund;
- losses; and
- expenses for research and development conducted in Indonesia.

Non-deductible expenses include:

- distributions of profit in any form, such as dividends;
- expenses for personal interests of shareholders, partners or members;
- establishment of reserves or provisions, with some exceptions, such as provisions for doubtful accounts for banking and financing companies, reclamation provisions for mining companies, forestation provisions for forestry companies, and provisions for closure and maintenance for industrial waste processing businesses;
- benefits in kind; however, meals and drinks provided to all employees, or benefits in kind in certain remote areas, are deductible as regulated by a Minister of Finance regulation;
- income tax payments; and
- tax penalties.

Pursuant to Article 11 of the Income Tax Law, expenditure incurred in relation to tangible assets with a useful life of more than one year (except for land titles) can be depreciated. Depreciation is commenced from the month of the acquisition of the assets by using the straight-line method or the declining method consistently. Buildings can be depreciated by using the straight-line method only.
Pursuant to Article 11A of the Income Tax Law, amortisation for expenditure to acquire intangible assets, including expenses for extension of land titles and goodwill having a useful life of more than one year, can be carried out by the straight-line method or declining method during the useful life by way of applying an amortisation tariff for such expenditure or on the remainder of the book value; provided this is done consistently, it is all amortised at the same time at the end of the useful life. The amortisation is commenced in the month in which the expenditure is incurred, except for in certain business sectors that are regulated further by a Minister of Finance regulation.

Basically, taxable profits are based on accounting profits. However, for the calculation of the tax obligation, some adjustments may be required, since certain expenses are not tax-deductible. Profits are taxed on an accruals or receipts basis, depending upon which book method the taxpayer has adopted. The book method must be conducted consistently by the taxpayer. A change of the book method must obtain the approval of the Director General of Tax.

**Capital and income**

In practice, there is still a distinction between the taxation of income and capital gain (profit). Currently, the income tax on income arises from the sale of shares in the stock exchange, and is a final tax of 0.1 per cent of the gross amount of the sale of shares. In the case of the sale of shares by founding shareholders in publicly listed companies, there is an additional tax of 0.5 per cent of the sale transaction value.

Tax on capital gains from the sale of shares in closely held companies by a foreign shareholder is 5 per cent of the value of the sale transaction, unless provided otherwise by a relevant tax treaty if the taxing authority is not Indonesia.

**Losses**

Pursuant to Article 6(2) of the Income Tax Law, losses may be carried forward for a maximum of five years. For a limited category of businesses in certain regions, or businesses subject to certain concessions, however, the period can extend up to 10 years. The carry-back of losses is not allowed. Losses can survive a change in shareholders of the PT.

**Rates**

Pursuant to Article 17 of the Income Tax Law, the flat tax rate for tax-resident entities (whether corporate or non-corporate) is generally 25 per cent. For individual tax residents, the tax rates are as follows:

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 50 million rupiah</td>
<td>5 per cent</td>
</tr>
<tr>
<td>Over 50 million rupiah but not exceeding 250 million rupiah</td>
<td>15 per cent</td>
</tr>
<tr>
<td>Over 250 million rupiah but not exceeding 500 million rupiah</td>
<td>25 per cent</td>
</tr>
<tr>
<td>Over 500 million rupiah</td>
<td>30 per cent</td>
</tr>
</tbody>
</table>

**Administration**

Businesses must pay tax and file tax returns for particular taxes either monthly or annually, depending on the tax obligation in question. For example, for many withholding taxes, the tax payment deadline is the 10th day of the following month, and the tax return filing
Indonesia

deadline is the 20th day of the following month. For corporate income tax, the tax payment deadline is at the end of the fourth month after the book year-end before filing the tax return, and the deadline for filing the tax return is the fourth month after the book year-end.

There are two kinds of tax authorities: at the national level (i.e., the Directorate General of Tax and the Directorate General of Customs and Excise, both under the Ministry of Finance: this chapter focuses on the authority of the Directorate General of Tax only) and at the local (regional) level.

The tax authorities may audit businesses from time to time at random to check the compliance of taxpayers. If a business requests a tax refund, this will always trigger a tax audit.

In practice, it is possible to obtain guidance or clearance from the tax authorities where there is uncertainty as to the correct tax treatment or if the tax treatment could apply in a way that would not seem to be intended. Normally, the tax authorities follow the written guidance or clearance they have issued to the taxpayer in treating such taxpayer. Since some of this written guidance and clearance has been made publicly available, taxpayers who believe that such guidance or clearance may also be beneficial to them usually attempt to rely on such documents in convincing the tax authorities that they are eligible for the same tax treatment.

In cases where a taxpayer does not agree with a tax position taken by the tax office as stipulated in the tax assessment letter, the taxpayer has the right to submit an objection application to the Director General of Tax to annul the tax assessment letter within three months as of the sending date of the tax assessment letter. If the taxpayer is not satisfied with the objection decree of the Director General of Tax, the taxpayer can ask for an appeal against such an objection decree to the Tax Court within three months as from the receipt of the objection decree.

Under the Tax Court Law of 2002, Tax Court decisions are final and binding, but are still subject to an extraordinary legal remedy for civil review to the Supreme Court based on limited grounds as provided for in the Tax Court Law.5 Under Article 91 of the Tax Court Law, those grounds are:

\[ a \] if the Tax Court decision is based on a lie or fraud by the counterparty that is known after the rendering of the decision, or based on evidence that later is declared forged by the criminal judge;

\[ b \] if there is new written evidence that is important and decisive that, if it is known in the proceedings at the Tax Court, will result in a different decision;

\[ c \] if something is granted that was not claimed, or that is more than what was claimed by a party;

\[ d \] if it concerns a part of the claim that has not been decided without considering the causes; or

\[ e \] if there is a decision that is clearly not in accordance with the provision of the prevailing laws and regulations.

Looking at the Supreme Court level, and from decisions of the Supreme Court on tax disputes on the Supreme Court website,6 the ground in (e) above is always used in civil review applications. Other grounds are very rarely used, and if they are, they are used only as an additional ground.

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5 This extraordinary legal remedy is available for both taxpayers and the tax authorities, such as the Director General of Tax.

6 www.mahkamahagung.go.id.
Pursuant to Article 93 of the Tax Court Law, the Supreme Court examines and renders a decision within six months as from the date the dossier is received by the Supreme Court in the event that the Tax Court has rendered its decision through an ordinary procedure examination; or within one month if the Tax Court has rendered its decision through an expediting procedure examination.

In recent practice, it is often that the Supreme Court renders its decisions within those timelines. However, there are still delays that are caused particularly by the administrative processing and sending of case dossiers by the Tax Court to the Supreme Court.

**Tax grouping**

There are no group tax relief provisions available in Indonesia. As a result, members of a group of companies are taxed individually.

**ii Other relevant taxes**

Other taxes relevant for businesses are, *inter alia*, VAT and luxury goods sales tax, land and building tax, income tax on land and building transfers, duty on the acquisition of land and building rights7 and stamp duty.

VAT is imposed on the transfer of taxable goods or the provision of taxable services in the Indonesian customs area. The current VAT rate is 10 per cent, as provided for in the VAT Law. Pursuant to the VAT Law, a government regulation can provide for a VAT rate ranging from 5 to 15 per cent.

In addition to VAT, certain goods regarded as luxury goods are subject to an additional luxury goods sales tax ranging from 10 to 75 per cent. Pursuant to the VAT Law, the rate of the luxury goods sales tax may be increased by the government up to 200 per cent.

Land and building tax (PBB) is divided into two categories,8 as follows:

- **PBB on general area:** this PBB is imposed annually on property in the form of land or a building based on an official assessment issued by the head of the region. The rate of this PBB is to be determined by the regional regulation, but it should not be more than 0.3 per cent. The tax due is calculated by applying the tax rate on the tax object sale value (NJOP) deducted with non-taxable NJOP, which is set at a minimum of 10 million rupiah. Any change to the non-taxable NJOP must be stipulated in a regional regulation.

- **PBB on plantation, forestry and mining areas:** this PBB is imposed annually on property in the form of land or a building based on an official assessment issued by the Director General of Tax. The rate of this tax is 0.5 per cent, and the tax due is calculated by applying the tax rate on the taxable sale value (NJKP). The NJKP is a predetermined portion of the NJOP. Currently, the NJKP is 40 per cent of the NJOP. The government can increase the NJKP rate by up to 100 per cent of the NJOP. The

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7 By Law No. 28 of 2009 on Regional Taxes and Dues, the duty on the acquisition of land and building rights became a local (regional) tax.

8 PBB was historically governed by Law No. 12 of 1985 on Tax on Land and Buildings, as amended by Law No. 12 of 1994 (PBB Law), and was part of the national taxes. Starting from 1 January 2010, by virtue of Law No. 28 of 2009 on Regional Taxes and Dues (Regional Tax Law), PBB became part of the local taxes governed thereunder with the exception of areas used for plantation, forestry and mining, where PBB remains part of the national taxes.
NJOP rates are determined by the Director General of Tax on behalf of the Minister of Finance. They may be adjusted every year or every three years, depending on the economic development of the region.

Income tax on land and building transfers is imposed on the seller for the transfer of land and buildings. The rate of this tax is 5 per cent of the gross transfer value unless such value is lower than the NJOP of the object. In the latter case, the tax base is the NJOP. The tax paid is a final tax.

Duty on the acquisition of land and buildings is imposed on the buyer to acquire land and buildings. The rate of this duty is 5 per cent of the acquisition value of the object, unless such value is lower than the NJOP of the object. In the latter case, the tax base is the NJOP.

Stamp duty of 6,000 rupiah is imposed for each of the documents prepared with the purposes of being used as an evidence instrument concerning an act, fact or situation that is civil in nature, such as agreements, notarial deeds and their copies, and every document to be presented as evidence before the courts.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence
A company is treated as an Indonesian tax resident if it is established or has its place of management in Indonesia. A foreign corporation can become a tax resident of Indonesia if it has a presence in Indonesia through a PE. Generally, a PE assumes the same tax obligations as a resident taxpayer.

ii Branch or permanent establishment
A foreign company can have a fiscal presence in Indonesia in the form of PE if it has or performs any of the following in Indonesia:

a a place of management;
b a branch office;
c a representative office;
d an office building;
e a factory, workshop or warehouse;
f a site for promotion and sales;
g a mining site;
h working area of oil and gas;
i fishery, husbandry, agriculture, plantation or forestry activities;
j construction, installation or assembly projects;
k provides services through employees or others for more than 60 days in any 12-month period;
l a dependent agent;
m an insurance company agent or employee receiving premiums or taking risks in Indonesia; or
n computer, electronic or internet devices used in Indonesia for internet (e-commerce) transactions.

The above, however, are subject to the provisions of a relevant tax treaty.
In addition to the standard corporate income tax, a PE is also subject to 20 per cent branch profit tax, which is applied to the net profit after tax of the PE unless the profit is reinvested in Indonesia.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes
Pursuant to Article 23(4)(c) in conjunction with Article 4(3)(f) of the Income Tax Law, withholding tax on the dividend is not applied if such dividend is received by a PT tax resident, provided the dividend derives from the retained earnings and the PT has at least 25 per cent of the paid-up capital in that company.

ii IP regimes
Currently, there are no IP regimes that are subject to special tax treatment in Indonesia.

iii State aid
There may be special tax treatment for the income tax of government projects funded by foreign loans or grants. For such projects, the income tax liability of the main contractors, consultants and suppliers may be borne by the government.

iv General
The fiscal incentives of import duty, or import-related tax relief or exemption, are generally applicable to foreign direct investment in manufacturing or processing for imports of capital equipment, spare parts and basic materials during the initial start-up period. The government has also provided income tax incentives and tax holidays.

Income tax incentives
For investments in certain industries and certain regions, income tax incentives are available under Government Regulation No. 18 of 2015 on Income Tax Facilities for Investment in Specific Business and/or Regions as amended by Government Regulation No. 9 of 2016 (taking effect from 7 May 2016). These incentives cover the following:

a an investment allowance of 30 per cent, spread over six years at a rate of 5 per cent annually;
b accelerated depreciation and amortisation;
c a reduction in the withholding tax tariff on dividends payable to the foreign investors of up to 10 per cent (subject to a lower rate being made applicable by a tax treaty); and
d a longer tax loss carry-forward period of up to 10 years meeting certain requirements.

The industries to which these incentives are available are listed in the governing Government Regulation. Industries eligible to obtain the incentives as listed in the Government Regulation include geothermal energy (exploration, drilling and conversion to electricity), oil refining, iron steel making, nickel ore mining and non-ferrous metal manufacture and various other industries such as food, textile, chemical substances, pharmacy, computers and electronic and optical goods, electricity equipment, motor vehicles and spare parts and electricity power.
Government Regulation No. 18 of 2015 as amended by Government Regulation No. 9 of 2016 is implemented further by Regulation of the Minister of Finance No. 89/PMK.010/2015 (taking effect since 6 May 2015).

**Tax holiday**

On 27 November 2018, the Minister of Finance issued Regulation No. 150/PMK.010/2018 on Facility on Income Tax Exemptions and Reduction for Business Entities. This Regulation replaced the previous Minister of Finance Regulation No. 35/PMK/010/2018 on the same. Under this Regulation, income tax exemptions can be granted to business entities for a maximum of 20 fiscal years or a minimum of five fiscal years.

The criteria established for business entities that qualify for income tax exemptions and reductions are as follows:

- **a** the business is categorised as a pioneering industry, such as:
  - integrated upstream basic metal industry;
  - integrated petroleum refinery industry;
  - integrated basic petrochemical industry;
  - integrated pharmaceutical raw material industry;
  - machinery industry;
  - ship parts manufacturing industry;
  - train parts manufacturing industry;
  - agricultural, farming or forestry-based processing industries;
  - economic infrastructure; or
  - digital economy;
- **b** the business is an Indonesian legal entity;
- **c** the business is a new investment that has not yet been issued a decree on the giving or notice of rejection to corporate income tax reduction;
- **d** the business has a new investment plan with a minimum value of 100 billion rupiah; and
- **e** the business meets the debt-to-equity ratio requirement as referred to in a Minister of Finance regulation.

**Tax amnesty**

On 1 July 2016, Law No. 11 of 2016 on Tax Amnesty took effect. Income tax, VAT and sales tax on luxury goods are covered by the Law. The objective of the Law is to increase tax revenues, make fairer tax reforms possible due to an expanded tax base and accelerate economic growth. There are several benefits for tax amnesty participants, including a waiver of any taxes due, and of administrative and tax criminal sanctions with respect to assets reported in declaration letters up to tax year 2015, as well as clearance levy rates that are significantly lower than the normal tax rates. Following the end of tax amnesty on 31 March 2017, the government issued several regulations to accelerate any unfinished asset repatriation, to strengthen tax-compliance supervision and to provide another opportunity for taxpayers to disclose or report their assets in the framework of tax amnesty. These regulations, applicable to both participants and non-participants of the tax amnesty, are, among others:

- **a** Government Regulation No. 36 of 2017 on the Imposition of Income Tax upon Certain Income in the Form of Net Assets Treated as or Deemed to Be Earnings (taking effect from 11 September 2017), which regulates the applicable final income tax rates for net assets;
Minister of Finance Regulation No. 141/PMK.08/2017 on Procedures for the Transfer of Taxpayer Assets to Indonesia and Their Placement in the Financial Market and Non-Financial Market through the Tax-Amnesty Framework (taking effect from 24 October 2017), which regulates asset repatriation; and

Minister of Finance Regulation No. 165/PMK.03/2017 on the Second Amendment of the Minister of Finance Regulation No. 118/PMK.03/2016 regarding the Implementation of Law No. 11 of 2016 on Tax Amnesty (taking effect from 20 November 2017), which regulates the further implementation of tax amnesty.

The Director General of Tax also issued Circular Letter No. SE-14/PJ/2018 on the Supervision of Taxpayers after the Tax-Amnesty Period (replacing the previous Circular Letter No. SE-20/PJ/2017), which took effect from 19 July 2018 and serves as a set of guidelines for the supervision of taxpayer compliance in the future.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)
Withholding tax at a rate of 15 per cent of the gross amount applies to dividends, interest and royalties paid by a company in Indonesia to Indonesian taxpayers or PEs. As discussed above, there is no withholding tax on the dividends paid out of retained earnings in cases where the company earning dividends has at least 25 per cent of the paid-up capital in the company distributing the dividends.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments
As discussed in Section V.iv, for investments in certain industries and certain regions there are income tax incentives that also cover a reduction in the withholding tax tariff on dividends payable to foreign investors to 10 per cent (subject to a lower rate under a relevant tax treaty). Contracts of work entered into by mining companies and the government prior to the 2009 Mining Law may provide such exclusions or exemptions from withholding.

iii Double tax treaties
Pursuant to Article 26 of the Income Tax Law, withholding tax at a rate of 20 per cent of the gross amount applies to distributions such as dividends, interest and royalties paid by resident taxpayers to non-residents, unless a relevant tax treaty provides otherwise. Currently, Indonesia has entered into tax treaties with more than 60 countries.

The tax treaties provide withholding tax exemptions for service fees, and reduced withholding tax rates on dividends, interest, royalties and branch profits received by residents of countries with which Indonesia is a party to such tax treaties. To claim the tax treaty benefits, the foreign taxpayer must present a certificate of domicile to the tax authority.

iv Taxation on receipt
Indonesian tax residents are taxed on their worldwide income. Pursuant to Article 24 of the Income Tax Law, the tax paid for income from foreign sources can be credited to the tax owed
under the Income Tax Law in the same tax year. The amount of the tax credit is the amount of
the foreign income tax paid abroad, but must not exceed the tax owed under the Indonesian
Income Tax Law.

VII TAXATION OF FUNDING STRUCTURES

Indonesian PTs are usually funded by capital pay-ins and loans. The minimum authorised
capital of PTs under the Indonesian Company Law of 2007 is 50 million rupiah. However,
laws and regulations governing certain types of businesses may determine a minimum capital
higher than this figure.

i Thin capitalisation
For foreign direct investment companies, there are requirements as to the debt-to-equity
ratios depending on the type of the business in which they will be engaged. Pursuant to
Minister of Finance Regulation No. 169/PMK.010/2015 on Determination of the Amount
of Debt-to-Equity Ratio of Companies for the Purpose of the Calculation of the Income Tax
(to take effect from tax year 2016), the maximum debt-to-equity ratio for companies is 4:1,
except for certain taxpayers such as banking, finance and insurance companies, and taxpayers
engaging in the business of oil and gas, mining and infrastructure. In cases where the debt-to-
equity ratio of the taxpayers exceeds the maximum figure, the expense to service the loan that
is tax deductible is only up to the expense to service the loan up to the maximum debt-to-
equity ratio.

ii Deduction of finance costs
Finance costs, such as interest and bank arrangement fees, can be deducted if these are
expenses for the purposes of earnings, or collecting or maintaining income.

iii Restrictions on payments
There are some rules on payments of dividends to shareholders of a PT under Indonesian
company law. Pursuant to the Indonesian Company Law of 2007, a PT can only declare and
distribute dividends out of its net profits to its shareholders provided that the requirement for
setting aside sums to the reserve fund has been satisfied. The Company Law does not provide
what particular percentage of the PT’s net profits in any one financial year must be set aside
for the reserve fund. The setting aside of net profits for the reserve fund shall be carried out
until the reserve fund reaches at least 20 per cent of the issued and paid-up capital of the
PT. This does not mean that in one financial year a PT must set aside its net profits for the
reserve funds to reach 20 per cent of its issued and paid-up capital. However, reserve funds
that have not reached 20 per cent of the issued and paid-up capital can only be used by the
PT to cover losses that cannot be covered by other reserves. The use of net profits, including
determination of the amount for the reserve fund, must be decided by a general shareholders’
meeting.

iv Return of capital
Return of capital can be achieved by a company purchasing its own shares from shareholders.
Pursuant to Article 37(1) of the Company Law, a PT can purchase its own shares based on a
resolution of the general shareholders’ meeting provided that:
the repurchase of the shares does not cause the net assets of the PT to become smaller than the issued capital plus the mandatory reserve fund that has been set aside; and

b the total amount of all shares repurchased by the PT, and the pledge of shares or the fiduciary encumbrance over the shares held by the PT or other companies, or both, whose shares, directly or indirectly owned by the PT, do not exceed 10 per cent of the issued capital of the PT, unless provided otherwise in capital market laws and regulations.

For tax purposes, the payment by a PT to a shareholder for purchasing the shares owned by such shareholder in the PT will be treated in the same manner as a distribution of dividends to a shareholder.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Foreign companies acquiring local businesses generally structure transactions by acquiring shares in the Indonesian target company (share deals) or by purchasing assets of the target company (asset deals).

Share deals

A foreign entity may acquire shares in an Indonesian target company directly or indirectly through another foreign entity provided that the business sector of the target company is open for foreign investment. For the transfer of shares in a closely held company, if the seller is another foreign entity, such seller will have a final income tax of 5 per cent of the share price (withholding tax of 20 per cent and net deemed profit of 25 per cent of the share price) imposed on it, unless, pursuant to the relevant tax treaty, the taxing authority is not Indonesia.

The PT should only record the transfer of the shares in the shareholders’ register if evidence is presented to it that the income tax has been completely settled. In cases where the purchaser of the shares is a foreign entity, the PT is deemed as the party who has the obligation to collect the income tax.

Pursuant to Article 18(3c) of the Income Tax Law, the sale of shares in an Indonesian (target) company by a conduit company or special purpose company established or domiciled in a tax haven country that has a special relationship with an entity established or domiciled in Indonesia or a PE in Indonesia can be deemed as the sale or transfer of shares by the Indonesian entity or PE in Indonesia.

Asset deals

A foreign entity is not allowed to acquire assets of an Indonesian entity directly to operate a business in Indonesia. As discussed above, except for certain limited business sectors, foreign entities are not eligible to obtain business licences in Indonesia. To acquire assets of the Indonesian (target) company and operate a business in Indonesia, a foreign entity must use its Indonesian company, or must first establish a PMA company, to acquire such assets. If the acquired assets are land and buildings, the purchaser of the assets will have duty imposed on the acquisition of land and buildings at a rate of 5 per cent of the price of the assets imposed on it.
Pursuant to Article 18(3b) of the Income Tax Law, the indirect purchase of shares or assets of an Indonesian (target) company by an Indonesian entity through a special purpose company can be deemed as the purchase of shares or assets by the Indonesian entity if the special purpose company has a special relationship with the Indonesian entity or if there is unreasonable pricing.

ii Reorganisation
As a general rule, the transfer of assets in business mergers, consolidations or spin-offs is conducted at market value. This results in taxable gain or loss. Such loss is basically tax-deductible. Upon approval of the Director General of Tax, the assets can be transferred at book value for a tax-neutral merger or consolidation provided that the business purpose tests are satisfied.

In Indonesia, there is no provision that can allow a merger of a local entity with a foreign entity.

iii Exit
If a business decides to relocate to another country, the Indonesian entity must be dissolved and must further be liquidated. As one of the exercises in the liquidation process, such entity must also resolve its tax liability, and for these purposes there will be a tax audit. Upon the settlement of the tax obligation, the tax authority will issue a tax clearance. Once the tax clearance has been obtained, the Indonesian entity can completely dissolve and cease to exist as a legal entity.

There is no tax penalty merely for relocation of a business to another country.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance
As discussed in Section VIII.i, the Indonesian Income Tax Law provides avoidance rules for the sale of shares or assets meeting certain requirements.

Pursuant to Article 18(3b) of the Income Tax Law, the indirect purchase of shares or assets of an Indonesian (target) company by an Indonesian entity through a special purpose company can be deemed as the purchase of shares or assets by the Indonesian entity if the special purpose company has a special relationship with the Indonesian entity or if there is unreasonable pricing.

Pursuant to Article 18(3c) of the Income Tax Law, the sale of shares in an Indonesian (target) company by a conduit company or special purpose company established or domiciled in a tax-haven country that has a special relationship with an entity established or domiciled in Indonesia, or a PE in Indonesia, can be deemed as the sale or transfer of shares by the Indonesian entity or PE in Indonesia.

Indonesia no longer has a tax treaty with Mauritius, a low-tax jurisdiction.

ii Controlled foreign corporations
As discussed above, in most business sectors controlled foreign corporations must take the form of a PT. As such, the rules for the distribution of dividends to a shareholder that is a foreign entity are basically the same as those that apply to shareholders of a closely held PT.
iii Transfer pricing

Pursuant to Article 18(3) of the Income Tax Law, the Director General of Tax has the authority to adjust taxpayers’ income or costs in transactions with related parties not carried out under the arm’s-length principle by using the comparable uncontrolled price method, resale price method, cost plus method and other methods. Currently, the transfer pricing documentation must also be attached to the corporate income tax return for any transaction with a related party that: (1) exceeds 20 billion rupiah for tangible goods transactions; or (2) exceeds 5 billion rupiah for service provision, interest payment, intangible goods utilisation or other affiliated transactions per entity per year. For such purpose, the taxpayer must conduct a comparable analysis or determine comparable data to show that the transaction with the related party conforms to the arm’s-length principle.

Pursuant to Article 18(3a) of the Income Tax Law, the Director General of Tax also has the authority to enter into advance pricing agreements with taxpayers or the tax authority of another country on the application of the arm’s-length principle to transactions between related parties.

iv Tax clearances and rulings

It is possible to obtain advance tax rulings from the tax authority to secure certainty. Tax rulings may also be required to acquire a local business.

To issue a tax clearance, the tax authority will need to conduct a tax audit. In the acquisition of a local business, the seller of the local business is usually reluctant if the tax clearance is required as a condition precedent for the conclusion of the transaction.

X YEAR IN REVIEW

The transfer pricing issues involved in transactions between related parties have been scrutinised by the Indonesian tax authorities in recent years. Many taxpayers have challenged the adjustments made by the tax authority to the Tax Court for nullification. The Tax Court has rendered decisions on some of these, but others are still pending before it. Certain of these disputes are also pending with the Supreme Court, and some disputes have been decided by the Supreme Court. The typical reason for taxpayers to challenge the adjustments is that the tax authority did not provide the comparable data necessary to show that transactions between related parties that have been entered into are not in accordance with the arm’s-length principle.

There is only one Tax Court in Indonesia, which is situated in Jakarta. However, the Tax Court has also held sessions in Yogyakarta and Surabaya on 7 June 2012 and 14 March 2013, respectively.

XI OUTLOOK AND CONCLUSIONS

It has been reported that there are plans to reform the current tax law regime, some of which are plans to amend the General Provisions and Procedures of Taxation Law, the Income Tax Law and the VAT Law, in the framework of tax reform. The reasons for the amendment of the General Provisions and Procedures of Taxation Law are, inter alia, to make it easier for taxpayers to fulfil their obligations, to ease the process of tax withholding, and to increase the state revenue from the tax sector. The revision of the articles in the Income Tax Law is expected to be in line with the paradigm and trend of global taxation, which emphasises
equality of rights, transparency, and moderation of tax rates. Meanwhile, the VAT Law revision is expected to make the VAT Law clearer, simpler and more certain. Further, the government is also looking to address the taxation issues of the digital economy/e-commerce industry and to expand the coverage of tax exemptions and reduction.
Chapter 14

IRELAND

Peter Maher

I  INTRODUCTION

Ireland has for many years attracted a disproportionately large amount of inward investment. This trend did not change during the recent economic downturn. In fact, paradoxically, the economic crisis enhanced Ireland’s attractiveness as an investment location. IBM’s 2018 Global Location Trends Report (the most recent version available) states that ‘Ireland continues to lead the world for attracting high-value investment’. For the seventh year in a row, the Report has ranked Ireland as the top destination globally for jobs by quality and value of investment ahead of other leading locations including Singapore, Lithuania, Switzerland and Hong Kong. Significant gains in inbound investment have been achieved in recent years.

The government and opposition parties have consistently reaffirmed their commitment to maintaining the corporation tax rate of 12.5 per cent (most recently in the 2019 Budget announcement on 9 October 2018), which is a cornerstone of Ireland’s inward investment strategy.

II  COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

There are various forms of business organisation to choose from in Ireland. Some involve the creation of a separate legal person, while others do not.

Only bodies corporate are subject to Irish corporation tax. This would include all limited or unlimited companies and registered societies. All income of an Irish-resident company or other body corporate, wherever it arises, will normally be liable to Irish corporation tax.

Entities without identities separate from those of their members are not subject to corporation tax, and include sole traders, partnerships and unincorporated associations. In general, income tax is charged on the profits of a person carrying on a trade or profession. There are special tax rules for partnerships under which each partner is taxed separately on his or her share of partnership profits.

i  Corporate

The private limited company is the most common form of Irish company. Its principal attraction is that shareholders’ liability for the company’s debts is limited to the amount they agreed to pay for their shares. Under the Companies Act 2014, there are two types of private limited company – the company limited by shares (ltd) and the designated activity company.

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Public limited companies are generally used where there is a larger dispersed ownership of the company or where shares will be traded on a stock exchange. There are more onerous disclosure requirements (particularly in relation to financial disclosures) on public companies than on private companies, and they are subject to a minimum capitalisation requirement.

In an unlimited company, the liability of the members for the company’s debts is not restricted. These types of company are not particularly common. Unlimited companies previously had certain advantages over limited companies as they enjoyed fewer disclosure requirements and greater flexibility in terms of returning share capital. However, the Companies (Accounting) Act 2017 amended the position somewhat with the effect that the majority of unlimited companies are now obliged to file financial statements in the Companies Registration Office.

ii Non-corporate

Non-corporate forms of business organisation are often used in Ireland either by sole traders or by groups of individuals who do not wish to, or are prohibited from, forming a body corporate. Partnerships are used by persons carrying on a business together with a view to profit, and are not registered or incorporated entities. Limited partnerships, where some of the members have limited liability for the debts of the partnership, can be created, but these do not constitute a legal entity separate to their members.

III DIRECT TAXATION OF BUSINESSES

The Irish tax system is based on the classical model, meaning that tax is generally payable at each level of the chain, without credit being given at a higher level in that chain for tax suffered lower down. Therefore, when profits are distributed by an Irish-resident company, Irish-resident shareholders are not given credit for underlying corporation tax already suffered by the company.

The tax system is a schedular system, in that income from different sources is allocated to different ‘schedules’ and ‘cases’ and may be taxed in different ways. Corporation tax rates, and the deductions available against income sources, vary depending on the source of the income.

i Tax on profits

Determination of taxable profit

A company’s income is generally computed in accordance with income tax principles. The aggregate net income as calculated under each of the schedules and cases gives the company’s taxable income, and when this in turn is aggregated with taxable capital gains, the company’s total profits are arrived at.

The profits of a trade carried on by a company are computed in accordance with generally accepted accounting practice, but subject to any adjustment required or authorised by law in computing such profits or gains for those purposes. Consequently, any deductions that are given in the accounts but are statutorily disallowed for Irish tax purposes need to be added back. As a general rule, no tax deduction is allowed against trading income for capital expenditure or for revenue payments that are not incurred wholly and exclusively for the purposes of the trade. By way of example, client entertainment expenditure is not allowed for tax purposes and motoring revenue expenses are generally restricted. In addition, accounting depreciation is disallowed for tax purposes, but instead a deduction may be granted for
allowances as provided for by Irish tax legislation – known as ‘capital allowances’ – in respect of capital expenditure incurred on various types of assets (e.g., plant and machinery, industrial buildings and intellectual property rights) for the purpose of the trade.

The general capital allowance regime for plant and machinery grants a capital allowance on a straight-line basis over eight years (12.5 per cent per annum) for the capital expenditure incurred on the asset. Generally, the rate of capital allowances for industrial buildings is 4 per cent per annum. In the case of capital expenditure on intellectual property rights, the allowances are generally granted in accordance with the amortisation of those assets in the accounts or, at the company’s election, over a period of 15 years (see also Section V.ii). Disposals of the assets for amounts greater than or less than the tax written-down value may result in balancing charges or balancing allowances for the company.

**Capital and income**

A fundamental feature of the Irish tax system is the separate treatment for Irish tax purposes of income and capital. Income is subject to income tax (or, in the case of companies within the charge to corporation tax, to corporation tax computed by reference to income tax principles), whereas capital receipts generally are subject to capital gains tax (CGT) (or, in the case of companies with a charge to corporation tax, to corporation tax by reference to CGT rules) and generally computed by reference to separate rules for capital gains. The rates of tax applicable to income and gains differ. Companies are taxed on income at a rate of either 12.5 or 25 per cent, whereas capital gains are generally taxed at 33 per cent.

**Losses**

When, after the deduction of trading expenses, a company incurs a current-year trading loss, it can normally use that loss to shelter other trading income in the current year and also trading income (from the same trade) in a preceding accounting period of corresponding length. When the company has excess trading losses, these losses can be used on a value basis to shelter other income of the same accounting period or preceding accounting period of corresponding length, reflecting that different corporation tax rates apply to trading and non-trading income. Unused losses can then be carried forward by the company for offsetting against income from the same trade in future accounting periods.

An anti-avoidance provision operates to deny the carry-forward of unused trading losses (and certain capital allowances) where, within a period of three years, there is both a change in ownership of the company, and a major change in the nature and conduct of the trade carried on by the company. The provision also denies the carry-forward where the activities in a trade have become small and negligible and there is a change in ownership of the company before any considerable revival of the trade.

In general, non-trading revenue losses can only be used for offset against non-trading income taxed in the same manner. For example, Irish rental losses can only be offset against Irish rental income in the same accounting period, or an earlier accounting period of corresponding length or subsequent accounting periods. Excess capital losses can shelter future capital gains, except gains on disposal of Irish development land.

Certain investment companies are allowed to claim expenses of management against their profits. If there is an excess of management expenses, such excess can be carried forward to future accounting periods.
Rates
The rate of tax applicable to most trading profits (other than profits derived from trading activities involving mining, petroleum activities and dealing in land) is 12.5 per cent. For profits generated from these excluded trades and all other non-trading income, the applicable rate is 25 per cent. In addition to the 25 per cent tax on trading profits from petroleum activities, a petroleum production tax (PPT) applies to oil and gas licences and options granted on or after 18 June 2014. The rate of PPT ranges from 5 to 40 per cent, but is tax deductible against profits or gains chargeable to corporation tax resulting in a maximum marginal rate of 55 per cent. The rate for capital gains has traditionally been different to these rates, and the current rate stands at 33 per cent. A 10 per cent rate applies to certain gains realised by entrepreneurs on the disposal of certain business assets).

Administration
The Revenue Commissioners are the sole taxation authority in Ireland.

A system of self-assessment applies for the payment of corporation tax, and a system of mandatory electronic payment and filing of returns (e-filing) is now largely in place. Companies are required to make a payment of preliminary tax that must, in general, be a minimum of 90 per cent of the corporation tax for that period. The dates and amounts for payment of preliminary tax differ depending on whether the company is a small or large company. For a small company, the payment of preliminary tax is due in the 11th month of the company's accounting period. For a large company, one with a tax liability of more than €200,000 in the previous accounting period, payment of preliminary tax is made in two instalments, in the sixth and 11th months of the accounting period.

A corporation tax return must be filed with the Revenue Commissioners before the nine months after the end of the accounting period (but no later than the 23rd day of that month), together with the balance of tax due.

Where a doubt exists about the tax treatment of a specific item, a company may take a view on the issue and express doubt on its tax return filing. A formal genuine expression of doubt protects a taxpayer from interest (provided any additional tax arising is paid when due) and penalties should the Revenue Commissioners take a different position to the company on the tax treatment.

An audit may be conducted by the Revenue Commissioners if, upon a review of a company's tax returns, queries are raised that are not answered satisfactorily. A revenue audit may also be conducted on a random basis, and in some cases randomly within a particular business or profession.

Tax grouping
Ireland does not permit the filing of consolidated tax returns. Affiliated companies may, however, be able to avail of corporate tax ‘group relief’ provisions. Where a direct or indirect 75 per cent relationship exists, and all the companies are resident in an EU Member State or an EEA country with which Ireland has a double taxation agreement (DTA), each of the companies will be deemed a member of the group.

Group relief can be claimed on a current year basis in respect of trading losses, excess management expenses and excess charges on income within a group. Irish legislation now provides that an Irish resident parent company may offset against its profits any losses of a
foreign subsidiary resident for tax purposes in an EU Member State or an EEA country with which Ireland has a DTA. This is provided that the losses cannot be used in the country in which the subsidiary is tax resident.

Capital losses cannot be surrendered within a group. Capital assets can, however, be transferred between members of a CGT group on a tax-neutral basis. Any gain referable to the group’s ownership will be precipitated when the asset is disposed of outside the group, or when a company that acquired the asset intra-group ceases to be a member of the group within 10 years of the acquisition.

A group for CGT purposes is a principal company and all its effective 75 per cent subsidiaries. For the purposes of identifying the relevant indirect ownership interest in a company, holdings by any EU Member State company, EEA resident company, company resident in a tax treaty partner country, or certain companies that are substantially and regularly traded on a recognised stock exchange, may be taken into consideration.

ii Other relevant taxes

VAT is payable on goods and services supplied in Ireland by taxable persons in the course of business. VAT is also payable on goods imported into Ireland from outside the EU. The rates of VAT currently range from zero to 23 per cent. An Irish established taxable person is required to register for VAT purposes when its annual turnover exceeds €37,500 if its business supplies services and where its annual turnover exceeds €75,000 if the business is supplying goods. A non-Irish established taxable person supplying taxable goods or services in Ireland is obliged to register and account for VAT irrespective of the level of turnover.

Stamp duty applies to documents that implement certain transactions and is payable within 30 days of execution. Transfers of Irish stocks and marketable securities are chargeable to stamp duty at 1 per cent. In his Budget 2017 speech, the Minister for Finance indicated the government’s intention to carry out a review in 2017 of the application of the 1 per cent rate to stocks and marketable securities of Irish incorporated companies in the context of the sustainability of the stamp duty yield and the future relationship of the UK with the EU. On 29 September 2017, the Department of Finance published its consultation paper on share transfers, which had a consultation period running to 14 November 2017. A report produced in October 2018 summarised the responses to the public consultation and outlines three (non-exclusive) possible courses of action that the Minister may wish to consider, being:

- retaining the status quo;
- reducing the rate of 1 per cent to 0.5 per cent to bring Ireland in line with the current UK rate; or
- reducing the rate from 1 per cent to zero per cent as a competitive measure.

The report concluded that a decision in relation to the issue of retaining or amending the stamp duty on transactions involving the stocks and marketable securities of Irish incorporation companies be deferred until there is greater clarity in relation to Brexit issues as they relate to shares.

Transfers of other non-residential property attract a flat rate of 6 per cent stamp duty. The rate was increased from 2 per cent by the Finance Act 2017. Exemptions exist in the case of intellectual property and certain financial instruments. In addition, various types of relief apply in the case of company reconstructions, amalgamations and intra-group asset transfers with the Finance Act 2017 having extended such reliefs in the context of a domestic
merger by absorption. An exemption from stamp duty also exists for the transfer of stocks and marketable securities of companies listed on the Enterprise Securities Market of the Irish Stock Exchange.

Employers have an obligation to register with the Revenue Commissioners and follow the procedures for the deduction at source of employee’s income tax, known as pay-as-you-earn (PAYE), and social insurance contributions, known as pay-related social insurance (PRSI) and the universal social charge (USC). Employers have primary responsibility for the collection of the tax, and must ensure PAYE, USC and PRSI are operated on any additional taxable benefits, such as benefits in kind, provided to employees. In addition to the PRSI deduction from an employee’s income, the employer must make a PRSI contribution for each employee, generally at a rate of 10.75 per cent of the gross salary of the employee.

**IV TAX RESIDENCE AND FISCAL DOMICILE**

**i Corporate residence**

Companies incorporated in Ireland on or after 1 January 2015 are automatically regarded as Irish tax resident unless treated as tax resident elsewhere under a tax treaty with Ireland. For companies incorporated before that date, this ‘incorporation rule’ applies from the earlier of 1 January 2021 or the date where there is a change in the ownership of the company and within a specified period there is also a major change in the nature or conduct of the business of the company. Otherwise until either of those events occurs the tax residence of a company incorporated in Ireland prior to 1 January 2015 is broadly determined by virtue of the common law rule that a company is Irish tax resident if it is ‘centrally managed and controlled’ in Ireland. This is subject to a ‘stateless’ company rule where an Irish-incorporated company is managed and controlled in another EU Member State or jurisdiction with which Ireland has a DTA and is not regarded as tax resident in any territory. In such a case, the company is regarded as resident in Ireland for tax purposes. The provision does not, however, affect structures that involve Irish-incorporated companies that are in fact managed and controlled in a non-EU or non-DTA jurisdiction (e.g., Bermuda).

A non-Irish-incorporated company (whether incorporated before or after 1 January 2015) can become resident in Ireland if its ‘central management and control’ is exercised in Ireland. Generally speaking, this case law concept is taken to denote control at the highest strategic level of a company’s business rather than at the level of day-to-day activities. Many factors need to be looked at when considering where a company is to be regarded as having its place of central management and control, for example, the place where company board meetings are held and the place where the directors of the relevant company are themselves resident.

**ii Branch or permanent establishment**

A company not resident in Ireland is subject to corporation tax if it carries on a trade in Ireland through a branch or agency, and it will be chargeable on all profits arising therefrom. However, an exemption exists in the case of an authorised investment manager who acts as an agent on behalf of a non-resident in carrying on a financial trade and is independent of the non-resident. This exception was extended so that appointing an Irish management company to manage a non-Irish undertaking for the collective investment in transferable securities (UCITS) fund should not as a result bring the non-Irish UCITS into the Irish tax net. The Finance Act 2014 extended the exemption further to an Irish management company appointed to manage a non-Irish alternative investment fund.
The concept of branch or agency is not defined in Irish statutory tax law; although similar to the OECD Model Treaty concept of the permanent establishment, it is likely wider in its scope. For example, the emphasis on a fixed presence, and on a degree of permanence, is probably not necessary for a branch or agency to exist for the purposes of Irish law. Liability to Irish tax will normally depend on whether the operation of the non-resident company constitutes trading in Ireland. The major consideration in this determination is whether there is power to conclude contracts and whether contracts are in fact concluded in Ireland.

In cases where the company is resident in a country with which Ireland has a tax treaty, liability to Irish corporation tax will depend on whether the company carries on a trade in Ireland through a permanent establishment. The treaty may displace an Irish corporation tax charge that would apply in the absence of the treaty.

There are many views as to how profits should be allocated to a permanent establishment, but given the wording of the business profits article in the majority of Ireland’s tax treaties, an approach that treats the permanent establishment as being a fictitious separate legal entity to which income and expenses are allocated as if it were an independent company is likely to be acceptable to the Irish Revenue Commissioners. There is no statutory basis for the calculation of profits to be allocated to a branch, but an approach that treats the Irish branch as a fictitious separate legal entity, similar to the approach taken for a permanent establishment, may be considered to be reasonable.

V  TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i  12.5 per cent tax rate for trading income
The cornerstone of Ireland’s attraction for foreign companies is undoubtedly the 12.5 per cent corporate tax rate. This applies to the income of a trade at least partly carried on in Ireland. There is no precise statutory definition of ‘trading’ or a ‘trade’, and it is therefore necessary to refer to relevant case law to determine whether a trade exists. A UK Royal Commission reported in the 1950s on a similar definition in the UK tax legislation and identified the relevant principles that are indicative of trading activity, known as the ‘badges of trade’. These include the length of the period of ownership of the relevant subject matter and the frequency of transactions that the relevant company enters into. It is important to note that the Irish Revenue Commissioners will also seek a minimum level of ‘substance’ or physical presence in Ireland.

ii  IP regimes
Irish tax legislation provides relief in relation to the acquisition of specified intangible assets, which include patents, copyright, registered designs, design rights or inventions, trademarks, trade names, brands, brand names, domain names, service marks or publishing titles, know-how and certain software. The definition of ‘specified intangible assets’ also includes the acquisition of ‘customer lists’ except where the lists are acquired directly or indirectly in connection with the transfer of a going concern. The relief is given by means of a capital allowance deduction available against trading income that is derived from activities that consist of the managing, developing or exploiting of the IP, including activities that comprise the sale of goods or services that derive the greater part of their value from the IP. The Finance
Act 2017 introduced an 80 per cent cap on the annual deductibility of capital allowances and related interest expense in relation to expenditure incurred on intangible assets on or after 11 October 2017.

A reward mechanism for key employees involved in R&D activities allows (where appropriate) a company to surrender part of its R&D tax credits to a qualifying employee to effectively enable him or her to receive part of his or her remuneration free from tax.

### iii Knowledge Development Box (KDB)

The Finance Act 2015 introduced a KDB, which provided for an effective 6.25 per cent rate of corporation tax on profits arising from qualifying assets, including certain patents and copyrighted software that are the result of qualifying R&D carried out by the company availing of the relief (i.e., the tax relief provides for an allowance of 50 per cent of the qualifying profits to be treated as a trading expense of the company, resulting in an effective 6.25 per cent tax rate on such profits). The definition of R&D is the same as that applying to the R&D tax credit, but only allows R&D expenditure incurred in another EU Member State to the extent it is tax deductible in Ireland. The KDB has been being promoted by the government as the first OECD-compliant preferential tax regime in the world.

### iv Holding company regimes

Ireland has a holding company regime that provides for an exemption from Irish tax on capital gains arising on a disposal of substantial shareholdings held by companies in subsidiaries. The exemption applies when the shares disposed of are in a company that is resident for tax purposes in the EU or in a country with which Ireland has signed a tax treaty. The Irish company must have held at least 5 per cent of the company whose shares are being sold for a period of at least 12 months ending in the previous 24 months; and the company whose shares are being sold, or the disposing company and all its 5 per cent affiliates taken as a whole, must be wholly or mainly involved in trading activities.

A parallel exemption applies with respect to options over shares and convertible securities, provided the disposing company is one that would be entitled to exemption on a disposal of shares.

### v Irish finance companies – recent extensions

Specific tax legislation was introduced a number of years ago to encourage the use of Ireland as a jurisdiction for locating finance vehicles. The asset classes that these companies are permitted to hold and manage include plant and machinery (e.g., aircraft), commodities and carbon credits as well as most forms of financial assets. A company coming within the relevant provision of the Irish tax legislation, Section 110, may be used advantageously in securitisations and in a wide range of finance transactions. The legislation effectively provides that where a relevant company falls within its ambit, its profits will be calculated as if it were carrying on a trade. As a result, expenses such as funding costs, payments made under hedging swaps and payments to services providers are generally deductible. The deductibility position is bolstered by two further specific statutory provisions. First, the normal distribution rules are modified to the extent that, broadly, the provision that recharacterises interest as a distribution (see below) does not apply to interest payable in respect of a debt obligation of a qualifying company where the interest is profit-dependent or excessive. Second, the statutory provision deals with the deductibility of bad or doubtful debts, and allows for a specific deduction in respect of such amounts to the extent they are not otherwise deductible under
general principles. It should be noted that some limited restrictions on deductibility were introduced in 2011; however, these would not affect the majority of structures. In addition, the Finance Act 2016 introduced further restrictions to interest deductibility, but again these are of limited application, affecting only debt instruments deriving most of their value from Irish real estate.

Notwithstanding the fact that profits are calculated on the assumption that the qualifying company is carrying on a trade for tax purposes, the taxable profit of that company is subject to tax at the higher corporation tax rate of 25 per cent. That higher rate of tax generally has little consequence, as most transactions entered into by a qualifying company are generally structured so that the deductions available to the company result in minimal taxable profit arising in the company.

Generally, to come within the provisions of Section 110 of the Irish tax legislation, a company must be resident for tax purposes in Ireland, and must acquire and manage or hold qualifying assets the market value of which, on the day it first acquires assets, is not less than €10 million. The definition of qualifying asset includes most types of financial assets, commodities, plant and machinery (including aircraft) and carbon offsets. A notification must be made by the company within eight weeks of the first acquisition of ‘qualifying assets’ to the Revenue Commissioners in relation to the company’s intention to be a qualifying company.

vi Tax-exempt regulated funds

Ireland is the largest hedge fund administration centre in the world, with the Irish funds industry servicing assets worth over €3 trillion held in over 13,000 funds. One of the principal factors in enabling Ireland to establish its position as a leading global fund jurisdiction is the tax neutrality of Irish-regulated funds.

There is a specific tax regime that applies to Irish-regulated funds, which is applicable to all types of funds that are established in Ireland and are authorised by the Central Bank of Ireland. These can include variable capital companies, unit trusts, investment limited partnerships and common contractual funds. The Irish Collective Asset Management Vehicles Act 2015 introduced a new corporate fund vehicle (ICAV) designed specifically for Irish investment funds to sit alongside the other existing fund structures. From a tax perspective, an important feature of the vehicle is that it is able to elect its classification under US ‘check the box’ taxation rules.

This tax regime treats all such funds (other than investment limited partnerships and common contractual funds) as resident in Ireland for Irish taxation purposes, but provides that the funds do not pay tax on their income or gains as they arise. Instead, it imposes an exit tax regime whereby an exit tax arises on the occasion of certain chargeable events arising in respect of investors. For the vast majority of investors, there is no actual Irish tax liability suffered through the investment in an Irish fund, since these chargeable events do not give rise to tax if the relevant investor is neither resident nor ordinarily resident in Ireland for Irish tax purposes.

Irish-resident or ordinarily resident investors (other than certain exempt residents, e.g., charities, pensions schemes) suffer an exit tax on the occasion of certain chargeable events. Such chargeable events are broadly:

\[ a \text{ income and other distributions;} \\
\[ b \text{ redemptions and repurchases of units by the fund;} \\
\[ c \text{ disposals of units by investors;} \\
\]

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deemed disposals occurring on each eight-year anniversary of an investor’s acquisition of units.

On these chargeable events, generally the fund is required to operate an exit tax. Where the chargeable event is an income or other distribution by the fund, tax will be deducted at a rate of 41 per cent or, where the investor is a company and the relevant declaration has been made to the fund, at a rate of 25 per cent. In relation to all other forms of chargeable events, tax will be deducted at a rate of 25 per cent for corporate investors where the relevant declaration has been made to the fund, and 41 per cent for all other types of investors. There are certain exemptions for fund reorganisations.

Exemptions applicable to Irish funds have also been introduced for indirect taxes. There is no stamp duty payable on the issue or transfer of units in a fund. There is an exemption from Irish inheritance tax and gift tax for gifts on inheritances between non-Irish residents of units in an Irish fund.

In general, no Irish VAT is suffered or payable by a fund in respect of investment management services, administration services or custodial services provided to it. There is a practice that can enable funds to recover any VAT paid by the fund in respect of supplies received by it by applying a specific formula either on the basis of the proportion of the assets of the fund that are outside the EU, or the proportion of investors that are outside the EU.

A real estate investment trust (REIT) regime was introduced by the Finance Act 2013 to complement the existing regulated fund regime. The introduction of the REIT regime provides investors with greater access to investments in regulated listed property vehicles. Broadly speaking, a publicly quoted REIT that meets certain conditions is exempt from tax at a corporate level. The profits of the REIT are instead subject to tax at shareholder level only.

The Finance Act 2016 introduced a 20 per cent withholding tax on certain payments by a non-UCITS fund that constitutes an Irish real estate fund (IREF) to certain investors. Broadly, an IREF refers to a non-UCITS fund where at least 25 per cent of the value of the fund (or sub fund in the case of an umbrella fund) derives from Irish real estate or assets that derive their value from Irish real estate.

vii State aid

IDA Ireland (IDA), one of Ireland’s principal inward investment promotion agencies, offers a range of services and incentives, including funding and grants, to companies considering an inward investment in Ireland.

The IDA will in certain cases offer capital grants that are available towards the cost of fixed assets including site development. Rent remissions and rent allowances may also be available. Grants may also be available to meet the cost of training workers in new projects, and there are a number of additional incentives available for companies undertaking R&D programmes in Ireland. The IDA owns several industrial parks with purpose-built factories and can also offer greenfield sites where promoters can erect custom-built facilities.

Employment grants may be available to a company where permanent full-time positions are created, and these are a commonly used IDA grant. The unique characteristics of any proposed project will determine the incentive package available, in particular its location. Employment grants are now mostly available for employment in the western and midlands regions of Ireland, and also in the areas that border Northern Ireland. The IDA evaluates
potential projects through a process of negotiation. Aside from location, amounts paid tend to depend on the level of investment involved, the activities undertaken and the skill level of the employee.

viii General

The ease of doing business in Ireland is an important factor for investors. It is to Ireland’s advantage that it is an English-speaking EU Member State (and will be the only English-speaking Member State apart from Malta after Brexit) and one with a common law legal regime. As a location, Ireland bridges the time zone gap between the East and West. In the World Bank ‘Doing Business 2018’ report, Ireland is ranked eighth in Europe and 17th in the world in terms of ease of doing business. A PwC ‘Paying Taxes 2018’ report has ranked Ireland first in Europe for ease of paying taxes. The Irish workforce is among the best educated in the world; the share of population aged 25 to 34 with a third-level qualification is higher than in the United States or the United Kingdom, and is above the OECD average.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)

Annual interest, patent royalties (however, see exemptions below), dividends and other distributions paid by an Irish-resident company are generally subject to withholding tax, currently at a rate of 20 per cent, absent an exemption. Withholding obligations are not generally imposed on non-patent IP royalties or on payments for the use of equipment, such as aircraft lease rentals.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

There are various exemptions under Irish domestic law applicable to interest and dividend payments. In particular, in the case of cross-border interest payments, interest will be exempt if it is paid:

- on quoted Eurobonds;
- by a company in the ordinary course of business to a company resident in an EU Member State (other than Ireland) or in a tax treaty country, provided that either the country generally imposes a tax on such interest receivable by the company or the interest is exempted under the relevant tax treaty. This exemption will not apply where it is paid in connection with a trade or business carried on in Ireland by the payee;
- by a securitisation qualifying company to a person resident in an EU Member State (other than Ireland) or in a tax treaty country, except where it is paid in connection with a trade or business carried on in Ireland by the payee; and
- on certain wholesale debt instruments for which the term is less than two years.

In the case of cross-border dividend or distribution payments, they will be exempt if paid by an Irish-resident company to:

- a non-resident individual resident in an EU Member State (other than Ireland) or in a tax treaty country;
- an EU company holding at least 5 per cent of the Irish company (Irish enactment of the Parent–Subsidiary Directive);
c a non-resident company that resides in an EU Member State (other than Ireland) or in a tax treaty country, provided that the company is not controlled by a person or persons resident in Ireland;
d a non-resident company that is ultimately controlled by a person or persons resident in an EU Member State (other than Ireland) or in a tax treaty country;
e a non-resident company whose principal class of shares is substantially and regularly traded on a stock exchange in Ireland or in an EU Member State (other than Ireland) or in a tax treaty country; or
f a non-resident company that is either a 75 per cent subsidiary of a company the principal class of shares of which is quoted and regularly traded on such a stock exchange, or that is wholly owned by two or more such companies.

The obligation to withhold tax and pay it to the Revenue Commissioners is placed on the company paying the dividend. With the exception of the application of the EU Parent–Subsidiary Directive, a shareholder who seeks to avail of an exemption must lodge an appropriate declaration with the paying company certifying that a particular exemption applies.

Patent royalties are also eligible for a domestic withholding exemption where the payments are made by a company in the course of a trade or business to a company resident in an EU Member State (other than Ireland) or in a tax treaty country. The payments must be made for bona fide commercial reasons to a company in a territory that generally imposes a tax on royalty payments receivable from outside that territory. The exemption does not apply where the royalties are paid in connection with a trade carried out in Ireland through a branch or agency by the receiving company.

In addition to the statutory exemptions from withholding on patent royalties, a further category of exemption can be obtained under an administrative statement of practice issued by the Revenue Commissioners. Permission for payment of patent royalties gross can be applied for where the recipient is not resident in the EU or in a tax treaty country once a number of conditions are satisfied. The royalty must be paid in respect of a non-Irish patent by a company in the course of its trade, and under a licence agreement executed and subject to law outside Ireland. There are restrictions on the recipient company, which must be the beneficial owner of the payment, and must be neither resident in Ireland nor carrying on a trade in Ireland through a branch or agency (even if that branch or agency is unconnected with the royalty payment).

iii Double tax treaties
Ireland has signed comprehensive double taxation treaties with 74 countries; 73 of those treaties are currently in effect. A new double taxation convention with Ghana was signed on 7 February 2018 and procedures to ratify the convention are under way. A new double taxation agreement with Kazakhstan was signed on 26 April 2017; the agreement entered into force on 29 December 2017 and into effect in Ireland on 1 January 2018.

In relation to outbound payments, generally the generous domestic withholding exemptions outlined above are relied upon rather than exemption under an applicable treaty, which often requires the authorisation of the Revenue Commissioners. In relation to inbound payments, the rates of withholding currently applicable under the Irish tax treaty network are set out in Appendix I.
iv  Taxation on receipt

Ireland generally operates a credit system rather than an exemption system, although, in the case of dividends, dividends received by an Irish-resident company are exempt if received from another Irish-resident company, or where the particular shareholding in the foreign company is less than 5 per cent and the dividends form part of the trading income of the Irish company. To the extent that dividends are received from companies resident in the EU, in a tax treaty country or in a territory that has ratified the Convention on Mutual Administrative Assistance in Tax Matters, and are payable out of the trading profits of such subsidiaries, those dividends are taxed in the hands of an Irish holding company at the lower 12.5 per cent rate. The lower rate may also apply to dividends paid out of the trading profits of companies resident in non-treaty countries where the company is owned by a publicly quoted company. In any other scenario, the 25 per cent rate should apply.

An Irish tax liability for dividends received from a foreign subsidiary may be reduced by any foreign withholding tax on the dividend and by an appropriate part of the foreign tax on the income underlying the dividend. This unilateral credit provision applies equally to countries that do not have a tax treaty with Ireland. The credit is not limited to first-tier tax, but to lower-tier companies having certain qualifying connections. The credit is available with respect to dividends from a 5 per cent shareholding in a foreign company. In such a case, the credit is available at a lower subsidiary level where the immediate relationship is at least 5 per cent and the Irish company itself also controls at least 5 per cent of the lower level company. Pooling of foreign tax credits is available to reduce the overall Irish tax bill when a company is in receipt of several foreign dividends, and excess foreign tax credits can be carried forward indefinitely.

A unilateral credit is also available to companies receiving royalties or interest as part of the income of a trade in respect of foreign tax suffered on the royalties or interest. This applies where no double tax treaty is in place to provide relief, or where the unilateral relief is greater than the provisions of an applicable double tax agreement.

VII  TAXATION OF FUNDING STRUCTURES

Irish companies are generally funded through a combination of debt and equity (and, by way of extension, ‘capital contributions’).

i  Thin capitalisation

Ireland does not have any general thin capitalisation rules. However, see below in relation to the reclassification of certain interest payments as non-deductible distributions. There are also some restrictions where related-party borrowings are used to purchase assets from another related party.

ii  Deduction of finance costs

A deduction is generally available for interest incurred by a company for the purposes of its trading operations, even where it may be suggested that the interest was incurred on capital account in the financing of a capital asset, rather than in the financing of current assets or general operations.

Interest incurred on borrowings of a company for the acquisition of shares of a trading company or of a company that holds shares in trading companies, or for lending to such companies, may also be deductible, subject to certain conditions being satisfied. Several
conditions are required to be satisfied, including that the borrowing company must beneficially own, directly or indirectly, more than 5 per cent of the relevant company, and must share at least one director with the company or a connected company. Restrictions apply to the recovery of capital by the borrower from the company, and anti-avoidance measures deny the interest relief in certain circumstances, such as certain wholly intra-group transactions and transactions where the purpose or one of the purposes of which is the avoidance of tax.

However, in certain circumstances an interest payment made by a company may be reclassified as a distribution for tax purposes, and no tax deduction will be available to the company in that instance. This can apply to interest paid on securities:

a. that are convertible into shares when they are neither quoted nor comparable to quoted convertible securities;
b. when the interest is profit-dependent or excessive;
c. that are held by a 75 per cent foreign parent company or affiliate that is not resident in an EU Member State (although, where the interest is paid in the ordinary course of a trade and the paying company makes an election, ‘interest’ treatment will apply to a company resident in a country with which Ireland has a treaty); or
d. ‘connected’ with shares.

iii Restrictions on payments

Under Irish company law, dividends can generally only be paid out of a company’s distributable reserves. These are its accumulated realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated realised losses, so far as not previously written off in a reduction or reorganisation of capital.

iv Return of capital

Irish company law permits a limited liability company to return share capital and acquire its own shares, provided this is from the company’s distributable reserves.

A court-approved reduction or repayment of share capital is possible when a number of statutory procedures are followed, the creditors of the company are adequately protected and the constitutional documents of the company allow for such a reduction. The court may refuse its consent in certain circumstances, for example where there is an infringement of class rights or where the reduction is not in the public interest.

In addition, the Companies Act 2014 includes a provision for a new ‘summary approval procedure’ to validate reduction in a company’s capital. This amended process offers an alternative to seeking court approval and is considered to be beneficial from a cost perspective.

Any payment made out of the assets of the company that represents a repayment of capital on shares is not treated as a distribution, whereas any payment in excess of the original capital subscription will be so treated. In certain circumstances, payments that would otherwise fall to be treated as a distribution can be treated instead as a capital payment and taxed under CGT rules.

In general, a payment made on the redemption, repayment or purchase of shares by a quoted company shall not be treated as a distribution unless made for tax-avoidance purposes. In the case of an unquoted trading company or unquoted holding company of a trading group, such a payment shall not be treated as a distribution subject to certain conditions. These include that the redemption, etc., must be for the purpose of benefiting a trade carried on by the company or by any of its 51 per cent subsidiaries, and must not be for tax-avoidance purposes. The vendor must also satisfy a number of conditions, which include
that it must be Irish resident, have owned the shares for a period of five years and satisfy a test of a ‘substantial reduction’ in shareholding where only part of its shares have been redeemed. The vendor must not be connected with the redeeming company after the redemption.

In addition, a reduction or reorganisation of share capital in exchange for a new holding may be treated as involving neither a disposal nor an acquisition of shares for capital gains purposes subject to certain restrictions.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

An Irish acquisition may be structured as an asset purchase or as a share purchase. Stamp duty is assessed on the transfer of Irish-registered shares at 1 per cent of the consideration, whereas the sale of business assets, subject to certain exemptions, may attract stamp duty at a rate of 6 per cent of the consideration due. Share sales are exempt from VAT. Irish asset sales are subject to VAT at rates of up to 23 per cent, although full VAT relief can be obtained where, broadly, the assets are being transferred as part of a transfer of a business.

In the case of a share purchase, Irish stamp duty will be charged on the acquisition of shares in an Irish company regardless of whether the acquisition company is established in or outside Ireland. It may be advantageous to use an Irish company as the acquisition company, given that dividends received by it from another Irish tax-resident company are generally tax-exempt in Ireland. The use of such an acquisition vehicle may also allow for the Irish substantial shareholdings capital gains exemption to be availed of. In addition, it is possible to surrender qualifying interest deductions as a charge within a group in certain circumstances (i.e., from the acquisition vehicle to the target company).

Even if the acquisition company is internationally held it is likely that, given the extensive exemptions from Irish dividend withholding tax, dividends may be paid by the Irish company free of dividend withholding tax. The use of a non-Irish tax resident acquisition vehicle will usually avoid a gain on the disposal of the stock unless its value is derived principally from Irish land or mineral rights.

In an asset acquisition, if the business is intended to be carried on in Ireland after the acquisition it may be preferable to use an Irish acquisition company, as the carrying on of the Irish business by a non-Irish tax-resident company is likely to bring it within the charge to Irish tax by virtue of carrying on a business in Ireland. The non-Irish resident acquisition company could be potentially liable to both Irish and foreign tax on the Irish business income.

ii Reorganisation

Mergers of Irish companies into other companies are possible under Irish law. It is also possible to merge companies in two EU Member States under the provisions of the Cross-border Mergers Directive, and reorganisations are generally done by way of a share-for-share exchange, or business assets for shares, sometimes combined with a liquidation of one of the companies.

Reliefs from Irish stamp duty and CGT (at company and shareholder levels) are generally available for share-for-share exchanges and for intra-group business asset transfers.

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2 2005/56/EC.
Since 2012, stamp duty relief has also been available for instruments of transfer pursuant to certain mergers, including cross-border mergers. CGT relieving provisions for certain cross-border mergers are also available. Under the Companies Act 2014, new procedures based on the Cross-Border Merger Regulations enable two Irish registered private companies (one of which must be a ‘ltd’ company) to merge, so that the assets and liabilities of one company are transferred to another and the transferring company is dissolved. This can be effected by using the summary approval procedure or court approval.

iii Exit

In his Budget 2018 speech, the Minister for Finance introduced an exit tax regime effective from 10 October 2018. The rules impose a tax on unrealised capital gains where companies migrate their tax residency and on certain other transactions outlined below.

Under the Finance Bill 2018, the charge applies at the standard corporate tax rate of 12.5 per cent with an exception for scenarios where the event triggering the tax is part of a transaction designed to ensure the gain is taxed at 12.5 per cent rather than the standard capital gains tax rate of 33 per cent. This is an anti-avoidance provision that ensures that a rate of 33 per cent rate applies if the event is for the purpose of ensuring that the gain is charged at a lower rate.

Broadly, the tax occurs where:

a a company resident in another Member State transfers assets from its Irish permanent establishment to another territory;

b a company resident in another Member State transfers a business (including the assets) carried on by its Irish permanent establishment to another territory; or

c an Irish-resident company ceases to be tax resident in Ireland.

Exit tax is not triggered if the assets of an Irish resident company continue to be used in Ireland by a permanent establishment of the company after the company has migrated.

There is an option available in certain instances for the exit tax to be deferred by paying it in instalments over five years.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

A general anti-avoidance provision is contained in tax legislation that denies tax advantages to transactions that are carried out primarily to create an artificial tax deduction, or to avoid or reduce a tax charge. Where a transaction is undertaken with a view to the realisation of profits in the course of a business carried on by a taxpayer and not primarily to confer a tax advantage, it will not be a tax-avoidance transaction. Nor will a transaction be a tax-avoidance transaction where it was arranged to obtain the benefit of any relief or allowance available under the Irish tax legislation that does not result in a misuse of the relevant provision.

Where a tax avoidance transaction is found to exist, the Revenue Commissioners may disallow any tax advantage arising as a result of the transaction and interest, and a surcharge may apply on any tax payable. A taxpayer may make a protective notification to the Revenue Commissioners in respect of a transaction within 90 days of beginning a transaction in circumstances where that taxpayer feels that there may be a risk that the transaction may be
regarded by the Revenue Commissioners as a tax-avoidance transaction. Making a notification will protect the taxpayer from the potential application of interest and a surcharge should the Revenue Commissioners take such a view.

There is also a separate mandatory disclosure regime, which requires the promoters of tax schemes that have certain characteristics to disclose them to the Revenue Commissioners shortly after they are first marketed or made available for use.

The Finance Act 2014 replaced the existing general anti-avoidance provisions with new provisions that update the administrative measures; these do not significantly move away from the existing principles, except that the process under which the Revenue Commissioners have the power to withdraw a tax advantage have been simplified.

ii Controlled foreign corporations (CFCs)

In his Budget 2018 speech, the Minister for Finance confirmed that the CFC rules will apply for accounting periods beginning on or after 1 January 2019. The CFC rules introduce additional compliance measures on Irish-headquartered groups and on international groups that have located their regional headquarters and holding structures in Ireland.

Ireland has chosen to adopt the transitional framework under the Anti-Tax Avoidance Directive (ATAD) that applies transfer pricing principles in determining whether profits of a low-taxed CFC should be taxed in Ireland. The general thrust of the regime is to assess an Irish company with a CFC charge based on an arm’s-length measure of the undistributed profits of the CFC that are attributable to the activities of significant people functions (SPFs) carried on in Ireland.

Under the Finance Bill 2018, the rules require an analysis as to the extent to which the CFC would hold the assets or bear the risks that it does were it not for the controlling company undertaking the SPFs in relation to those assets and risks. In line with ATAD a number of exemptions are provided, including exemptions for CFCs with low profits or a low profit margin and an exemption where the essential purpose of the arrangements is not to secure a tax advantage. A one-year grace period is also allowed in respect of newly acquired CFCs where certain conditions apply.

iii Transfer pricing

Ireland has transfer pricing rules that apply to trading transactions between associated persons where the receipts are understated or the expenses overstated. The rules are not applicable to small and medium-sized enterprises. The introduction of transfer pricing rules in Ireland aligns the Irish Tax Code with best international practice by adopting the OECD Transfer Pricing Guidelines. Under grandfathering arrangements, related-party arrangements entered into before 1 July 2010 fall outside the scope of the rules. New transfer pricing rules were agreed at the OECD in May 2016. In accordance with the Coffey Report recommendation (a government commissioned review of the Irish corporation tax code), Ireland is expected to adopt the 2017 OECD transfer pricing guidelines.

iv Tax clearances and rulings

Ireland does not have a formal system of ‘rulings’ from the Revenue Commissioners. However, the Revenue Commissioners may issue informal pre-transaction opinions where clarity is sought in relation to complex issues arising, for example, regarding corporate restructurings or new inward investment projects, provided that they are given detailed and full information on the matter in respect of which the ruling is sought. The opinions of
the Revenue Commissioners are not legally binding, and it is open to them to review their position when a transaction is complete and all the facts are known. However, where full disclosure of all the relevant facts and circumstances has been made by the taxpayer and an opinion has been issued, it is likely that the Revenue Commissioners would be estopped from resiling from their opinion.

X YEAR IN REVIEW

Changes to Ireland’s tax legislation in 2018 continued to emphasise Ireland’s commitment to job creation, and attracting and retaining investment, particularly in the context of Brexit.

The government has continued to reiterate its commitment to maintaining the 12.5 per cent corporation tax rate on trading profits, which is beyond doubt the cornerstone of the Irish corporation tax policy. In September 2018, it published ‘Ireland’s Corporation Tax Roadmap’. The Roadmap outlined Ireland’s actions to date in the context of the changing international tax environment (e.g., introduction of country-by-country reporting by the Finance Act 2015, compliance with new international best practice by the Global Forum on Tax Transparency and the Exchange of Information, the implementation of DAC3). It also set out the next steps in Ireland’s implementation of the various commitments it has made through EU directives and the OECD BEPS reports. In particular, the Roadmap signposted the following:

a CFC rules (BEPS Action 4 and ATAD Article 4) – legislation is being introduced in the Finance Bill 2018 to introduce CFC rules with effect from 1 January 2019;

b Multilateral Instrument (MLI) (BEPS Actions 2, 5, 6, 14 and 15) – the final legislative steps required to allow Ireland to complete ratification of the MLI are being taken in the Finance Bill 2018;

c interest limitation rules (BEPS Action 4 and ATAD Article 4) – given the complexity of Ireland’s existing interest limitation rules any transposition could potentially advance at the earliest to the Finance Bill 2019;

d transfer pricing rules (BEPS Actions 8–10 and 13) – legislation will be introduced in the Finance Bill 2019 to update Ireland’s transfer pricing rules; and

e mandatory disclosure rules (BEPS Action 12 and DAC 6) – legislation will be introduced in the Finance Bill 2019 to ensure Ireland fully implements the DAC6 Directive.

XI OUTLOOK AND CONCLUSIONS

The increase in inward investment witnessed in recent years continued into 2018, and reflects Ireland’s commitment to attracting dynamic, innovative and technology-based business investment.

In 2011, the Prime Minister launched a five-year plan for Dublin’s International Financial Services Centre with a view to creating 10,000 new jobs in this highly skilled area over a five-year period.

According to PwC’s 2017 Irish CEO Pulse Survey, multinational corporations operating in Ireland remain confident about their Irish investments, with an overwhelming majority (96 per cent) of multinational CEOs confirming that their investment in Ireland is a success.
Forty-two per cent indicated that they anticipate additional capital investment over that of last year. Meanwhile, 49 per cent of Irish companies now plan to expand their workforce, compared to just over one-third (34 per cent) in 2013.

Evidence of these trends is provided by companies such as PayPal, Boston Scientific Corporation, Analog Devices, Dell, McAfee, Accenture, Amgen, Deutsche Bank, BNY Mellon, Symantec and Ericsson undertaking expansions of their Irish operations, and by companies such as Twitter, Google, LinkedIn, Facebook, Zynga and many other major internet companies opening their European headquarters in Ireland in recent years.

The optimistic outlook is no doubt tempered by the recent economic difficulties and continuing uncertainty regarding Brexit negotiations. However, Ireland is making strides in addressing its challenges while still retaining its long-standing status as an excellent place to do business.
### Appendix I: Treaty rates for dividends, interest and royalties (per cent)

<table>
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<th>Dividends</th>
<th>Interest</th>
<th>Royalties</th>
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Chapter 15

ISRAEL

Meir Linzen

I  INTRODUCTION

Israel has witnessed significant progress in its economy and capital markets in recent years. As evidence of its economic progress, Israel became a member of the OECD in 2010, placing Israel alongside the advanced economies of the world. While some economies have contracted in recent years, Israel’s GDP grew by 4 per cent and 3.2 per cent in 2016 and 2017 respectively, and it is expected to have further grown in 2018.

As discussed further below, the Israeli tax system is relatively advanced, and includes both direct and indirect taxes. The income tax law is governed by the Israeli Income Tax Ordinance (New Version), 5721-1961 (the Ordinance), which was significantly amended in 2003. Specifically, new provisions were added to the Israeli international tax regime to address the increased sophistication of the Israeli economy with respect to both inbound and outbound investments.

II  COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i  Corporate

The most common entity for operating a trade or business in Israel is the company limited by shares, which may be private or public. The shares of a public company are listed on a stock exchange or offered to the public pursuant to a prospectus. A private company is any company other than a public company.

In general, the Israeli corporate tax regime involves two-tier taxation: first, at the company level; and second, upon dividend distribution, at the shareholder level. Dividend income is subject to income tax at lower rates than ordinary income.

ii  Non-corporate

A partnership is a pass-through entity that is not subject to tax. While only the partners of the partnership are subject to tax in respect of its income, the taxable income is determined at partnership level. Partnerships are widely used in the case of private equity firms and hedge funds.

In a general partnership each partner is liable for all the liabilities of the partnership. In a limited partnership, the limited partners are liable only to the extent of their contribution

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to the partnership. A limited partnership must have a general partner, who has unlimited liability; only the general partner is allowed to participate in the management of the limited partnership.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

Israeli companies are taxed in Israel on their worldwide income. Foreign (i.e., non-Israeli) companies are subject to tax in Israel only with respect to their Israeli-sourced income.

The tax base for the Israeli corporate tax is the company’s net income as determined under Israeli accounting principles and adjusted in accordance with the provisions of the Ordinance and regulations. As a general rule, Israeli companies must report their income for accounting and tax purposes according to the accrual method of accounting. Corporate tax is generally assessed for the calendar year.

Expenses are deductible only if they are incurred in the production of taxable income. Expenses that were not incurred in the production of income, such as private expenses, are not allowed as a deduction.

In most cases, the assets of a business are depreciated for tax purposes pursuant to the straight-line method of depreciation. The annual depreciation amount is calculated based on a percentage of the cost of the asset, depending on the type of asset. Subject to the aforementioned general rule, depreciation deductions are allowed only with respect to assets used in the production of income.

There are differences between the accounting rules and the tax rules, which are set out in the Ordinance and the regulations. The principal differences are as follows:

a rate of depreciation and amortisation;

b certain kinds of expenses being limited in respect of the ability to be deducted from income, such as expenses attributable to overseas travel, car expenses and similar expenses that are determined under relevant regulations; and

c accounting income that derives under the grouping rules being eliminated for the purpose of the tax return.

Capital and income

Special rules apply in the case of the recognition of capital gains and losses by Israeli companies. These rules are set out in Part E of the Ordinance. The corporate tax rate is equal to the tax rate imposed on real capital gains derived by a company. As of 2018, this tax rate is 23 per cent. Capital gains and losses arising from real estate transactions located in Israel (including real estate associations) are taxed in accordance with the Real Estate Taxation Law (Capital Gains and Purchase) 1963.

Losses

The losses a company recognises from a trade or business may be used to offset any other income recognised by the company in the same tax year. Ordinary losses can be used against capital gains; however, capital losses are not allowed to be used against ordinary income. The losses of a company from foreign sources can only be used against foreign-sourced income,
pursuant to a ‘basket’ system (e.g., passive loss can only be used to deduct passive income). Net operating losses of a company may be carried forward; however, they are not allowed to be carried back. There is no limitation on the carry-forward period.

While net operating loss carry-forwards survive a company’s change of ownership, the courts in Israel held that when the sole objective of the acquisition of the company’s stock was the use of its loss carry-forwards, such losses will not be allowed to be used against income recognised by the company following the change of ownership. The courts based their decisions on the anti-avoidance provisions of Section 86 of the Ordinance, which is discussed below.

Rates
The tax rate on corporate profits in Israel decreased to 23 per cent in 2018. The rate of corporate tax on profits derived from a ‘preferred enterprise’ may be either 7.5 or 16 per cent (depending on the location of the enterprise), and for a ‘special preferred enterprise’ – either 5 or 8 per cent, as further discussed below. Income derived from a ‘preferred technological enterprise’ will be subject to a tax rate of 7.5 per cent or 12 per cent (depending on the location of the enterprise), and a ‘special preferred technological enterprise’ will be subject to tax rate of 6 per cent (regardless of its location).

Administration
Israel has a single tax authority that is responsible for collecting both the direct and indirect taxes. A municipal tax is imposed on real property by local authorities.

Corporate tax is generally assessed for the calendar year; however, the greater part of the tax is paid during the tax year through estimated advance payments. The final tax payment is made, together with the filing of the annual tax return, by 31 May following the end of the tax year. It is possible, in certain circumstances, to obtain an extension for the filing and payment deadline.

Within four years, and in certain circumstances five years, from the year in which a return was filed, the assessing officer may audit the company’s tax return. The assessment of the officer may be appealed to another officer within the same local office. The decision of the second officer is subject to appeal to the district court. The decision of the district court may then be appealed to the Supreme Court.

Tax grouping
Consolidated tax returns are not allowed under Israeli law; an exception applies, however, in the case of an Israeli-resident ‘industrial’ company or a company that is a holding company of industrial companies. An industrial company is a company that receives at least 90 per cent of its revenues from an industrial facility engaged in manufacturing activities. An industrial company, or an industrial holding company, may file a single consolidated tax return in respect of itself and its subsidiaries, which are by themselves industrial companies, provided that all the industrial companies included in the consolidated group are part of a single assembly line or manufacturing process. An industrial holding company that has subsidiaries engaged in different assembly lines is entitled to consolidate its return only with the company or companies having a single assembly line in which it has the largest capital investment.
ii Other relevant taxes

Israel has a value added tax (VAT) charged on transactions in Israel and on the importation of goods into Israel, the standard rate of which is currently 17 per cent (as from 1 October 2015). A transaction that is a sale of goods is deemed to take place in Israel if, in the case of a tangible asset, it was delivered in Israel or exported, and if, in the case of intangible assets, the seller is an Israeli resident. Certain transactions are subject to a zero-rate tax (principally exports of goods and services) or exempt (such as certain financial services and certain real estate transactions). Financial institutions are subject to a profit tax and a tax on paid salaries (salary tax), both at a rate of 17 per cent, subject to certain adjustments. Businesses are entitled to recover input VAT costs in connection with goods or services used by the business to create their taxable (including a zero-rated) supply.

Israel imposes customs duties on certain imported goods and sales tax on certain imported and domestic goods. Israel also imposes various duties, such as trade levies and dumping levies, pursuant to the Trade Levy Law.

Israel also imposes an additional 3 per cent ‘wealth tax’ on taxable income and gains in excess of 640,000 new Israeli shekels (adjusted yearly for inflation, 641,880 new Israeli shekels as of 2018).

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

A company is considered a resident of Israel if it was incorporated in Israel, or, if it was incorporated abroad, if it is managed and controlled in Israel. The management and control test is based on a similar test under the tax laws of the UK. Pursuant to guidance published by the Israeli Tax Authority (ITA), a company is managed and controlled in the place where the business strategy of the company is determined. For that purpose, it should be considered where, as a factual matter, the principal substantive business decisions of the company are made. While the place where the board of directors holds its meetings is an important factor, it is not determinative, especially in a case where the board authorises another organ of the company to manage the company. In a 2012 Supreme Court case, which is the main case that deals with the issue of management and control, the managers of a foreign company acted as an artificial platform for conducting the business of the Israeli company and were not involved, in a substantive sense, in the foreign company’s business management, the foreign company was regarded as having been managed and controlled from Israel (see the further discussion below).2

ii Branch or permanent establishment

The taxable profits of a local branch of a foreign company are generally calculated by reference to the income and deductions attributable to the branch under the assumption it operates as an independent business unit and in accordance with transfer pricing rules. The Ordinance,

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2 CA 3102/12 Niago v. Kefar Sava Assessing Officer, Missim 26/1 (February 2012) E-12. Additional Israeli case law deals with this issue. See, for example, CA 805/14 Yanko Weiss Holdings v. Holon Assessing Officer, Missim Online (October 2015), which overturns the District Court, but does not seem to argue with the Control and Management question. See also ITA 32172-05-13 Shai Tzamorot Company v. Petah Tikvah VAT Commissioner, Nevo (November 2015).
however, does not include specific rules regarding the taxation of a branch or the allocation of income and expenses to a branch in Israel. In addition, there is no branch profits tax in Israel. In some relatively rare cases, however, the profits of a non-resident company that qualifies as a foreign investment company, derived from its Israeli enterprise may be subject to a 15 per cent tax rate in addition to the corporate tax that applies to such profits. The 15 per cent tax may be deferred if it is demonstrated that such profits remain in Israel and are used for the purpose of the company’s business in Israel. In any event, this 15 per cent tax is relevant only to certain enterprises that were already in existence prior to 2011.

It should be noted that the ITA has recently published a circular regarding the taxation of non-Israeli corporations’ activities in Israel through the internet. Under this circular, the ITA expresses its opinion that certain activities made through the internet may be sufficient to give rise to a permanent establishment in Israel, both for corporate tax and VAT purposes.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes

Since 1 January 2006, corporations that are classified as Israeli holding companies (IHCs) have been entitled to a participation exemption. The tax benefits available to an IHC include the following:

- dividends which the IHC receives from its subsidiaries are tax-exempt;
- capital gains from the sale of subsidiaries are tax-exempt;
- dividend distributions from the IHC to its foreign shareholders are subject to a reduced withholding rate of 5 per cent; this benefit does not apply to Israeli shareholders of the IHC;
- interest income, dividends and capital gains that the IHC receives from securities that are traded on the Tel Aviv Stock Exchange are tax-exempt;
- interest received from certain financial institutions is tax-exempt; and
- the IHC is not subject to the Israeli-controlled foreign corporation regime.

To qualify as an IHC, inter alia, the company must be registered, and managed and controlled in Israel. The company must be a private company and invest at least 50 million new Israeli shekels in its subsidiaries, which should constitute 75 per cent or more of the total investments of the holding company. At the subsidiary level, it is required that the subsidiary resides in a treaty country or in a country with at least a 15 per cent corporate tax rate. In addition, it is required that 75 per cent or more of the subsidiary’s income will be derived from a trade or business. Moreover, the subsidiary may not hold more than 20 per cent of its assets in Israel or derive more than 20 per cent of its income from within Israel.

ii IP regimes

The Israeli Innovation Authority (IIA) (formerly known as the Office of the Chief Scientist of the Ministry of Economy (OCS)), which operates under the Law for the Encouragement of Industrial Research and Development, 5744-1984, supports R&D projects of Israeli companies by way of financial support. The extent of the IIA funding depends on the R&D project, the location of business, the rate of the local production and its contribution to research in Israel. In general, an IIA-funded company has to repay the IIA funding it received and the accrued interest by way of royalty payments from its sales. In addition, the know-how
that is developed in connection with the IIA funding and any right therein cannot be shared with or transferred to others without the approval of the IIA and subject to the conditions set in the law, which include in some cases payments to the IIA.

### iii  State aid

Various investment incentives are outlined in the Law for the Encouragement of Capital Investment 5719-1959, which was materially amended and simplified in 2011 (Encouragement Law) and further amended in 2017. As of January 2011, the incentives under the Encouragement Law are directed towards corporations deemed ‘preferred companies’. A ‘preferred company’ is entitled to a reduced corporate tax rate with respect to its ‘preferred income’ generated by its ‘preferred enterprise’. The tax rates for preferred enterprises, depending upon where they are located, have been 9 or 16 per cent since 2014 and have been reduced to 7.5 or 16 per cent as of 2017. More significant reductions in the corporate tax rate apply to companies that have a ‘special preferred enterprise’ the profits of which are subject to corporate tax rate of 5 or 8 per cent. It should be noted that under certain conditions, a ‘preferred enterprise’ may also be entitled to a grant in an amount of up to 20 per cent of the investment in tangible fixed assets. In addition, reduced tax rates of 7.5 per cent or 12 per cent, may be available for preferred technological enterprises, and a tax rate of 6 per cent for a special preferred technological enterprise. It should be noted that a preferred technological enterprise may be entitled to a reduced capital gains tax in the case of a sale of an intangible asset that it has imported into Israel.

In addition, it should be noted that as of 2017, the calculation of the income to which the preferred enterprises have benefited may trigger certain issues, owing to a ‘nexus mechanism’ that was introduced in the 2017 amendment, in order to ensure that the Israeli regime that provides state aid is consistent with the international rules regarding such regimes. For this purpose, a ‘preferred enterprise’ is defined as an industrial enterprise that meets at least one of the following conditions:

- **a** it operates in the field of biotechnology or nanotechnology, having received the approval of the head of the Research and Industrial Development Administration;
- **b** its income from sales in a particular market does not exceed 75 per cent of its total income in a given tax year; or
- **c** 25 per cent or more of its total income in a given tax year derives from sales in a particular market to at least 14 million residents (this increases on 1 January of each tax year by 1.4 per cent in relation to the number of residents as compared to the previous year).

‘Special preferred enterprises’ are enterprises that have preferred yearly incomes of at least 1.5 billion new Israeli shekels and belong to companies with preferred yearly incomes of at least 20 billion shekels. To obtain such status, an enterprise’s business plan must include either certain minimum investment levels in production assets, R&D investment or the employment of a minimum number of workers – all based on the location of the enterprise.

‘Preferred technological enterprise’ is an enterprise that meets the following conditions:

- **a** the conditions stated above with respect to preferred enterprise;
- **b** the R&D condition stated in the Encouragement Law (namely, the enterprise’s R&D expenses in each of the preceding three tax years were at least 7 per cent of its income or exceeded 75 million new Israeli shekels); and
- **c** it meets one of the following:
• at least 20 per cent of the enterprise’s employees are R&D employees, or it has at least 200 R&D employees;
• a venture capitalist has invested at least 8 million new Israeli shekels in the enterprise;
• the enterprise’s income has increased in the preceding three tax years by at least 25 per cent (this only applies where the income in the tax year and the three preceding years was higher than 10 million new Israeli shekels); or
• the company employed, on an average basis, 25 per cent more employees in the preceding three years (this only applies where the enterprise employs at least 50 employees in the tax year and the three preceding years).

Alternatively, an enterprise may be entitled to a preferred technological enterprise status based on an approval from the IIA.

A ‘special preferred technological enterprise’ is an enterprise that meets the conditions mentioned above with respect to preferred technological enterprise and is a member of a group of companies that has an income which in aggregate exceeds 10 billion new Israeli shekels or more.

iv General
Capital gains recognised by a foreign resident on the sale of securities that are publicly traded in Israel are exempt from tax in Israel, provided that the capital gains are not attributable to a permanent Israeli establishment. However, this exemption does not apply to capital gains derived from the sale of short-term government bonds with a maturity of up to 13 months and to future transactions, the underlying assets of which are directly or indirectly short-term government bonds.

In addition, a foreign resident who acquired the stock of an Israeli company after 1 January 2009 will often be exempt from tax in Israel on the sale of the stock.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS
i Withholding on outward-bound payments (domestic law)
As of 1 January 2012, dividend distributions paid by an Israeli resident company to a non-resident individual are generally subject to withholding tax at a rate of 25 per cent (30 per cent in the case of a payment to a person who owns 10 per cent or more of the company’s stock – a ‘substantive shareholder’). Dividend distributions to foreign corporations are subject to withholding tax of 30 per cent if the foreign corporation is a substantial shareholder of the Israeli-resident company (which holds more than 10 per cent) and 25 per cent if it is not such a substantial shareholder.

As a general rule, interest paid by a local company to a non-resident is generally subject to withholding tax at a rate of 25 per cent or 50 per cent in the case of a payment to a person who owns 10 per cent or more of the company’s stock.

Royalties paid by an Israeli company to a non-resident are subject to withholding tax at a rate of 25 per cent.
ii  Domestic law exclusions or exemptions from withholding on outward-bound payments

In the case of a dividend by a preferred enterprise, a reduced rate of withholding tax of 20 per cent applies. Lower rates may apply in the case of a special preferred enterprise, preferred technological enterprise or a special preferred technological enterprise, under certain conditions set under the Encouragement Law.

As noted above, the ‘participation exemption’ applies in the case of dividend distributions to an IHC. However, dividend distributions from the IHC to its foreign shareholders are subject to reduced withholding rates of 5 per cent. Interest may also be exempt from withholding tax in certain circumstances. For example, interest income paid to a foreign resident with respect to publicly traded bonds of a company that is listed in Israel is tax-exempt in Israel as long as the foreign resident owns less than 10 per cent of the stock of the Israeli company, is not related to the Israeli company, and no special relationship exists between the foreign resident and the Israeli company. In addition, interest received by a foreign resident with respect to publicly traded bonds that were issued by the government will usually be exempt from tax in Israel to the extent that they are not repayable within 13 months of the date that they are issued.

iii  Double taxation treaties (DTTs)

As of 2018, there are approximately 50 DTTs to which Israel is a party and that are in force in Israel. Israel’s DTTs generally follow the OECD model with the exception of a number of treaties (with the United Kingdom, Norway and Sweden) that were signed in the 1960s and the 1970s, before the OECD model was widely accepted. In 2017, new treaties with Germany and Canada came into force. In 2018, a new treaty with Azerbaijan was ratified and came into force as of 1 January 2018, and a new treaty with Austria was also ratified and came into force on 1 January 2019. A new treaty with Macedonia has been signed but has not yet been ratified.

iv  Taxation on receipt

Dividend distributions received by an Israeli company are not subject to tax in Israel as long as the distribution is attributable to Israeli-sourced income and was subject to corporate tax in Israel. The distribution should be subject to tax at a rate of 23 per cent if it is attributable to foreign-sourced income. The Israeli company may claim as credit foreign taxes paid with respect to the distribution pursuant to one of the following methods:

a  Direct credit, where the Israeli company may claim credits with respect to foreign withholding tax paid on the dividend distribution. In this case, the dividend distribution will be subject to a 23 per cent tax rate in Israel.

b  Indirect credit, where the Israeli company may claim credits with respect to both allocable share of the foreign taxes paid by the distributing company on its foreign source income and the foreign withholding tax paid on the dividend distribution. In this case, the dividend distribution will be subject to the regular corporate tax rate in Israel (which is also 23 per cent).
VII TAXATION OF TRUSTS

i Amendments to the taxation of trusts

While there were no further significant amendments regarding the taxation of trusts during 2018, it should be noted that on 1 January 2014, the law significantly changed the regime for the taxation of trusts in Israel. The main change was the cancellation of the ‘foreign settlor trust’ regime. Under previous legislation, trusts that were settled by foreign residents were generally tax-exempt in Israel, even after the settlor’s demise. Furthermore, distributions to Israeli-resident beneficiaries were exempt from tax.

As of 1 January 2014, these trusts are tax-exempt in Israel only to the extent that all their beneficiaries are foreign residents. If a trust that was settled by foreign residents who is still alive has Israeli beneficiaries, then the trust will be subject to tax in Israel on distributions either at a rate of 30 per cent, or at a rate of 25 per cent on its current income allocated to Israeli beneficiaries, if an irrevocable election is made, provided that the settlor is still alive and is a relative of all the beneficiaries. If either of these criteria is not met, then the trust will be subject to tax on its entire worldwide income at the applicable rates.

VIII TAXATION OF FUNDING STRUCTURES

i Thin capitalisation

There are no thin capitalisation rules under Israeli domestic tax rules.

ii Deduction of finance costs

Subject to the general rule regarding the deduction of expenses, interest expenses will be allowed as a deduction only if they are paid with respect to capital that is being used in the production of income. Recent Supreme Court verdicts have further ratified this position.

iii Restrictions on payments

A company may make dividend distributions only if it meets the following two requirements. First, the company is allowed to distribute only out of its retained earnings and profits. Second, there must be no reasonable risk that the dividend distribution will cause the company to be in a position where it is unable to pay its debts (outstanding and foreseeable) as they become due. The distribution in this case is not allowed unless a court approved the distribution.

iv Return of capital

As noted above, a company is not allowed to make a distribution to its shareholders unless it has retained earnings and profits, or if a court has approved the distribution. In such a case, according to the ITA’s position the return of capital may be regarded as a dividend to the shareholders.

IX ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

In most cases, it is advisable that a foreign person hold the stock of an Israeli company, particularly when the stock of the Israeli company is intended to be sold. As noted above, capital gain on the sale of the stock of an Israeli company by a foreign resident is exempt
from tax in Israel if the stock was acquired after 1 January 2009. It is advisable to use an Israeli company as the acquisition vehicle if it is intended that the target company will make substantial dividend distributions following the acquisition, because dividend distribution between two Israeli companies are not generally subject to tax in Israel.

It is important to note, however, that the exemption does not apply in cases where:

- the capital gain can be attributed to a permanent establishment of the seller in Israel;
- the securities were acquired from the seller’s relative;
- the securities are traded on an Israeli Stock Exchange when the shares are sold; or
- on the date of acquisition of the securities and during the two-year period preceding the sale, the ‘primary value’ of the securities was derived, directly or indirectly, from one of the following:
  - property rights or rights in a ‘real property association’ (i.e., a company whose asset’s primary value is real property assets), including long-term leases;
  - rights to use real property or any asset attached to real property in Israel;
  - a right to exploit natural resources in Israel; and
  - a right to benefit from real property situated in Israel.

The last of the above exceptions follows an amendment to the Ordinance that took effect on 1 August 2013. Prior to the amendment, the exception applied only if the assets were real property (or rights in a real property association) as narrowly defined under Israeli law. The term ‘primary value’ is not explicitly defined in the Ordinance, but should be interpreted as 50 per cent or more of the assets of the company whose shares are being sold.

On 20 July 2014, the ITA issued a circular, which provides its interpretation of an amendment that came into force in August 2013. The circular includes, *inter alia*, the following interpretations:

- the ‘right to use real property or any asset attached to real property’, which includes the following:
  - the right to use real property or any asset attached to real property; and
  - direct or indirect rights in concessions for the provision of services (public private partnerships), for example, the rights to use buildings such as industrial factories or residential homes;

- the ‘right to benefit from real property situated in Israel’, which includes the following:
  - benefits derived from solar energy, wind turbines, etc.;
  - power stations from water desalination;
  - right to extract geothermic energy; and
  - any recurring or renewable right stemming from the use of land.

As a result of the limitations on the deduction of interest expense, the acquiring group would only recognise limited Israeli tax benefits by funding the acquisition with debt. In this regard, generally, debt drop-down should generally be treated as a dividend distribution for Israeli tax purposes.

Because only a limited number of transactions would qualify as a tax-free reorganisation, as discussed below, very often cash presents the principal consideration in the transaction. Generally, the selling shareholders should be subject to tax with respect to deferred consideration only upon receipt of such consideration.
ii Reorganisation

Part E2 of the Ordinance includes the principal rules regarding reorganisations, including spin-offs. On 6 August 2017, amendments to the Israeli tax-free reorganisation law were published (the Reform). This legislation relaxes many restrictive limitations previously imposed by the law. The Reform expands the availability of Israeli tax-free corporate reorganisations, such as mergers, divisions, stock-for-stock exchanges, and other forms of intra-group asset transfers. According to the new legislation, to qualify as a tax-free merger, a transaction has to meet various requirements, which include, inter alia, the following:

a immediately after the reorganisation, all of the shareholders that participated in the merger are required to hold 100 per cent of the acquiring company rights, and during a prescribed period, their holding rate in the acquiring company shall not be less than 25 per cent (instead of generally 50 per cent under the prior law);
b the reorganisation must have a valid business purpose;
c the reorganisation has to meet certain continuity of business requirements, which means that the acquiring company has to hold at least 50 per cent of the assets of the target company;
d the value of the acquiring company cannot exceed nine times the value of the target company (as opposed to generally four times the value, which used to be the case prior to the reform); and
e the reorganisation plan has to receive the prior consent of the tax authorities. In this regard, the prior approval of the tax authorities is required if the parties to the reorganisation include foreign companies. The reform sets out some reliefs from the need to obtain a pre-ruling application, such that certain forms of reorganisation, which previously required a pre-ruling application (which could be an extended process), now merely require providing a notice to the ITA within 30 days of the reorganisation (e.g., a share-for-share exchange).

The Reform included certain additional changes to the tax-free reorganisation law, including, inter alia, the following:

a under the prior law, the shareholders of the target company were allowed to receive only stock consideration, while the Reform permits cash consideration in tax-free mergers, so long as the cash consideration does not exceed 40 per cent of the total consideration. While the cash consideration will be subject to tax, the consideration in shares will benefit from the tax deferral;
b it should also be noted that under the amendment provides a relief with regard to the utilisation of losses in certain cases (mainly with respect to parent-subsidiary mergers and corporate divisions), although it also includes several new limitations in this regard;
c the amendment permits companies that underwent a reorganisation to carry out an additional reorganisation during the limitation period in certain circumstances, provided that an ITA approval is obtained and several conditions are met; and
d the amendment also expands the applicable tax benefits with regard to the transfer of an asset by partners in a partnership or by a partnership to an existing company.
iii Exit

The Ordinance imposes an exit tax on individuals and companies that have ceased to be Israeli residents. The assets of a company that ceased to be an Israeli resident are deemed sold one day prior to its cessation of residency. The company may defer the gain recognition until the actual sale of the assets.

X ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

Section 86 of the Ordinance is a general anti-avoidance provision that permits a tax-assessing officer to disregard a transaction that is artificial or fictitious, or one whose principal objectives is an improper avoidance or reduction of tax. In addition, even in the absence of express statutory provisions, the ‘substance over form’ doctrine is a generally accepted principle of Israeli case law. Regulations have also been made under the Ordinance that imposes a disclosure requirement with respect to certain defined categories of transactions.

ii Controlled foreign corporations (CFCs)

In general, a controlling shareholder of a CFC that has undistributed profits must include in its income its allocable share of such profits. For this purpose, a controlling shareholder is a shareholder of the CFC that owns a 10 per cent or greater interest in the CFC. Certain ownership attribution rules will apply in determining a shareholder’s interest in the foreign company.

A CFC is a foreign company that meets the following requirements:

- the company is not a resident of Israel;
- the company is not listed on an exchange, and if it is listed, less than 30 per cent of the interests in the company have been offered to the public, excluding the shares held by controlling shareholders;
- most of the income of the company is from passive sources;
- the passive income of the foreign company is subject to a 15 per cent or less tax rate in the foreign jurisdiction; and
- the foreign company is controlled by Israeli residents.

For purposes of the requirement (e), a company is considered as controlled by Israeli residents if any of the following occurs:

- Israeli residents hold more than 50 per cent of the interests in the foreign company;
- Israeli residents hold more than 40 per cent of the interests in the foreign company and more than 50 per cent together with the holdings of related parties; or
- an Israeli resident has veto power over substantive decisions of the company.

The controlling shareholder’s allocable share of the CFC’s passive income is treated as a dividend distribution by the CFC to the controlling shareholder. Only foreign taxes that have been imposed in the case of an actual dividend distribution by the CFC can be claimed as a credit by the controlling shareholder against its Israeli tax liability. A number of other changes to the CFC regime in Israel came into effect in 2014.
iii Transfer pricing

Section 85A of the Ordinance states that where there is a special relationship between the parties to an international transaction, as a result of which the price of the transaction results in a smaller profit than would have been realised if the transaction price had been set on arm’s-length terms, the transaction must be reported and taxed on the basis of its fair market value. Regulations published in 2006 stipulate certain methods that should be to determine fair market value. The preferred method is to compare the price of the transaction in question with the price of a similar international transaction between unrelated parties. If this method cannot be used, then the taxpayer must use one of the following methods:

a a comparison between the profitability rate of the transaction in question and a similar transaction; or

b a comparison between profit and loss allocation between the parties under the transaction in question and a similar transaction. If neither of the above methods can be used, the taxpayer is permitted to use any other suitable method of comparison.

The regulations do not specifically require the taxpayer to prepare an annual transfer pricing study; however, the tax-assessing officer has the authority to demand a transfer pricing study at any time within 60 days. In addition, the taxpayer is required to describe the terms of any international transaction with a party with whom it has a special relationship (price, conditions, and the price and conditions of an arm’s-length transaction) in its annual tax return to be set out in a special annex to the tax return.

iv Tax clearances and rulings

Generally, a taxpayer may obtain a pre-ruling from the tax authorities before it files its tax return. In the context of the transfer pricing rules, a taxpayer may apply for an advanced pricing agreement, which is similar to the tax procedure applicable in the US.

XI YEAR IN REVIEW

2017 was a year of highly important reforms to the Israeli tax law, giving rise to significant legislative changes, as well as new case law during the year, affecting many private clients and companies. The substantive issues that occurred over 2017 are as summarised in this section. There have not been as many significant material reforms in 2018. Notwithstanding the above, a reform was made in the taxation of Israeli real estate companies that have elected to be regarded as disregarded entities for Israeli tax purposes, and the Israeli Tax Authority published several circulars in 2018, providing its position with respect to certain tax issues, such as the taxation of repurchase of shares, the taxation of activity involving cryptocurrency, the taxation of shares-based compensation and more.

i ‘Wallet’ companies

The taxable income of a closely held corporation (a company that is controlled by up to five people), which results from the activity of its individual substantial shareholder (whether directly or indirectly, including through a relative), will be considered as the individual’s personal earned income, where the company’s income results from:

a the individual’s activity as a functionary (i.e., office holder) in another corporation (unless the individual is also a substantial shareholder of the other corporation); or
b an employer–employee relationship of the individual with another person (unless the individual is also a substantial shareholder or a partner of the other person).

For this purpose, where 70 per cent or more of the company's total revenues derive from the activity of the individual for one person, for a period of at least 30 months during a period of four years, the individual's activity will be regarded as constituting employer–employee relationship.

ii Withdrawals by substantial shareholders

According to the new legislation, a withdrawal of more than 100,000 new Israeli shekels from a company, including by way of a loan (if such a loan was not repaid by during the tax year in which it was extended or in the succeeding year) or by way of providing security for a loan, and the constant use of company's assets, by a substantial individual shareholder, shall be regarded as an income of such an individual shareholder.

Where the company has 'accumulated profits' as defined under the Israeli Companies Law, this income of the individual shareholder shall be deemed to be a dividend income. Where the company does not have 'accumulated profits' and employer-employee relationship exists between the individual and the company, this income shall be deemed to be an employment income of the individual shareholder. Otherwise, the income shall be regarded as income from business or occupation.

iii Real estate taxation

As part of the Budget Law, the Knesset has passed a law whereby as of 1 January 2017 an additional annual tax will be imposed on owners of residential properties who own three properties or more. This new tax should apply for each residential property beginning with the third property. The imposed tax is 1 per cent of the value of the cheapest properties (i.e., it will not include the value of the two more expensive properties), and will not exceed 1,500 new Israeli shekels per month per property.

However, on 6 August 2017, the High Court of Justice ruled that a procedural flaw had occurred in the process of approving this part of the Budget Law and that accordingly this part of the law is not in force. Currently, this new taxation does not apply; however, the Minister of Finance announced that he will submit the bill for implementing this taxation for a new approval by the Knesset. Having said that, the bill has not been introduced yet and it is not expected to be introduced soon.

iv Encouragement of capital investments law

As part of the Budget Law, the Law for the Encouragement of Capital Investments 1959 has been amended. One of the main amendments was the addition of a new category for benefits for high-tech companies that develop intellectual property in Israel – ‘preferred technological enterprise’, in accordance with the OECD guidelines in the BEPS report. See Section V.iii for more details.

XII OUTLOOK AND CONCLUSIONS

After the large reforms that were presented in 2017, 2018 has been a relatively quiet year. As discussed above, 2017 was a year of dramatic legislative changes in Israeli tax law, including a reduction of the corporate tax rate, commencing in 2017, to 24 per cent, and from 2018
to 23 per cent; and changes to individual tax brackets that increased the lower tax rates and reduced the rate to 47 per cent for the higher tax rates. Wealth tax was increased to 3 per cent and is imposed on any income that exceeds 640,000 new Israeli shekels. In addition, the taxable income of a closely held corporation that results from the activity of its individual shareholders, will be considered as the individual’s personal earned income, and in certain cases, the withdrawal of cash from the company, including by way of a loan or by way of providing security for a loan, and the constant use of company’s assets by a substantial individual shareholder, will be regarded as income of the individual shareholder. Other changes impose preferential tax rates on foreign IP-based high-tech and large multinational companies in order to encourage investment in the Israeli economy.

Beside the above legislative changes, which were included in the Budget Law, new amendments in the Israeli tax-free reorganisation law were enacted, resulting in the increased availability of tax-free corporate reorganisations.

After several years in which the tax yield was quite high, *inter alia*, owing to one-time income sources such as the Voluntary Disclosure Process and significant transactions, it is questionable whether the 2018 tax yield, and even more so the 2019 tax yield, will be as significant and will meet the needs of the Israeli government. In addition, the general elections for the Israeli parliament are expected to take place in 2019, which may influence both government expenditure and its willingness and ability to complete significant tax reforms. Lastly, the director of the Israeli Tax Authority for the last five years has recently retired from his position and was replaced by a new director. It is hard to anticipate how the above situation will affect the Israeli tax regime and the Israeli Tax Authority’s attitudes to taxpayers in 2019.
Chapter 16

ITALY

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I INTRODUCTION

The Italian corporate tax system is mostly aligned with that of other major European countries. In past years, driven by EU obligations and the OECD base erosion and profit shifting project, the Italian parliament has laid down new legislation that has introduced significant amendments to the tax system, the latest of which was the undergoing enactment of Council Directive 2016/1164, as amended by Council Directive 2017/952, known as the Anti-Tax Avoidance Directive (ATAD), which on the one hand have settled certain past inconsistencies and will provide greater certainty to foreign investors, and on the other will probably give rise to new doubts and potential litigation.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate

Businesses normally adopt a corporate form. The most commonly used corporate entities are the joint-stock company (SpA) and the limited liability company (Srl). SpAs require a minimum share capital of €50,000, and provide for the mandatory appointment of a board of auditors or supervisory board. SpAs may issue different classes of shares, with specific governance and economic rights (preference shares, tracking shares, etc.). Srls generally have a minimum capital requirement of €10,000 (to encourage new business initiatives, as from 2012 Srls meeting some specific requirements may have a minimum share capital of €1). Srls provide for a higher degree of flexibility as regards the relationships among members, as most of the governance provisions may be incorporated in the by-laws, including certain matters normally covered by shareholders’ agreements. A third type of corporate entity is the partnership limited by shares (SApA), whose main feature is the distinction between unlimited liability partners and limited partners, who are only liable within the limits of their capital contributions. SApAs are normally used as family holdings.

Corporate entities are autonomous taxable persons; however, subject to certain conditions, companies may elect for a tax transparency regime for corporate income tax (IRES) purposes.
ii Non-corporate

Italian corporate law provides for three types of partnership: the simple partnership (Ss), which cannot perform business activities; the general partnership (Snc); and the limited partnership (Sas).

Partnerships do not have legal personality and their partners are subject to unlimited liability, with the exception of limited partners in an Sas. Partnerships are normally adopted for small family businesses. Partnerships are fiscally transparent (i.e., their income is allocated for tax purposes to the partners). In the private equity and real estate sectors, closed-end funds are frequently used. Legally speaking, said funds are pools of assets without separate legal personality, which are managed by special regulated entities. Private equity and real estate investment funds are generally exempt from income taxes (however, such exemption regime does not apply with reference to investment funds that are not subject to the supervision by a regulatory authority). Taxation only occurs upon distribution or redemption of the units.

In 2014, Italy implemented the AIFM Directive, which introduced specific rules aimed at creating a European market of operators in alternative investment funds (AIFs). According to the Directive, AIFs can be freely established and managed throughout the European Union through the ‘EU marketing passport’, thus without having a fixed place in the country of establishment of the fund. In the context of the Italian implementation of the AIFM Directive, investment companies with fixed capital have also been regulated in the Italian legal system.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

IRES applies to both resident and non-resident entities. Resident entities are taxed on their worldwide income, while non-resident entities are subject to tax on Italian-source income only. The taxable base for IRES purposes is the accounting result determined in the profit and loss account, as adjusted according to the provisions of the Italian Tax Code (ITC). The main adjustments relate to limits to tax deductibility of depreciation, amortisation, write-offs and interest expenses. Taxation applies on an accrual basis. Based on the allowance for corporate equity (ACE), enacted in 2011, a ‘notional deduction’ is allowed in the case of new equity injections in the form of cash contributions or the allocation of profits to reserves. The deductible amount under the ACE regime has varied over the past years, in particular: for 2018, the notional deduction amounts to 1.5 per cent, for 2017, to 1.6 per cent of the equity injection, and for 2016 such deduction amounted to 4.75 per cent. Any excess deductions may be carried forward without time limitations or converted into a tax credit used to decrease the regional income tax. Moreover, starting from 2017, the provision according to which companies admitted to be listed in the Stock Exchange after 25 June 2014 that meet specific requirements could benefit from an increase of 40 per cent of the ACE benefit for the tax period of admittance and for the subsequent two tax periods is no longer in force.

According to the draft Budget Law for 2019, the ACE will be repealed as of 2019, but any excess deduction available at 31 December 2018 may be carried forward without time limitations or converted into a tax credit to decrease the regional income tax.

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In parallel to the repeal of the ACE, the draft Budget Law for 2019 provides for a new regime aimed at reducing the applicable CIT rate from 24 per cent to 15 per cent to profits that are reinvested to purchase new tangible fixed assets and hire new employees. The rule looks at the profits realised in the previous fiscal year and limits the benefit to a portion thereof equal to the fiscal cost of the new investments. For the provision to be applicable, it is also necessary that the profits have been allocated to disposable reserve and that both new tangible fixed assets and employees are located in Italy. Any profits falling under the scope of the tax benefit but exceeding net income may be carried forward.

If a company does not reach a certain threshold of activity (in terms of earnings) it can be qualified as ‘dormant’; in these circumstances, a minimum deemed taxable income is calculated as a percentage of the book value of its fixed assets. Further, starting from 2012, an Italian company is deemed as dormant also when it has made tax losses for five consecutive years.

**Capital and income**

Capital gains are normally included in the overall taxable income. Subject to certain conditions, capital gains realised upon disposal of assets held for more than three years may be split into up to five annual instalments. Under the participation exemption regime, capital gains on qualifying shareholdings are subject to tax on only 5 per cent of their amount (95 per cent exemption).

**Losses**

Since 2011, tax losses can be carried forward indefinitely and offset up to 80 per cent of the taxable income of subsequent years; however, subject to certain conditions, losses incurred in the first three years from incorporation can be carried forward indefinitely and offset without limitations. Certain limits of losses carried forward apply in the case of a change of control, when a change in the main activity also occurs and certain ‘vitality tests’ are not met; losses carried forward are also limited in the case of a merger or demerger.

Pursuant to a regime of transfer of losses introduced by Budget Law for fiscal year 2017, a company is allowed to ‘sell’ – against a consideration equal to the nominal corporate tax rate – losses realised in the first three fiscal years from establishment, if certain conditions are met, in particular: (1) among the ‘seller’ and the ‘buyer’ of the losses there shall be a shareholding granting the right to 20 per cent of the profits and 20 per cent voting rights; (2) the ‘buyer’ (or the company that directly or indirectly controls the ‘buyer’) shall be listed; (3) the ‘seller’ shall not be a real estate company; and (4) the losses must refer to a new business activity.

**Rates**

Starting from 2017, the corporate income tax rate is set at 24 per cent, save for banks and other financial institutions, to which a special 3.5 per cent surcharge will apply for an overall 27.5 per cent rate. Note that until 2016, the corporate income tax was 27.5 per cent.

The tax rate is increased by 10.5 per cent if a company qualifies as dormant.

**Administration**

Corporate taxpayers must file a tax return within nine months from the end of the financial year. The tax year for corporate income tax purposes is the financial year of the company,
as determined by the law or the by-laws, or, if it is not specified, the calendar year (so filing usually by 30 September, yet, for the return relating to fiscal year 2017 the deadline was postponed to 31 October).

Corporate income tax is due in advance, with a final balance payment. The advance payment, which is due in two instalments, is usually based on a percentage of the tax paid for the previous tax year. The balance payment is due by the 30th day of the sixth month after the end of the financial year (for taxpayers with a financial year corresponding to the calendar year, the balance is due by 30 June), and any excess tax paid may either be carried forward or refunded.

There is no regular audit cycle for corporate entities, except for certain large taxpayers with turnover, revenues or earnings exceeding €100 million, who are audited once every two years.

In the event of uncertainty regarding the correct interpretation of tax provisions, the taxpayer may ask for a ruling by filing a written request with the tax authorities, which must issue a written and motivated reply (see Section IX.iv).

The tax litigation trial encompasses two degrees of judgment before a provincial tax court and a regional tax court, and a third degree before the Cassation Court, which deals only with issues on points of law. Various pre-litigation and composition procedures are available, aimed at reaching settlements with the tax authorities by virtue of significant reductions in penalties.

**Tax grouping**

Both a domestic and a worldwide consolidation regime are available under the Italian tax system, as outlined below.

**Domestic consolidation**

Election for domestic tax consolidation may be made jointly by the resident controlling company and each resident controlled company (also indirectly controlled, if intermediate controlled companies are resident in foreign white-listed countries). A company is controlled by another company if the latter directly or indirectly has the majority of the voting rights (i.e., more than 50 per cent) in the general shareholders’ meeting of the former. Under domestic tax consolidation, the taxable income of each consolidated company is aggregated and taxed at the level of the controlling company, regardless of the percentage of shareholding. Only losses incurred after the election can be offset against the profits of other group companies; losses incurred before such option may only be used at company level. Once the option is exercised, it is irrevocable for three tax years and can be renewed. Special rules apply in the case of a change of control during the tax grouping period.

Following one of the amendments mentioned at the outset, from 2015 the Italian tax system adopted a new form of domestic consolidation, namely the possibility of horizontal consolidation (i.e., in essence, consolidation of resident sister companies with a common parent resident in EU or EEA Member States): the amendment at hand followed the delivering of the European Court of Justice decision in *SCA Group*.

3 *SCA Group* (C-39/13, C-40/13 and C-41/13).
Worldwide consolidation

The option for worldwide consolidation may be exercised by a resident controlling company with respect to all controlled foreign companies provided that certain conditions are met. Under this regime, the income of the controlled companies (adjusted according to Italian tax provisions) is allocated to the controlling company in proportion to its profits entitlement. Losses incurred before the exercise of the option cannot be used in the consolidation; foreign tax credit relating to taxes paid abroad is normally available. Once the option is exercised, it is irrevocable for five tax years and is subject to renewal for periods of three years. Certain specific rules apply in the case of election for the worldwide consolidation regime, or for the interruption of the election and in the case of reduction of the participation of the holding in the controlled companies.

ii Other relevant taxes

Regional income tax

Corporate entities are also subject to a regional income tax, IRAP, which is levied on the net value of the production derived in each Italian region. In particular, for commercial and manufacturing enterprises the tax base is equal to the difference between the operating income and the costs of production; in general, labour costs (other than employee-related, from 2015), bad debts and financial expenses are not deductible. For dormant companies, the tax base is equal to the minimum income determined for IRES purposes increased by employment costs and interest expenses. Special rules are provided for industrial holding companies, banks and financial entities, and insurance companies.

The standard rate is 3.9 per cent, but the Italian regions are entitled to increase or decrease this rate by up to 0.92 per cent. IRAP is partially deductible from the IRES tax base. The partial IRAP deduction reflects the interest expenses that are not deductible for IRAP purposes. As from tax year 2012, IRAP levied on the cost of personnel (for the amount that is not deductible from the IRAP tax base) has been fully deductible from the IRES tax base.

Value added tax

VAT is levied on the supply of goods and services made in the course of a business, artistic or professional activity. VAT is also levied on any individuals or legal entities that import goods from outside the European Union. According to the ‘territoriality’ principle, the sale of goods is deemed to have occurred in Italy if the goods are located in Italy at the time of transfer. Services are deemed to be supplied in Italy when the service is supplied to a taxable person for VAT purposes that has established its business in Italy; or the service is supplied to a non-taxable person for VAT purposes by a taxable person that has established its business in Italy. Special provisions apply to services relating to cultural, artistic, sport, scientific, educational, entertainment or similar activities: in general, these services are considered to have been rendered in Italy if the activities carried out in relation to them physically take place therein.

VAT is ordinarily due upon the transfer of ownership of goods or, in any event, when an invoice is issued or the payment received; however, taxpayers with turnover not exceeding €2 million can elect for the VAT cash-basis regime, under which the VAT payment obligation is deferred at the moment of collection of VAT from the client. Similarly, the deduction right on input VAT arises upon the payment of purchase invoices.
The deduction of input VAT is subject to the condition that goods and services purchased are used for taxable transactions (according to the pro rata deduction). VAT on certain goods and services is always non-deductible (e.g., food and drinks, hotels).

The ordinary VAT rate is 22 per cent. Reduced rates, namely 10, 5, 4 and zero per cent (i.e., exemptions) apply to specific categories of goods and services.

**VAT group**

Pursuant to Budget Law for fiscal year 2017, Italy has exercised the option for enacting VAT group legislation (Article 11 of Directive 2006/112/EC). Starting from fiscal year 2018, VAT taxable persons established in Italy, including fixed establishments of taxable persons established abroad, subject to certain requirements – a ‘close connection’ among the applicants through certain financial (i.e., corporate control is required; in the case of a foreign parent company of Italian sister companies, direct corporate control is required), economic and organisational links – may elect to be treated as a single taxable person for VAT purposes; accordingly, dealings among members of the VAT group are not taxable for VAT purposes (unless the VAT group has opted for the application of the segregation of activities according to which some internal dealings may be taxable for VAT purposes).

The election for the VAT group is binding for three years, unless eligibility requirements cease to apply, and is automatically renewed for each following year until it is revoked. Pure holding companies are excluded from the scope of application, but controlling active parent companies or holding companies carrying out ‘mixed’ activity are not. The option must have been exercised before 15 November 2018 for the effects to be applicable as of 2019. For the following years, the deadline is 30 September. In both cases, the financial link requirement must be met as of 1 July of the year of the request.

**VAT financial consolidation**

The VAT financial consolidation is an elective regime, according to which, subject to certain requirements, the VAT periodical payments due by the companies belonging to the same group (i.e., corporate control is required) may be made by the controlling entity on a consolidated basis. The election for VAT financial consolidation has effect until it is revoked, unless eligibility requirements cease to apply.

**Registration tax**

Registration tax is due on deeds and agreements executed in Italy subject to mandatory registration in public registers (e.g., transfer of real estate, transfer of a business as a going concern) or voluntarily filed in such registers.

As of January 2014, the indirect tax regime applicable to real estate transfers has changed. In particular, real estate transfers that do not fall within the scope of VAT will ordinarily be subject to proportional registration tax at a rate of 9 per cent, and mortgage and cadastral taxes apply at a fixed amount of €50 each. Further, registration tax rates may vary according to the nature of the deed or contract from 0.5 to 9 per cent (15 per cent on the sale of farm land).

As a general rule, if a transaction is subject to VAT, registration, mortgage and cadastral taxes are applicable at a fixed rate of €200 each (mortgage and cadastral taxes apply at 3 per cent and 1 per cent rates, respectively, to transactions involving buildings used as fixed assets).
Local property tax
The Budget Law for 2014 enacted a reform of local taxes whereby a new ‘service tax’, aimed at funding all local services and to be called IUC (the unified local tax), will be formed of an urban waste and disposal service tax (TARI), a tax related to community services provided by the municipalities (TASI) and a local property tax (IMU).

TARI applies to all properties. It is assessed on the occupant to fully cover the costs of urban waste and disposal. Although the tax is initially based on property size, municipalities may refine the tax to reflect property-specific waste production.

TASI is used to finance public services targeted to the entire community (e.g., street maintenance, street lights). Its purpose is to tax the ownership or possession of any kind of real estate, excluding rural lands and first dwelling other than premium properties, as defined for the purposes of local property tax. The TASI standard rate is 0.1 per cent, which can be increased or reduced by the municipalities.

IMU is the local property tax levied on the ownership of immovable properties (buildings, development land, rural land) located in Italy, and its tax base is determined according to certain cadastral values. IMU standard rates on dwelling places range from 0.46 to 1.06 per cent, depending on the nature of the properties and on the municipality in which the property is located. The municipality, in fact, may decide to reduce or increase the coefficient of 0.76 per cent for an amount of 0.3 per cent. As TASI, IMU is not due in connection with dwelling places that qualify as first dwelling places, except for premium properties.

Net wealth tax
There is no net wealth tax. As of 2014, an annual stamp duty of 0.2 per cent (previously, 0.1 per cent for 2012 and 0.15 per cent for 2013) is due on the value of financial instruments held at a resident bank. With respect to clients other than individuals, stamp duty on financial instruments ranges from €100 to €14,000.

IVIE and IVAFE
In 2011, a tax on the value of real estate property located abroad (IVIE) and a tax on financial assets held abroad (IVAFE) were introduced. Both taxes are applicable to individuals resident in Italy.

IVIE applies at a rate of 0.76 per cent on the cadastral value set by the foreign state (EU or EEA Member States) or the arm’s-length value, save for first dwelling places that are either exempt, or taxed at 0.40 per cent in the case of premium properties. A foreign tax credit related to equivalent taxes paid in the country in which the property is located is normally allowed.

IVAFE shall be due on the value of financial instruments, current accounts and savings accounts held abroad. The tax rate is equal to 0.2 per cent on financial instruments (previously, 0.1 per cent for 2012 and 0.15 per cent for 2013) and to €34.20 on bank accounts, postal accounts and savings accounts held abroad. A foreign tax credit related to taxes paid in the country where the above-mentioned assets are held may be allowed.
IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

Companies are deemed to be resident in Italy if, for the greater part of the tax year, they have their legal seat, place of management or main business purpose in Italy. The place of management is deemed to be the place where the main decisions regarding the business are taken (usually, where the board meetings are held).

Moreover, pursuant to certain presumptions set out by the ITC, a foreign-incorporated company is deemed as resident in Italy if it controls an Italian-resident company and, at the same time, it is either controlled by an Italian-resident person (company or individual), or managed by a board of directors with a majority of Italian-resident members. The presumption of residence can be rebutted by the taxpayer.

Among the amendments the Italian tax system underwent in 2015 and 2018, new rules have been laid down to assess the tax basis of the assets of companies that move from another country and take up Italian residence.

In this respect, starting from 2015, inbound transfers of residence are to be distinguished depending upon the former country of residence: if the company was a resident of a white-listed country, for Italian tax purposes the entry tax basis of its assets and liabilities is equal to their arm’s-length value; on the other hand, if the company is exiting a blacklisted country, the entry tax basis of its assets and liabilities is equal to their arm’s-length value subject to a successful ruling. Where a ruling does not succeed, for Italian tax purposes the tax basis of the company's assets will be the lowest among their cost basis, book value and arm’s-length value and, as to liabilities, the highest among their cost basis, book value and arm’s-length value.

Further, pursuant to the Italian undergoing implementation of the ATAD, the scope of application of such provision now covers the transfers to the Italian territory of: (1) a permanent establishment of a non-resident company; (2) a business; (3) a permanent establishment of a resident company under the branch exemption regime; and (4) cross-border mergers. In a public ruling (Resolution No. 69/E of 5 August 2016), the Italian tax authorities clarified that the entry tax regime is available also to a foreign real estate holding company established in Luxembourg, since it carries out an ‘economic’ activity. Further, in that context, the Italian tax authorities also confirmed that the assets of the foreign company that are either booked at a lower value than fair market or are no longer booked in the company’s accounts owing to full depreciation can be booked at their arm’s-length value upon entry in the Italian tax system.

ii Branch or permanent establishment

Under the ITC, a permanent establishment is defined as a fixed place of business through which the business of a non-resident enterprise is wholly or partly carried out in Italy (physical permanent establishment). In addition, a permanent establishment occurs when a person who is not independent from the foreign enterprise has the power to engage the non-resident enterprise and usually does so (agency permanent establishment). A fixed place of business is not considered as a permanent establishment if the activity carried out is of an internal nature (i.e., it is rendered solely in favour of the enterprise owning such fixed place of business), or has a preparatory or ancillary nature in respect of the ordinary activity carried out by the enterprise. A special definition of permanent establishment applies to businesses engaged in the gambling sector, according to which if a resident carries out betting intermediary activity...
by means of a fixed place of business on behalf of a non-resident – even by collecting the bets or by providing the customers with the proper machines – and the financial flows related to such activities overcome the threshold of €500,000, the non-resident is deemed to have a permanent establishment in Italy.

Starting from 2018, the legislator has introduced a new definition of permanent establishment that, on the one hand is in line with the new Article 5 of the OECD Model Convention, and on the other hand introduces a new definition of digital permanent establishment. The new definition of ‘digital’ permanent establishment covers cases of significant and continuous economic presence designed to avoid a physical one.

Such domestic definition, however, is not applicable insofar as the foreign taxpayer is covered by a double tax agreement that provides for a definition of permanent establishment that is more favourable to the taxpayer than the relevant domestic definition.

As regards the allocation of profits to permanent establishments, reference is made to OECD guidelines and principles; such principles are adopted by the Italian tax authorities according to the functionally separate entity approach.

While Italy relieves double taxation through the ordinary credit method (both in its double tax treaties and through domestic rules), a 2015 piece of legislation provides for an alternative relief method for foreign branches of Italian companies (the s.c. branch exemption). Under the branch exemption regime, an Italian company having permanent establishments located in white-listed countries can elect for the application of the exemption method rather than the credit method. The election is irrevocable and follows the ‘all-in, all-out’ approach. The election for the exemption method does not ‘defuse’ the controlled foreign corporation (CFC) legislation, but exemptions can be sought through the ruling procedure.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes

Italian tax law does not provide for any special holding company tax regimes.

A general participation exemption regime is available under which capital gains realised by an Italian company on the disposal of shares are exempt from corporate income tax for 95 per cent of their amount, if all the following conditions are met:

a the shares are held, without interruption, from the first day of the 12th month prior to the month in which the sale occurs (shares purchased most recently shall be deemed to have been sold first);

b the shares are accounted for as ‘financial fixed assets’ (or an equivalent accounting classification) in the first statutory financial statements closed during the period in which the shares are held;

c the company whose shares are sold is not resident in low-tax jurisdictions; and

d the company whose shares are sold performs an actual business activity (such condition must not be verified for listed companies).

The conditions under points (c) and (d) must be met, at least, from the beginning of the third tax year preceding the date of disposal. Real estate companies (other than those trading in real estate and building companies) are deemed not to perform an actual business activity, and therefore are not able to meet the condition under point (d).
In 2018 a foreign jurisdiction is a low-tax jurisdiction if the nominal corporate tax rate is lower than 50 per cent of the applicable nominal tax rate in Italy. However, within the pending enactment of the ATAD, the definition of low-tax jurisdiction would be changed and starting from 2019 it will vary depending upon the shareholding at stake. In particular, a jurisdiction will be a low-tax one if it has (1) an effective tax rate lower than 50 per cent of the applicable effective tax rate in Italy, in case of majority shareholdings; and (2) a nominal tax rate lower than 50 per cent of the applicable nominal tax rate in Italy, in case of minority shareholdings.

Capital losses realised on the disposal of shares that would benefit from the participation exemption regime on capital gains are not deductible for corporate income tax purposes.

Under the participation exemption regime, dividends flowing from a non-low tax jurisdiction are always exempt from corporate income tax for 95 per cent of their amount. On the contrary, dividends derived from a company resident in a low-tax jurisdiction are taxable in full, unless the following evidence is provided (possibly through the ruling procedure):

a. genuine establishment of the foreign company occurs, in which case an exemption from corporate income tax of 50 per cent applies (starting from 2018); and

b. no effect of obtaining low taxation of the income made by the foreign company is achieved, in which case an exemption from corporate income tax of 95 per cent applies.

Dividends are also considered to be ‘derived’ from a low-tax jurisdiction if they are distributed by a controlled (even de facto) non-low tax entity that in turns received dividends from the company located in a low-tax jurisdiction.

In the context of the recent changes in the domestic tax system, starting from 2015 an indirect foreign tax credit may be available depending upon certain circumstances.

Under the Italian participation exemption regime, qualifying capital gains and dividends are subject to an effective tax rate of 1.2 per cent (i.e., 24 per cent times 5 per cent) starting from 2017. Note that the effective tax rate has been 1.375 per cent until 2016 (i.e., 27.5 per cent times 5 per cent).

ii IP regimes

In 2015, the Italian parliament laid down a new patent box regime by election, according to which certain tax incentives are granted for the exploitation of IP.

The election is effective for five fiscal years, is irrevocable, and is limited to Italian businesses and white-list foreign entities.

The regime covers income derived from the exploitation of IP, such as patents, formulae, models, licences and software copyright (qualifying income). The regime is available also for self-exploitation of IP, but in this case the amount of the incentive must be determined through a ruling procedure. Note that, starting from 2017, patent box elections no longer cover the income derived from trademarks.

The tax benefit is calculated by taking into account the portion of the costs that are aimed at the enhancement of intellectual property (qualifying expenditures): if all the costs borne by the business are qualifying expenditures, then all the income derived from IP will benefit from the ‘patent box’ regime.

The regime provides for taxation of the income from IP reduced to 50 per cent (for the 2015 and 2016 tax periods, the incentive was equal to 30 per cent and 40 per cent of the income, respectively).
The incentive at hand is available also in relation to the consideration received upon the sale of IP subject to the fulfilment of certain requirements, such as the reinvestment of the consideration received.

### iii  State aid

Starting from 2018 the legislator has introduced some measures against the transfer of business in the event the taxpayer has been granted a ‘state aid’ (e.g., start-up companies regime, discussed below). As a general rule, if a business is transferred outside of the European Union territory (and EEA Member States) within five years from the benefit, it triggers the loss of the benefit and, potentially, the application of penalties that range from 200 per cent to 400 per cent of the benefit granted. On the contrary, if a taxpayer that has been granted a state aid on the basis of the presence of their business in a specific area of the Italian territory, transfers the business to another area of Italy or of the European Union (and EEA Member States), the benefit will be lost, but no penalties apply.

A similar provision applies to the sale or transfer of assets that have benefited from a ‘hyper-depreciation’ regime (i.e., extra depreciation on the purchase of certain tangible assets), but without any application of penalties.

### iv  Start-up companies

A special regime applies for start-up companies that meet certain specific requirements (e.g., turnover not exceeding €5 million, a minimum annual amount of research and development expenditures). Start-up companies are exempt from incorporation fees and stamp duties, and can benefit from the non-application of the dormant company legislation. Starting from 2017, companies investing in start-up companies are able to deduct from their taxable income 30 per cent of the invested amount. Note that for the tax years 2013, 2014, 2015 and 2016, the deduction was equal to 20 per cent of the invested amount. The investment in each innovative start-up company may not exceed €1.8 million per tax year and shall be kept for at least three years.

The same regime has been extended, if certain requirements are met, to small and medium-sized enterprises as defined by Commission Recommendation 2003/361/EC (enterprises that employ fewer than 250 persons and that have an annual turnover not exceeding €50 million, or an annual balance sheet total not exceeding €43 million).

### VI  WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

#### i  Withholding on outward-bound payments (domestic law)

As from 1 July 2014, the base withholding tax rate applicable to financial income has been increased from 20 to 26 per cent.

Under Italian domestic tax laws, the following withholding taxes apply to outbound payments made by an Italian-resident company.

**Dividends**

Dividends paid to non-Italian resident persons without a permanent establishment in Italy are generally subject to a 26 per cent withholding tax. Non-resident shareholders may claim the refund of up to 11/26 of the withholding tax levied in Italy (one-quarter for dividends
paid until 30 June 2014) if they provide evidence to the Italian tax authorities that income tax has been paid on the same dividends in the foreign country in an amount at least equal to the total refund claimed (non-residents seeking such refunds have experienced extensive delays).

A reduced 1.2 per cent (1.375 per cent before 2017, as a result of the IRES rate reduction from 27.5 to 24 per cent) withholding tax applies to dividends paid to companies or entities resident for tax purposes in an EU Member State or in a state party to the Agreement on the European Economic Area, which allows the exchange of information.

**Interest**

Interest paid to non-Italian resident persons is normally subject to a final 26 per cent withholding tax.

**Royalties**

Royalties paid to non-Italian resident persons are subject to a 30 per cent final withholding tax to be levied on 75 per cent of the taxable amount (effective rate equal to 22.5 per cent).

**ii Domestic law exclusions or exemptions from withholding on outward-bound payments**

Under Italian domestic law, the following exclusions or exemptions from withholding on outbound payments are provided.

**Dividends**

Under the Parent–Subsidiary Directive as implemented in Italy, no withholding tax applies on dividends paid to a company that:

- **a** is incorporated under one of the forms listed in Annex I – Part A to the Directive;
- **b** is resident for tax purposes in an EU Member State;
- **c** is subject in its state of residence to one of the corporate taxes listed in the Annex I – Part B to the Directive; and
- **d** has held a 10 per cent minimum shareholding in the distributing company for at least one year at the time of distribution (if the minimum holding period is gained after the dividend distribution, the levied withholding tax may be claimed for refund by the non-resident).

Directive No. 2015/121 dated 27 January 2015, aimed at tackling artificial arrangements potentially put in place to benefit from the advantages of the Parent–Subsidiary Directive, is enacted through the application of the general anti-avoidance clause, which provides for that the burden of proof of artificiality of arrangements, undue tax savings and motive test lies with the tax authorities.

The enactment of Directive No. 2015/121 is limited to dividend payments made starting from January 2016. As to the payments made up to December 2015, a different rule is in place (now repealed), according to which no exemption from Italian withholding tax is granted to EU parent companies controlled directly or indirectly by one or more residents.

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of states that are not EU Member States, unless that legal person provides proof that the principal purpose or one of the principal purposes of the chain of interests is not to take advantage of the Parent–Subsidiary Directive.

Note that a similar provision of the French tax system has been recently deemed incompatible with the freedom of establishment (decision by the Court of Justice of the European Union in case C-6/16 of 7 September 2017, Eqiom and Enka).

**Interest**

Under the domestic provisions implementing the Interest and Royalties Directive, interest payments arising in Italy are exempt from any Italian tax imposed on those payments upon condition that the beneficial owner of the interest is an associated company of another EU Member State (or a permanent establishment located in another EU Member State of an associated company of an EU Member State). The exemption applies if both the person paying interest and the beneficial owner have one of the legal forms, and are subject to one of the corporate taxes, listed in the Annexes to the Directive. As to the status of associated companies:

- the first company directly holds a stake equal to at least 25 per cent of the voting rights in the second company;
- the second company directly holds a stake equal to at least 25 per cent of the voting rights in the first company; or
- a third company directly holds a stake equal to at least 25 per cent of the voting rights in both the first and second company.

The relevant shareholding must be held for an uninterrupted period of at least one year.

Under domestic tax law, no withholding tax is levied on interest paid to non-resident persons on deposits or bank accounts. Furthermore, an exemption from withholding tax applies to interest on bonds and similar securities issued by the state, and by banks and listed companies, provided that the recipient is a resident of a country that allows the exchange of information (a white-listed country); to benefit from this exemption, the non-resident shall deposit the bonds with a resident bank or other qualified intermediary. As from 2012, the exemption from withholding tax also applies to interest on bonds issued by non-listed companies, provided that the bonds are listed on an EU regulated market or multilateral trading facilities.

As regards medium long-term loans (i.e., maturity over 18 months), provided the compliance with regulatory financial requirements, an exemption from withholding tax is provided on interest paid by companies to financial institutions established in a EU Member State, insurance companies set up and authorised pursuant to the laws of a EU Member State, and institutional investors supervised in the state when they are set up, to the extent that such state allows for an effective exchange of information.

**Royalties**

Pursuant to the Interest and Royalties Directive as implemented in Italy, royalty payments are exempt from Italian withholding tax under the same conditions mentioned above in respect of interest payments.
iii  **Double tax treaties**

Italy has an extensive double taxation treaty network (more than 90 treaties are currently in force). Double taxation treaties concluded by Italy are generally compliant with the provisions set forth by the OECD Model Convention. Under the treaties, dividend withholding tax rates are reduced to 10 or 15 per cent in most cases, while interest and royalties withholding tax rates are frequently reduced to 10 per cent or less.

Subject to certain formalities, it is normally possible to obtain direct application of the treaty-reduced rates.

iv  **Taxation on receipt**

No tax on gross receipts applies in Italy.

Under the participation exemption regime, both Italian-sourced and foreign-sourced dividends are exempt from corporate income tax for 95 per cent of their amount (except in cases of dividends paid by entities located in low-tax jurisdictions on which see above). No imputation credit is granted in respect of non-local underlying taxes paid at the level of the entity distributing dividends. Subject to certain conditions, a foreign tax credit is usually available (both under domestic law and the treaties) in respect of withholding taxes suffered abroad.

VII  **TAXATION OF FUNDING STRUCTURES**

i  **Thin capitalisation**

Thin capitalisation rules no longer apply. As from 2008, thin capitalisation rules have been replaced by the interest barrier regime mentioned below.

ii  **Deduction of finance costs**

Interest expenses accrued in a given tax year are deductible up to the amount of interest income and similar proceeds accrued in the same tax year. Any excess interest is deductible up to an amount equal to 30 per cent of the earnings before interest, tax, depreciation and amortisation (EBITDA) of the same year. Any interest expenses exceeding the above threshold may be carried forward and deducted in the following tax years (with no time limitation) within the same limit of 30 per cent of the annual EBITDA. Furthermore, any excess EBITDA capacity that is not used in a given tax year to deduct interest expenses may be carried forward and used in the following tax years (with no time limitation). The provision at stake also applies to other finance costs deriving from loans, financial leases, issuance of bonds and similar financial instruments, excluding interest for deferred payments in relation to commercial debts. Certain special rules are provided for entities joining the tax consolidation regime: in principle, it is possible to use the EBITDA capacity of one company joining the tax grouping to deduct interest expenses incurred by another group company.

The above rules do not apply to banks, insurance companies and other financial entities, for which different rules are provided. In particular, interest expenses are: (1) deductible up to 96 per cent of their amount (4 per cent non-deductible) for insurance companies, controlling entities of insurance groups and fund management companies; and (2) fully deductible for financial intermediaries.

A special exemption from the interest limitation rule (i.e., interest expenses are fully deductible) is provided with respect to long-term public infrastructure projects.
Despite being almost completely in line with the ATAD wording, the interest limitation rule is undergoing certain amendments under the Italian ATAD implementation. Accordingly, (1) EBITDA capacity is calculated by taking into account fiscal rules; (2) interest income exceeding interest expenses may be carried forward indefinitely; and (3) excess EBITDA capacity may be carried forward only for five years.

iii Restrictions on payments
Payment of dividends is subject to approval by an ordinary shareholders’ meeting. Dividends can only be paid out of realised profits and distributable reserves. According to the Italian Civil Code, an amount equal to 5 per cent of the profit of the company for the year must be set aside for the legal reserve until said reserve amounts to at least one-fifth of the share capital; the legal reserve is not available for payment of dividends. The distribution of interim dividends is only allowed for companies that are subject to a mandatory audit (e.g., listed companies), and it is subject to certain formalities and limitations, including approval by the auditors.

iv Return of capital
Distributions of capital reserves (share premiums, informal capital contributions, etc.) are allowed upon approval by the shareholders’ meeting, and they are not subject to specific limitations, while repayment of formal share capital must be resolved by an extraordinary shareholders’ meeting and is subject to certain procedural formalities. In principle, the repayment of capital reserves is tax-neutral; a taxable income may arise if the amount distributed exceeds the tax basis of the shareholding in the distributing company. If a company can dispose of capital reserves and profit reserves, pursuant to a special presumption, for tax purposes profit reserves are always deemed to be distributed first, regardless of the allocation made in the relevant resolution for civil law purposes.

v Financial transaction tax (FTT)
The Budget Law for 2013 introduced the FTT, whose implementing rules were provided by the Ministry of Economy and Finance. FTT applies as of March 2013 to transactions related to the transfer of the ownership of securities and other financial instruments issued by companies having their registered offices in Italy and securities representing equity investment, regardless of the place of residence of the issuer (shares). Specific exclusions from the scope of application of FTT are provided (e.g., transfers of the ownership of the quotas of SICAVs, SRLs and ETFs, as well as the transfer of listed shares of companies with an average capitalisation lower than €500 million).

FTT is calculated with reference to the net balance of the transactions regulated on a daily basis and the tax rate is equal to 0.1 per cent (0.12 per cent for the 2013 tax period) for transactions effected on regulated markets or in multilateral trading facilities; and 0.2 per cent (0.22 per cent for 2013 tax period) for any other transactions. FTT also applies as of September 2013 to transactions relating to financial derivatives having as their main underlying asset one or more shares (or the value of which mainly derives from shares), and transferable securities giving the right to acquire or sell mainly shares or giving rise to a cash settlement determined mainly by reference to shares (derivatives). FTT applies to ‘high-frequency’ trading activities regarding the foregoing financial instruments (shares and derivatives).
FTT is not deductible for the purposes of IRES and IRAP. Non-resident intermediaries and persons intervening in a transaction with a permanent establishment in Italy must comply with the obligations deriving from FTT through such permanent establishment. In the absence of such permanent establishment, non-resident intermediaries and persons intervening in transactions can appoint an Italian tax representative or, alternatively, can comply with the applicable provisions and procedure directly.

vi  Issuance of debt securities by non-listed companies

Law Decree No. 83/2012, as amended and supplemented, introduced significant amendments affecting corporate bonds listed on a regulated market or multilateral trading facilities of an EU Member State or an EEA ‘white-listed’ Member State (the qualified exchanges) issued by non-listed companies; and issued by non-listed companies and subscribed by qualified investors as per Article 100 of the Italian Financial Act, including:

a  the deductibility of interest paid, or interest expenses arising from such bonds, are not subject to limitations ordinarily provided for high-yield bonds;

b  the exemption for non-listed companies issuing corporate bonds listed on a qualified exchange from the limit of issuance of bonds provided for by Article 2412 of the Italian Civil Code – equal to twice the value of the share capital and reserves of the issuer available for distribution – thereby granting them the same treatment applicable to Italian-listed companies; and

c  the exemption from withholding tax on interest paid to investors resident in ‘white-listed’ countries. Moreover, interest paid to Italian or EU collective investment funds and to securitisation companies are also exempt from withholding tax subject to specific requirements.

As a consequence, bonds listed on a qualified exchange issued by non-listed companies are now subject to the same withholding tax regime applicable to bonds issued by Italian banks and Italian listed companies, including the exemption regime provided for interest paid to investors resident in a ‘white-listed’ country.

vii  Venture capital investment funds (FVCs)

According to a regime enacted in 2013, income from capital arising from participation in FVCs is not subject to income tax. To apply this exemption with specific reference to individuals holding quotas in the course of their business, Italy asked for the approval from the European Commission, which granted it.

Pursuant to the aforementioned rule, FVCs are defined as OICRs (Italian UCITs) that invest at least 75 per cent of the collected capital in unlisted companies as seed financing, start-up financing, early-stage financing or expansion financing.5

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5  To benefit from this exemption, investee companies must meet certain requirements. In particular:

a  they must be unlisted;

b  they must have their operative seat in Italy;

c  their quotas or shares must be held directly, mainly by individuals;

d  they must be subject to corporate income tax or similar taxes under local law, without being totally or partly exempted;

e  they must have been engaged in business for no longer than 36 months; and

f  they must have a turnover not exceeding €50 million, according the latest financial statements approved prior to investment by the FVC).
The quotas of FVCs may be acquired only by: investors who are considered professional investors according to Section I of Annex II to Directive 2004/39/EC; investors who may, on request, be treated as professional investors according to Section II of Annex II to Directive 2004/39/EC; and other investors if certain requirements are met (e.g., investors declare that they are aware of risks related to the investment, and undertake to invest at least €100,000).

viii Receivables of the shareholders
If a company benefits from a write-off of a receivable in the hands of its shareholders (e.g., shareholders loans), such former company is subject to tax for the amount exceeding the fiscal value of the receivable. The shareholder has to communicate the fiscal value of the receivable to the company; absent this communication, the fiscal value of the receivable is assumed to be zero. The same provision applies also to the conversion of receivables into equity.

ix PIR
The Budget Law for fiscal year 2017 introduced a beneficial tax regime available to a specific kind of investment scheme, known as Individual Plan of Saving (PIR), to be provided by Italian resident financial institutions and Italian branches of foreign financial institutions, for the benefit of non-entrepreneur individuals investing less than €30,000 per year, up to a maximum of €150,000.

According to this regime, capital gains and financial income derived from the PIR-compliant investments are exempt from the 26 per cent substitute tax, which would ordinarily apply on such income, as well as from inheritance tax.

For a portfolio of investment to be PIR-compliant, certain requirements shall be met, among which: (1) the investment in the PIR must be held for more than five years; (2) at least 70 per cent of the investment portfolio consists of shares or debt securities issued by Italian companies (or EU companies having an Italian branch) or units of UCITS complying with such requirements; (3) 30 per cent of the issuers of such securities are small or medium-sized enterprises; and (4) concentration risk in one single investment is limited to 10 per cent.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition
Usually, the acquisition of Italian businesses is structured through the incorporation of an Italian-resident acquisition vehicle, which is adequately funded through a mix of equity, shareholder loans and bank debt. In more complex structures, one or more foreign holding companies are normally used to provide for mezzanine or hybrid financing. Deduction of interest on debt is achieved either through the merger of the acquisition vehicle with the target or through a tax grouping: after many years of uncertainty; in 2016 the Italian tax authorities provided guidelines according to which the deduction of interest is, in principle, admitted.

Frequently, the acquisition of business concerns is structured as an initial contribution in kind into a wholly owned subsidiary followed by a sale of shares of the subsidiary; indeed, the contribution is tax-neutral, and the transfer of shares would usually benefit from the participation exemption regime. Although there has been some uncertainty and consequent litigation as to the transfer taxes applicable to these transactions, the Budget Law for 2018 amended the relevant rule in order to clarify that non-proportional transfer taxes apply.
As regards mid- to long-term loans (i.e., loans having a final maturity of over 18 months) and the related guarantees and transfer of receivables, it is possible – by election – to benefit from a 0.25 per cent substitute tax instead of applying the ordinary registration, stamp, mortgage and cadastral taxes. Medium-term loans granted by securitisation companies, EU insurance companies and white-listed collective investment funds established in the EU or white-listed countries included in the EEA can also benefit from such regime.

### ii Reorganisation

Mergers and demergers are, in principle, tax-neutral transactions, both in a purely domestic scenario as well as in cross-border transactions. Indeed, such corporate reorganisations do not imply the realisation of capital gains or losses on the assets of the participating companies, even when these gains or losses are accounted for in the financial statements; at the same time, no taxation arises for the shareholders of the participating companies. In cross-border mergers, tax-neutrality is achieved provided that the assets of the Italian-resident participating company are allocated to an Italian permanent establishment of the foreign combined entity. A similar, tax-neutral regime normally applies to the contributions of businesses in exchange for shares.

### iii Exit

Capital gains on shares are taxable in Italy only to the extent that the sale concerns substantial holdings (i.e., shareholdings granting more than 2 per cent of voting rights or more than 5 per cent of profits, in case of shares in listed companies; more than 20 per cent of voting rights or more than 25 per cent of profits, in the case of shares in non-listed companies), in which case taxation at 26 per cent applies. However, also these capital gains are generally not taxed in Italy, if the investor is covered by a double tax treaty entered into with Italy (note, however, that certain double tax treaties depart from the standard Article 13 of the OECD Model Tax Convention, such as those with France, Brazil and China).

A provision enacted in 2017, coupled with the guidelines issued by the Italian tax authorities in Circular Letter No. 25/E of 2017, provided that the carried interest – namely the enhanced economic rights connected to the holding of shares, units or other instruments in companies, funds or investment entities by managers and employees – qualifies as financial income subject to certain requirements, which, in general, are aimed at aligning the risk of investment to that of the ordinary shareholders (i.e., minimum investment, deferral in distribution, minimum holding period). This qualification is beneficial to managers and employees, given the lighter tax burden on the financial income (generally 26 per cent), compared to that on employment income (up to 43 per cent), and to the paying entity in relation to its obligations as withholding agent.

With respect to exit taxation, the transfer abroad of the legal seat of an Italian company is allowed under Italian corporate law. For tax purposes, the transfer of tax residence ordinarily triggers realisation of capital gains or losses on the company’s assets, unless the said assets are allocated to the Italian permanent establishment of a foreign company. The same regime applies to the transfer of a permanent establishment.

However, if the tax residence of the company or the permanent establishment is transferred to an EU Member State or a white-listed state belonging to the EEA the taxpayer, instead of being subject to the ordinary tax regime, may elect to either defer at the moment of their disposal the exit tax due in relation to the assets that are not transferred to a permanent
establishment in Italy (maximum deferral equal to 10 years); or to pay the exit tax in six annual instalments. The tax authorities may make the deferral or the instalment payment conditional upon the provision of guarantees.

The transfer may also be achieved through the incorporation of the Italian company into a foreign company; in this scenario, tax-neutrality is also achieved provided that the assets of the absorbed company are allocated to an Italian permanent establishment of the merging foreign company.

By means of the pending enactment of the ATAD, starting from 2019, the election for the deferral of taxation upon exit will no longer be available (so, alternatives will be either full payment or payment by instalments) and the payment will have to occur in a maximum of five annual instalments.

iv Further remarks

Italian tax authorities have provided certain guidelines on leveraged buyout transactions, also by way of merger (LBOs and MLBOs), aimed at clarifying the tax treatment of fees and the entitlement to EU Directives or double tax conventions.

With reference to fees, the private equity firm charges to the SPV or to the target company for its services (i.e., transaction or arrangement fees and monitoring fees), the deductibility in the hands of the SPV or the target is denied if such fees refer to services that are provided in the exclusive interest of the investment fund and its investors. In all other circumstances (i.e., the cost refers to a service provided in the interest of the target), ordinary transfer pricing rules apply.

In addition, Italian tax authorities clarified that the SPV is not entitled to the deduction or the refund of VAT on the transaction costs (including the above fees), unless the latter actually carries out a commercial activity.

With reference to the exemption or other tax benefits provided by EU Directives or double tax conventions, such benefits are denied if the non-resident shareholders or holding company lacks ‘adequate’ economic substance (e.g., there is a light organisational structure in terms of personnel, equipment and premises; limited decisional powers; and back-to-back financial structures are in place).

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

In 2015, the Italian parliament enacted a piece of legislation providing for a new general anti-avoidance clause, which replaced the previously existing clause and also has disciplined the ‘abuse of law’ doctrine that was developed in recent years by the tax courts.

This rule provides that the tax authorities may disallow any tax advantage obtained through acts or transactions carried out without genuine economic reasons for the purposes of circumventing tax obligations or prohibitions, or for obtaining undue tax benefits.

The burden of proof lies with the tax authorities, which, in order to apply the general anti-avoidance clause, must issue an ad hoc notice of assessment to be provided with specific grounds in respect of the conduct that is deemed abusive.

It must be noted that, even prior to the enactment of the above general anti-avoidance provision, in recent years the Italian Supreme Court has delivered various decisions on the
‘abuse-of-law’ principle to tax matters, as derived from judgments rendered by the European Court of Justice. The new piece of legislation is aimed at, *inter alia*, providing a better definition of the boundaries of abusive conducts.

The ATAD requires EU Member States to lay down a general anti-avoidance rule in each jurisdiction starting from 2019; the Italian legislator, however, deemed the domestic legislative framework to be already in compliance with this requirement through the regime in place from 2015.

### ii Controlled foreign corporations (CFCs)

CFC legislation applies to all resident taxable entities holding a controlling participation in foreign entities located in low-tax jurisdictions (i.e., providing for a nominal corporate tax rate lower than half of the IRES rate) other than EU and EEA Member States.

It should be noted that the criterion for determining the countries falling within the scope of the CFC regime changed in 2015, taking the place of a previous system of blacklists based upon the effective level of taxation and the adequacy of exchange of information of such countries.

When CFC rules apply, the Italian-resident shareholder is taxed on its share of the CFC’s profits, determined according to national rules regardless of the actual distribution. However, this tax treatment does not apply if the Italian taxpayer is able to demonstrate that the non-resident entity mainly carries out a genuine business activity in the market of the country where it is located, or that the participation in the entity located in a low-tax jurisdiction does not result in any way in the allocation of income in a low-tax jurisdiction. This burden of proof can be waived by way of a ruling.

The CFC regime also applies when a controlled company that is not resident in a low-tax jurisdiction is subject to effective taxation that is lower than half of the effective burden that it would have suffered as an Italian resident, and more than 50 per cent of its revenues derive either from passive income (i.e., dividends, interest, royalties, capital gains) or from intra-group services. In such cases, the CFC rules do not apply if the Italian taxpayer is able to demonstrate, possibly through a ruling concerning proof (on which, see below), that the establishment of the CFC is not an artificial arrangement aimed at achieving an unfair fiscal advantage.

Pending the Italian Implementation of ATAD, CFC legislation is being amended once again. According to these new rules, CFC legislation applies if the controlled foreign entity is subject to an effective tax rate lower than 50 per cent of the virtually applicable Italian one and if more than one-third of its revenues derive from passive income-producing activities.

‘Parent company’ includes a permanent establishment in Italy of non-resident companies, whereas the definition of ‘controlled foreign company’ also covers permanent establishments of resident companies that opted for the application of the branch exemption regime.

The Italian resident taxpayer wishing to disapply CFC rules has to prove that the non-resident entity carries on a substantive economic activity supported by staff, equipment, assets and premises. This burden of proof can be waived by way of a ruling.

Dividends distributed by the CFC are not subject to tax in the hands of the parent company (up to the amount already taxed under CFC rules).
iii  Transfer pricing

Transactions between resident and non-resident affiliated entities must be valued at their ‘fair market value’. Adjustments in compliance with such evaluation shall be made either if an increase or a decrease of the taxable income occurs. In this respect, adjustments made by the tax authorities of other countries can be recognised with special procedures and according to specific rules that were recently amended in 2017. The concept of fair value as defined by the ITC has, in principle, the same meaning as the arm’s-length price defined in the OECD guidelines, to which reference is also usually made by the tax authorities in their interpretative instructions.

Specific rules have been issued providing for standard transfer pricing documentation to be prepared; such rules are compliant with the EU Code of Conduct and OECD guidelines. The main effect of providing such documentation is to avoid the possible application of administrative penalties in the case of adjustments by the Italian tax authorities.

Under a special ruling procedure, it is possible to negotiate advance pricing agreements with the Italian tax authorities: the number of advance pricing agreements have been increasing over the past few years, and are likely to continue to do so in light of a recent legislation that further enhanced the international standard ruling.

iv  Tax clearances and rulings

Tax clearances and Italian tax laws on rulings have undergone significant restyling, and the recently enacted rules provide for six ruling procedures, namely:

a  ordinary ruling;
b  ruling concerning proof;
c  anti-avoidance ruling;
d  requests for non-application of certain provisions;
e  ruling on new investments; and
f  international standard ruling.

The ordinary ruling procedure relates to the correct interpretation of tax provisions in cases of uncertainty. Following the filing of the ruling request, the tax authorities must issue a written and motivated reply within 90 days. A positive reply is binding on the tax authorities for the case submitted. If no reply is provided within 90 days, it is assumed that the tax authorities agree with the proposed interpretation.

The procedures under (b), (c) and (d) allow the tax authorities to reply within 120 days, while rulings under (f) are basically an agreement between the authorities and the taxpayer that is valid from the fiscal year it is signed in and throughout the following four years.

Under the international standard ruling, it is possible to define a number of aspects such as assessing the transfer pricing of certain goods and services, determining the value of assets at exit or at entry, agreeing the fair value of intercompany royalties and assessing whether a permanent establishment exists.

X  YEAR IN REVIEW

Four main pieces of legislation having tax relevance have been enacted in 2018: the Dignity Decree, the draft Budget Law for 2019 along with the draft Fiscal Decree linked thereto and, finally, the implementation of the ATAD.
The Dignity Decree, the Fiscal Decree and the Budget Law for 2019 enact some new tax rules, such as certain special rules concerning the transfer of assets abroad, the repeal of ACE and the reopening of the tax amnesty on tax debts, now including assessment notices, tax bills and pending litigation. These rules are innovative and seem to be strictly connected to the current political situation.

On the other hand, the implementation of the ATAD derives from EU obligations and follows the outcome of the BEPS project at the OECD level: as such, the implementation of the ATAD is likely to have more significant consequences on Italian tax system. In this respect, the ATAD affects various items of corporate income tax, in particular (1) GAAR; (2) an interest barrier rule; (3) CFC legislation; (4) dividends and capital gains from low-tax jurisdictions; (5) an exit tax regime and entry tax regime; and (6) a special regime for hybrid mismatches.

XI  OUTLOOK AND CONCLUSIONS

In 2018, the Italian economy maintained a positive trend, for instance in the M&A sector and by attracting high net worth individuals through the flat-tax regime for new resident individuals who have not been resident in Italy in nine out of the last 10 years and wish to move their tax residence to Italy (yearly €100,000 substitute tax on any foreign-source income due).

The current political situation prevents a reliable forecast of consolidation of the achievements of recent years, but also in light of a strong economic structure of medium-sized businesses, we do not expect an extraordinary fall in M&A transactions.
Chapter 17

JAPAN

Kei Sasaki, Fumiaki Kawazoe and Kohei Kajiwara

I  INTRODUCTION

Even as preparations for the Tokyo 2020 Olympics and Paralympic Games are under way, Prime Minister Shinzō Abe, with the Liberal Democratic Party, is continuing the ‘Abenomics’ economic programme, targeted at increasing inbound investments in Japan and stimulating domestic demand. An area of significant reform is that of tax. On one hand, the effective tax rate for corporations in Japan has been on a gradual downslide – it was 34.62 per cent in 2014 and was lowered to 29.74 per cent in 2018 – in line with policy initiatives to encourage more inbound investments in Japan.

On the other hand, Japan has a flat national consumption tax rate of 8 per cent as of November 2018, which is anticipated to rise to 10 per cent (except with respect to selected food and beverage items and daily newspapers) on 1 October 2019. This increase in consumption tax is expected to adversely affect the momentum in Japan’s economic recovery. The rapid growth in online purchases of digital content, goods and services, especially from vendors located abroad, has also prompted the introduction of a ‘reverse-charge’ system that allows consumption tax to be imposed on certain categories of taxpayers for their online transactions.

Tax reform in 2018 for inbound investment or cross-border transactions in Japan was not drastic but the Japanese government is definitely planning to continue to accelerate inbound investment by introducing or extending tax benefits over the coming years.

II  COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i  Corporate

In Japan, with the exception of sole proprietorships, businesses generally adopt a corporate form. Under the Companies Act of Japan (Companies Act), there are four types of companies one can establish:

a  stock company (KK);

b  general partnership company;

c  limited partnership company; and

d  limited liability company (GK).

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The corporate form chosen will determine whether ownership of a company is separated from the management thereof, and the extent to which shareholders or members are liable to perform the company’s obligations. The main differences between these four types of corporations are as follows: a KK is owned by shareholders but managed by its directors. The three other types of companies are, however, owned and managed by their members. The shareholders of a KK and members of a GK are only liable to the extent of their investments in their respective companies. On the other hand, the liability of members in a general partnership company is unlimited. By contrast, a limited partnership company has two types of members: those with limited liability and those with unlimited liability. As their names suggest, limited liability members are only liable to the extent of their investment in the company, while the liability of unlimited liability members is unlimited.

The KK is the most widely used corporate form in Japan. The GK, although not as popular as the KK, is also often used especially as a vehicle in structured finance. Limited partnership companies and limited liability companies, on the other hand, are not so common.

In addition to the corporate forms under the Companies Act, there are also laws in Japan that enable corporations of other forms to be incorporated for special purposes. These include:

a) specific purpose companies (TMKs), which are often used in asset securitisation;
b) investment corporations, which are commonly used to accumulate funds for investment in securities and real estate;
c) mutual companies, which are commonly used in insurance-related transactions; and
d) medical corporations, which are commonly used for holding hospitals.

ii Non-corporate

Non-corporate entities (except sole proprietorships) can generally be categorised as partnerships, silent partnerships (TKs) and trusts.

Most partnerships are general partnerships formed under the Civil Code of Japan (NKs). The partners in such partnerships are subject to unlimited liability. Additionally, there are other types of partnerships such as investment limited partnerships (LPSs) and limited liability partnerships (LLPs) that are derivatives of the NK. These partnerships may be established under special legislation. An LPS has partners with both limited and unlimited liability. LPSs are usually used for forming venture capital firms. An LLP is a partnership in which all partners are liable only to the extent of their investment in the partnership, and is typically used in joint ventures for academic research and development.

A TK is formed by way of a bilateral agreement between a business operator and its silent partners. A silent partner is someone who has contributed capital toward the relevant business operations in return for a share in the profits generated from the business. TKs are often used in structured finance.

Corporations incorporated under the Companies Act (i.e., KKs, general partnership companies, limited partnership companies and GKs) are fiscally opaque. On the other hand, partnerships such as NKs, TKs and most forms of trusts are fiscally transparent (i.e., they are pass-through entities). By comparison, TMKs and investment corporations are pay-through entities, such that the amount of profits they distribute (if any) to equity holders will be deducted from their taxable income.
III DIRECT TAXATION OF BUSINESSES

i Tax on profits

*Determinance of taxable profit*

Under the Corporation Tax Act of Japan (CTA), taxable income is derived by subtracting deductible expenses from gross profits. Deductible expenses are similar to accounting expenses, but with some important differences, and exclude certain kinds of accounting expenses. Gross profits are similar to accounting incomes, but with some important differences, and exclude certain kinds of accounting income.

There are major differences between deductible expenses and accounting expenses under the CTA, as follows:

1. In respect of depreciable or amortizable assets, the amount of depreciation or amortization permitted to be included in deductible expenses is limited. Specifically, the amount of depreciation or amortization deductible for each year is calculated based on the useful life of the relevant asset, which in turn is determined based on the category of the relevant asset, and on the method of depreciation or amortization adopted by the company. It should also be noted that under the Japanese tax system, depreciation and amortization are required to be recorded first as accounting expenses before they can be registered as expenses deductible from taxable income in the relevant financial year;

2. The amount of remuneration paid to officers shall not be included in the deductible expenses unless the period of remuneration payment is a constant period of one month or less, and the amount thereof is the same at each time of payment, remuneration is paid based on a provision with registration that ascertains an amount to be paid at a fixed time or remuneration is a certain kind of performance-linked remuneration;

3. The amount of contribution or donation exceeding a certain amount shall not be included in the deductible expenses; and

4. The amount of entertainment account exceeding a certain amount shall not be included in the deductible expenses.

Practically speaking, taxable income is derived from accounting profits. Once accounting profits have been ascertained, taxable incomes can be calculated by adding to the accounting profits the non-deductible expenses referred to above, and deducting therefrom, exclusive of gross profits, such items as certain portions of dividends distributed from a corporation.

In Japan, profits are taxed on an accrual basis and not on a receipt basis. Japanese corporations are subject to taxation on their worldwide income. Foreign corporations, on the other hand, are only subject to taxation on Japan-source income for the purposes of Japanese taxation. A foreign corporation's taxable Japan-source income differs depending on whether the foreign corporation is deemed to have a permanent establishment (PE) in Japan. Japan's system of taxable domestically sourced income adopts the 'attributable income principle'. Under this principle, in relation to taxation on business profits of a foreign corporation, only the portion that is attributable to its PE in Japan will be recognised as Japan-source income and, therefore, subject to Japanese taxation.

*Capital and income*

Realisation of and taxation on capital profits are usually deferred to the time of sale of the relevant asset. Where assets are sold at a profit, corporate income and capital profits will be aggregated and subject to corporate income tax at the corporate income tax rate.
**Losses**

*Tax loss carry back*

Where a domestic corporation incurs losses in a financial year, it may, simultaneously with the filing of its tax return, also file a claim for a corporate income tax refund for a certain amount of corporate income tax for any financial year commencing within one year prior to the beginning of the relevant loss-making financial year, depending on the amount of the said loss. However, where a corporation is not a small or medium-sized company (i.e., not a corporation with stated capital of ¥100 million or less, but excluding a corporation that is completely controlled by a corporation with stated capital of ¥500 million or more), this refund will not be applicable.

*Tax loss carry-forward*

When a domestic corporation files a final tax return that indicates losses in a financial year commencing within nine years prior to the first day of each of its financial years (or that indicates losses in a financial year beginning on or after 1 April 2018 and commencing within 10 years prior to the first day of each of its financial years), an amount equivalent to the said loss will be permitted to be included within the deductible expenses for each relevant financial year. However, where a corporation is not a small or medium-sized company and the amount of said loss exceeds the maximum deductible amount stated in the following table for the relevant financial year, inclusion within the deductible expenses will not apply to the amount of the said excess.

<table>
<thead>
<tr>
<th>Commencement date of the financial year when the relevant loss is included within the deductible expenses</th>
<th>1 April 2017 to 31 March 2018</th>
<th>1 April 2018 onwards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum deductible amount</td>
<td>55 per cent of the taxable income</td>
<td>50 per cent of the taxable income</td>
</tr>
</tbody>
</table>

In the case of a merger, losses are not usually permitted to be succeeded by the surviving corporation unless certain requirements for exceptional treatment are satisfied.

Under the CTA, taxable income is subject to aggregate taxation and is not taxed on an income category-by-category basis. Accordingly, in cases where losses are incurred by a business, but it receives capital gains from the sale of some assets, then said losses offset the income of the capital gain and reduce the taxable income.

**Rates**

The corporate income tax rate applicable to small or medium-sized companies is 15 per cent for income up to ¥8 million and 23.4 per cent for the portion of income in excess of ¥8 million. The corporate income tax rate applicable to companies other than small or medium-sized companies is 23.4 per cent. The corporate income tax rates will, however, be amended in the manner set forth below.

<table>
<thead>
<tr>
<th>Commencement date of the financial year</th>
<th>1 April 2016 to 31 March 2018</th>
<th>1 April 2018 to 31 March 2019</th>
<th>1 April 2019 to 31 March 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small or medium-sized companies</td>
<td>Up to ¥8 million</td>
<td>15 per cent</td>
<td>15 per cent</td>
</tr>
<tr>
<td></td>
<td>Portion in excess of ¥8 million</td>
<td>23.4 per cent</td>
<td>23.2 per cent</td>
</tr>
<tr>
<td>Companies other than small or medium-sized companies</td>
<td>Overall</td>
<td>23.4 per cent</td>
<td>23.2 per cent</td>
</tr>
</tbody>
</table>
Other than corporate income tax, companies are also subject to, *inter alia*, the following taxes, which are proportional with a rate that is flat or progressive, on profits generated:

- **a** local corporation tax
- **b** special local corporation tax (to be abolished for financial years beginning on or after 1 October 2019);
- **c** inhabitant tax; and
- **d** enterprise tax.

A corporation’s effective corporate income tax rate is determined by the amount of its stated capital and the location of its office. Corporations that have stated capital of more than ¥100 million and offices located in an area where the excess tax rate is not applied have an effective corporate income tax rate of 29.97 per cent from 1 April 2016 to 31 March 2018, and 29.74 per cent from 1 April 2018 to 31 March 2019. ‘Effective tax rate’ means the tax rate taking into account the deductibility of special local corporation tax and enterprise tax payments from taxable income.

**Administration**

Corporations are required to file their final tax return to the district director of the relevant tax office for corporate income tax (national tax) within two months following the end of each financial year (final return). A corporation whose financial year exceeds six months is also required to file an interim tax return to the district director of the relevant tax office within two months of the end of the first six months of its financial year (interim return).

In some cases, the competent district director may extend the filing deadline for a final return by one month or more if such extension is requested. Regardless of whether the deadline is postponed, corporations are required to pay corporate income tax by the original tax return filing deadline. Therefore, where the tax return filing deadline is extended, corporations are liable to pay interest on payable corporate income tax for the period of extension.

The primary objectives of the National Tax Agency (NTA) include the enhancement of transparency in tax filing procedures, creating predictability for taxpayers, encouraging taxpayers’ cooperation in investigations by the tax authority, improving the efficiency of the self-assessment system and strengthening accountability.

Matters of national tax (excluding internal consumption tax on imported goods, which is under the jurisdiction of the Customs and Tariff Bureau) are within the NTA’s purview. The NTA has 11 regional tax bureaux, a national tax office in Okinawa and around 500 tax offices located throughout Japan.

Matters of local tax fall within the jurisdiction of the relevant prefectural tax office or city office of the relevant local government.

Tax offices have the authority to conduct tax audits for corporate income tax. The timing of such audits is not prescribed in the relevant laws and regulations. Notwithstanding this, there is a general understanding that tax audits are conducted once every few years and are typically focused on corporations whose profits swing widely from year to year.

Revised tax returns may be filed to increase tax liability when the declared tax amount is less than the correct amount stated in the new tax return.

On the other hand, if the declared tax amount is more than the correct amount, corporate income tax reassessments may be requested by taxpayers, provided such requests are conducted within the permitted time frame (as indicated in the table below).
The district director of the relevant tax office may conduct reassessments of corporate income tax, provided such reassessments are conducted within the permitted time frame (as indicated in the table below).

<table>
<thead>
<tr>
<th>Type of tax reassessment</th>
<th>Permitted time frame (beginning from the deadline for filing of the relevant tax return)</th>
</tr>
</thead>
<tbody>
<tr>
<td>General</td>
<td>Five years</td>
</tr>
<tr>
<td>Tax reassessment in relation to transfer pricing</td>
<td>Six years</td>
</tr>
<tr>
<td>Tax reassessment in cases of changes to net loss amount</td>
<td>31 March 2018 Nine years</td>
</tr>
<tr>
<td></td>
<td>1 April 2018– 10 years</td>
</tr>
</tbody>
</table>

Taxpayers wishing to appeal a tax assessment can do so through the following avenues:

a  making a request for reinvestigation to the director of the relevant tax office that had performed the original tax assessment (taxpayers are not obliged but have the right to request a reinvestigation before requesting a re-examination under (b));

b  making a request to the National Tax Tribunal (NTT) for a re-examination of the original tax assessment; and

c  filing a lawsuit. (Lawsuits can only be filed, in principle, after the results of the NTT’s re-examination under item (b) have been released.)

As stated above, item (c) may be conducted only after following the procedure mentioned in item (b). On the other hand, a taxpayer may skip item (a) and go straight to item (b) instead.

**Tax grouping**

There are two regulatory frameworks in Japan in respect of tax consolidation: the full controlling interest framework and the consolidated return framework.

The full controlling interest framework applies mandatorily to intra-group transactions (including transactions involving transfers of assets, losses, dividends and interest) where all companies in the group are wholly owned (whether directly or indirectly) by the ultimate parent of the group, regardless of whether the ultimate parent is a foreign or domestic company or individual, provided that the parties to the relevant transaction are domestic companies. Under this regulatory framework, taxation on intra-group profits from transfers of certain kinds of assets, such as fixed assets, securities, monetary claims and deferred assets (qualifying assets), is deferred until those assets are transferred outside the group. Additionally, intra-group contributions, donations and dividends are disregarded. Where the full controlling interest framework applies, certain tax incentives to which corporations with stated capital of ¥100 million or less are normally entitled would no longer be available to a small or medium-sized company that is fully controlled by a large corporation with stated capital of ¥500 million or more.
On the other hand, the consolidated return framework is, where approved by the Commissioner of the NTA, only applicable to groups in which all companies are wholly owned (whether directly or indirectly) by the ultimate parent of the group and the companies consist only of domestic companies. Under this framework, corporate income tax is calculated based on the group's consolidated income and payable by the domestic controlling corporation as the taxpayer. In respect of subsidiaries in such groups, unrealised profits and losses of qualifying assets will be imputed to taxable income or losses for the financial year immediately preceding that in which the consolidated return applies to the group. In addition, under the consolidated return framework, taxation on profits from intra-group transfers of qualifying assets is deferred until those assets are transferred outside the group. Intra-group contributions, donations and dividends are also disregarded under the consolidated return framework.

ii Other relevant taxes

In addition to corporate income tax and other taxes on profits, which are stated above, the taxes that generally apply to businesses are, *inter alia*, withholding tax under the Income Tax Act of Japan, fixed property tax, consumption tax, stamp duty, registration tax and real estate acquisition tax.

Fixed property tax is proportional to the book value of the relevant property as indicated in the property register. Consumption tax is imposed on transfers of assets, with the transferor being deemed the taxpayer, although such tax is borne by the transferee in practice. Notwithstanding the above, in certain categories of online transactions, a ‘reverse charge’ was introduced and the transferee is deemed the taxpayer of consumption tax. Stamp duty is generally imposed on documents such as written contracts. Registration tax is imposed when registration is undertaken with the authorities, such as when real estate is registered on the national real estate register. Real estate acquisition tax, as its name suggests, is imposed on acquirers of real estate.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

An entity becomes a Japanese tax resident (that is, it is deemed a domestic corporation for Japanese tax purposes) if its head office or principal office is located in Japan. The place where management and control are exercised is irrelevant for the purposes of determining tax residency in Japan. Accordingly, a foreign-incorporated entity cannot be a Japanese tax resident, even though it exercises its management and control functions in Japan.

ii Permanent establishment

A foreign company will be considered to have a fiscal presence for purposes of Japanese tax if it has a PE in Japan, such as a fixed place of business (branch PE), building or site (building PE), or a person who is predominantly based in Japan to act on the corporation's behalf (agent PE). Several factors are relevant in determining whether a PE exists. For example, in determining whether a foreign company has a PE in Japan, relevant factors include, *inter alia*, whether the corporation's business is conducted at such a fixed place. Several steps can be taken to avoid being deemed to have a PE in Japan, including using the fixed place only for the purchase or storing of goods, or for performing supporting functions such as advertising, information collection or dispensation, and conducting of market research and feasibility studies.
The definition of PE will be amended from the financial years beginning on or after 1 January 2019 to align it with the OECD Model Tax Convention on Income and on Capital (OECD Model Convention) 2017. In addition, the most notable new rule is that the definition of PE under domestic tax law will be overwritten by the definition of PE under a relevant tax treaty applicable to a foreign company if the definition under the relevant treaty is different from that of domestic tax law. The other major amendments to domestic tax law include the following:

a. After the amendments to the definition of agent PE, agent PE will include not only a person who has an authority to conclude a contract in Japan on behalf of the foreign company but also a person who has a principal role in concluding a contract in Japan on its behalf. However, an agent of a foreign company will not be considered as PE if the agent is ‘independent’ from the foreign company and acts in the ordinary course of its business unless the agent acts only on behalf of one or more related parties.

b. After the amendments to the exception of definition of PE, even places that are used only for certain purposes, such as storing, exhibiting or delivering goods, etc., would not be excluded from PE unless the activity is purely preparatory or auxiliary in nature.

Japanese tax law adopts the attributable income principle, under which only the income attributable to the PE in light of the Authorised OECD Approach is taxable. Thus profits calculated by deeming that the PE was a distinct and separate entity from the corporation, was engaged in the same or similar activities under the same or similar conditions with the corporation, and was dealing wholly independently from the enterprise, are attributable to the PE.

Treaty tiebreakers, such as Article 4, Paragraph 3 of the US–Japan tax treaty (or the US–Japan double tax treaties (DTAs)), prescribe the method by which to determine the tax residence of a person who falls within the definition of tax resident in both the US and Japan. There is no concept of branch profit tax in Japan.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes
There is no special tax regime applicable to holding companies in Japan.

ii IP regimes
There is no special tax regime applicable to intellectual property in Japan, although withholding tax on royalty payments is exempt under some tax conventions.

iii State aid
State aid is available in certain sectors, such as the agriculture and manufacturing sectors. State aid comes in various forms, including tax exemptions, tax reductions and tax-free subsidies that encourage investments and the conducting of research and development in Japan. State aid is generally available as long as the relevant taxpayer is a tax resident of Japan, regardless of whether it is controlled by a foreign entity or individual.
iv General
The government provides several tax incentives to foreign business operators to encourage their investment in some sectors in Japan. Certain areas in Tokyo have been designated to fall within the Special Zone for Asian Headquarters, established to induce foreign companies to set up their offices and facilities in Japan. Specifically, a foreign company that establishes its Asian headquarter or its research and development centre in such special areas and also satisfies certain requirements will be entitled to enjoy tax incentives in the form of special depreciation rates or investment tax credits and several local tax exemptions.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)
Dividends and certain forms of profit distribution (such as capital repayment or repurchase of shares) by a domestic corporation to a non-resident or a foreign corporation are subject to withholding tax at a rate of 20.42 per cent (or 15.315 per cent in the case of dividends from listed shares).

The Income Tax Act of Japan contains different rules on sources of income in respect of interest income from Japanese government bonds, certain kinds of domestic corporate bonds and deposits with financial institutions’ business offices or facilities located in Japan (bond interest), and interest income from loans to business entities that conduct business in Japan (loan interest). Under Japanese law, bond interest is deemed Japan-sourced income, and is generally subject to withholding tax at a rate of 15.315 per cent if paid to a non-resident or a foreign corporation. Loan interest attributable to business conducted in Japan is also deemed Japan-sourced income, but is generally subject to withholding tax at a rate of 20.42 per cent when paid to a non-resident or a foreign corporation.

Royalties paid to non-residents or foreign corporations by entities or residents conducting business in Japan are subject to withholding tax at a rate of 20.42 per cent.

Notwithstanding the above, non-residents and foreign corporations with PEs in Japan may apply for an exemption from withholding tax on interest income from government bonds or corporate bonds received by way of the book-entry system, and interest income from corporate bonds issued outside Japan that is paid to recipients outside Japan. It should be noted, however, that such exemption does not apply to cases where interest income on corporate bonds is paid to related parties (such as relatives or controlling shareholders with more than 50 per cent equity interest in the issuer of the relevant corporate bonds). In addition, it should also be noted that interest income on corporate bonds that is attributable to PEs of non-residents and foreign corporations is still taxable under the self-assessment system instead of the withholding tax system.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments
As stated above, bond interest is generally subject to withholding tax. However, non-residents and foreign corporations may apply for an exemption from the withholding tax on interest income from government bonds or corporate bonds received by way of the book-entry system, and interest income from corporate bonds issued outside Japan is paid to recipients outside Japan. It should be noted, however, that such exemption does not apply to cases where interest income on corporate bonds is paid to related parties (such as relatives or controlling shareholders with more than 50 per cent equity interest in the issuer of the relevant corporate bonds). In addition, it should also be noted that interest income on corporate bonds that is attributable to PEs of non-residents and foreign corporations is still taxable under the self-assessment system instead of the withholding tax system.

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As stated above, interest income from deposits with financial institutions’ business offices or facilities located in Japan is generally subject to withholding tax. Foreign corporations may, however, apply for an exemption from the withholding tax on interest income derived from deposits in special international financial transactions accounts maintained with certain financial institutions. It should be noted that interest income from the deposits that is attributable to PEs of foreign corporations is still taxable under the self-assessment system instead of the withholding tax system.

iii Double tax treaties

As of 1 November 2018, Japan is party to 74 tax treaties with 126 countries and regions. These treaties comprise 61 tax treaties on avoidance of double taxation on income with 71 countries and regions (DTAs); 11 tax treaties on exchange of information with 11 countries and regions; a tax convention on mutual administrative assistance in tax matters among 90 countries; and a tax agreement between Japan and Taiwan.

Although Japan does not publish its general policies under the tax treaties it has entered into, most of the 61 DTAs are substantially based on the OECD Model Convention. In particular, the 2004 US–Japan DTA, which was based on the OECD Model Convention, serves as a base for many of the subsequent tax treaties entered into by Japan. It should be noted in this connection that even though the US–Japan DTA is based on the OECD Model Convention, it provides for lower tax rates on investment income such as interest, dividends or royalties in the source country to facilitate international investments; and contains anti-treaty abuse clauses, limitation-on-benefit clauses and exchange-of-information clauses to prevent treaty abuse.

The following table indicates the withholding tax rates in Japan, and how such rates are reduced or eliminated based on Japan’s DTAs with various developed and developing countries.

<table>
<thead>
<tr>
<th>Contracting state</th>
<th>Dividend</th>
<th>Interest</th>
<th>Royalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Domestic standard in Japan)</td>
<td>20.42 per cent</td>
<td>15.315 per cent or 20.42 per cent</td>
<td>20.42 per cent</td>
</tr>
<tr>
<td>United States</td>
<td>10 per cent</td>
<td>5 per cent or zero per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>10 per cent</td>
<td>zero per cent</td>
<td>zero per cent</td>
</tr>
<tr>
<td>France</td>
<td>10 per cent</td>
<td>5 per cent or zero per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Netherlands</td>
<td>10 per cent</td>
<td>5 per cent or zero per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Switzerland</td>
<td>10 per cent</td>
<td>5 per cent or zero per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Australia</td>
<td>10 per cent</td>
<td>5 per cent or zero per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Singapore</td>
<td>15 per cent</td>
<td>5 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Vietnam</td>
<td>10 per cent</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>China</td>
<td>10 per cent</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
</tbody>
</table>
iv Taxation on receipt

A domestic corporation that receives dividends from a domestic or foreign corporation is required to include dividends in its taxable income, although it is eligible for withholding tax credits or foreign tax credits.

However, a domestic corporation that receives dividends from another domestic corporation may exclude all or part of such dividends from its taxable income, depending on the relationship between the payer and recipient of the dividends. Where a dividend recipient holds 100 per cent of the shares in the dividend payer, received dividends may be entirely excluded from the recipient's taxable income. Where a dividend recipient holds more than one-third but less than 100 per cent of the shares in the dividend payer, 100 per cent of received dividends after deducting the relevant interest cost may be excluded from the recipient's taxable income. Where a dividend recipient holds more than 5 per cent but one-third or less of the shares in the dividend payer, 50 per cent of received dividends may be excluded from the recipient's taxable income. Where a dividend recipient holds 5 per cent or less of the shares in the dividend payer, 20 per cent of received dividends may be excluded from the recipient's taxable income. Further, such dividends are generally subject to withholding tax at a rate of 20.42 per cent (or 15.315 per cent for dividends received in respect of listed shares). A dividend recipient is eligible for withholding tax credits.

On the other hand, dividends received by a domestic corporation from a foreign corporation are generally required to be included in the domestic corporation's taxable income. Where the dividend recipient holds 25 per cent or more of the shares in the foreign dividend payer, then 95 per cent of the dividend may be excluded from the recipient's taxable income.

If a foreign country withholds tax on dividends, interest or royalties paid to a Japanese corporation recipient, the recipient will be eligible for foreign tax credits up to a certain amount in general. However, certain types of foreign tax, including but not limited to withholding tax on dividends received by a domestic corporation holding 25 per cent or more of the shares in the foreign dividend payer, are ineligible for the foreign tax credit.

VII TAXATION OF FUNDING STRUCTURES

Entities in Japan are commonly funded through equity or debt, or both. In situations involving foreign parent companies and Japanese subsidiaries, foreign parent companies will typically provide loans to their Japanese subsidiaries until the latter achieve operational stability and necessary critical mass.

i Thin capitalisation

Japanese tax law includes thin capitalisation rules. Under these rules, if interest is paid to a foreign controlling shareholder by a domestic corporation (i.e., a Japanese corporation) when the payer's average interest-bearing debt to the foreign controlling shareholder in the financial year exceeds three times the value of the foreign controlling shareholder's equity interest in the payer in the said financial year, and the payer's average aggregate interest-bearing debt in the said financial year exceeds three times the value of the aggregate equity interest in the payer, the interest income related to the excess debt will not be deductible from the payer's taxable income. A domestic corporation may, however, apply a different debt-to-equity ratio (instead of three times) if it can prove that a different ratio is appropriate in light of the debt-to-equity ratio of similar corporations.
ii  Deduction of finance costs

Finance costs such as interest or bank arrangement fees are generally considered deductible expenses. However, because Japanese tax law includes earnings stripping rules, transfer pricing rules and thin capitalisation rules, the inclusion of finance costs in deductible expenses is restricted.

Under the earnings stripping rules, when interest payments to related foreign corporations (such as a foreign parent company or subsidiary) exceed 50 per cent of the statutory income of the payer, the portion of interest payments exceeding 50 per cent of the statutory income of the payer is not deductible from the payer’s taxable income in the financial year. However, such excess portion is carried forward for seven financial years and can be used as deductible expenses until the total amount of deductible expenses reaches a 50 per cent threshold in each of the following seven financial years.

Under the transfer pricing rules, the portion of finance costs exceeding arm’s-length prices will not be deductible from the payer’s taxable income if the transaction giving rise to the relevant finance costs (including interest payments) is not conducted at arm’s length.

The thin capitalisation rules also place restrictions on the amount of deductible expenses claimable as stated above.

iii  Restrictions on payments

Under the Companies Act, a KK’s distributable profits, which are subject to statutory limits, are calculated based on surplus funds available. A GK’s distributable profits are also limited to a certain amount. By contrast, the profits distributable by a general partnership company and limited partnership company are unlimited, unless restrictions on profit distribution are contained in their articles of incorporation.

iv  Return of capital

A KK is permitted under the Companies Act to repay its capital to shareholders in the form of dividends through the reduction of its capital or statutory reserves. This involves approval for the capital or statutory reduction being obtained from the KK’s shareholders at a shareholders’ meeting; and the notification of the KK’s creditors about the reduction in capital or statutory reserves and, in the event of any objection to such reduction by any creditor, the taking of the required statutory procedures to protect the interests of the objecting creditor. Upon the implementation of the reduction, the KK will be generally deemed to have returned capital to its shareholders of an amount equivalent to the capital of reserves reduced.

However, if there is any portion as a result of a calculation subtracting the value of capital attributable to the shares held by the shareholder from the amount of such capital return, such portion is deemed to be a dividend instead of a capital return for tax purposes. Accordingly, if the shareholders of a KK are domestic corporations, a certain amount of deemed dividends may be excluded from the recipient’s taxable income depending on the relationship between the payer and recipient of the dividends, as stated above.

Further, if the shareholder of a KK is a domestic corporation, then the shareholder may include the capital gain or loss in its taxable income or loss. Such capital gain or loss is calculated by subtracting the acquisition cost basis of the share held by the shareholder from the capital return amount attributable to the share.
Overall, dividends distributed by a KK through the reduction of its capital or statutory reserves are viewed and taxed differently depending on which portion of the dividends is deemed to be a capital return or a dividend. Such a tax regime is not considered to be tax-neutral.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Foreign corporations often acquire businesses in Japan by acquiring shares or assets (including employees) of a target entity in Japan. Doing so obviates the need to establish a new entity in Japan. Based on the prevailing interpretation of the Companies Act, however, a Japanese corporation cannot engage in a merger or demerger with a foreign corporation. Accordingly, if a foreign acquirer wishes to merge with or demerge from a Japanese target entity, it has to establish a new wholly owned subsidiary in Japan (if it does not already have a Japanese subsidiary) through which to merge with or demerge from the target entity indirectly. In transactions where foreign corporations adopt such a structure, the new wholly owned Japanese subsidiary is typically financed by capital or debt, or both. The debt-to-equity ratio of such subsidiary is determined in light of the thin capitalisation rules and the earnings stripping rules.

Consideration for the acquisition of shares or assets is typically paid in cash. It should be noted, however, that consideration in forms other than cash (such as shares issued by the acquirer or a parent company of the acquirer, corporate bonds and other assets) is also permissible.

ii Reorganisation

Under Japanese tax law, mergers and demergers may be classified as tax-qualified mergers or demergers if certain conditions prescribed by the CTA are satisfied. One notable condition is that the consideration in tax-qualified mergers or demergers has to consist solely of shares in the acquirer or the wholly owning parent company of the acquirer in principle.

However, the consideration in tax-qualified mergers can include cash in the case that the acquirer holds two-thirds or more of the target corporation's shares and the merger is conducted in order to squeeze out minority shareholders.

Assets and liabilities in non-tax-qualified mergers or demergers are transferred at fair market value. In tax-qualified mergers or demergers, however, assets and liabilities are transferred at book value. This means that capital gains or losses arising from transfers in tax-qualified mergers or demergers may be deferred at both the merged corporation level and the level of its shareholders. Notwithstanding this, tax-qualified mergers or demergers may not always offer the most favourable tax treatment to taxpayers where unrealised losses are deferred. However, taxpayers wishing to avoid requirements in respect of tax-qualified mergers or demergers can easily do so by paying consideration in forms other than shares. In this sense, Japanese tax law does not prevent consolidation between an acquired business and an existing local business, although mergers and demergers between Japanese corporations and foreign corporations are not permitted under the Companies Act, as stated above. Ultimately, the most suitable type of merger or demerger depends on the relevant situation.
Exit

Foreign corporations wishing to exit the Japanese market commonly do so by selling the shares in their Japanese subsidiaries. Capital gains arising from such sales are taxable under the CTA. As a result, foreign corporations are required to file tax returns with the applicable tax office within two months following the end of their financial year.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

Japanese tax laws contain general avoidance rules such as the disallowance of acts or calculations:

a by family-owned corporations;
b in relation to organisational restructuring;
c by consolidated corporate groups; and
d regarding foreign entity profits that are attributable to a PE.

In respect of low-tax jurisdictions, the Japanese tax authorities apply the controlled foreign corporation rules (the CFC rules) in addition to other rules such as transfer pricing rules, thin capitalisation rules and earnings stripping rules.

ii Controlled foreign corporations (CFCs)

The financial year 2017 tax reform substantively revised the CFC rules, which have been effective from the financial year of foreign corporations commencing on or after 1 April 2018. An overview of the revised CFC rules is as follows. The CFC rules will apply if: (1) more than 50 per cent of shares in a foreign corporation are held directly by one or more Japanese residents (domestic corporations or individual residents in Japan) and/or indirectly by one or more foreign affiliates more than 50 per cent of shares in which are held by one or more Japanese residents or such foreign affiliates; or (2) the foreign corporation is substantially controlled by a Japanese resident. The foreign corporation will be considered to be substantially controlled by a Japanese resident if the Japanese resident has the right to receive most of the residual property of the foreign corporation or if the Japanese resident can determine most of the policy on property disposal of the foreign corporation based on an agreement.

The CFC rules differ depending on activity of a foreign corporation.

If a foreign corporation falls within the category of a paper company, a company deemed to be an actual cash box or a company located in a blacklisted country (a Paper Company etc.), a Japanese resident, who: (1) owns 10 per cent or more of the shares in; or (2) has a substantial controlling interest in such foreign corporation, is taxed on the retained profits of the foreign corporation: (1) in proportion to the ratio of the resident’s stock ownership in that corporation; or (2) in consideration of such substantial controlling interest in that corporation unless the amount of taxes on a foreign corporation’s income that is earned in a foreign country where the head office or principal office of the foreign corporation is located is 30 per cent or more of the foreign corporation’s income (the Tax Burden Rate).

If a foreign corporation (which is not a Paper Company, etc.) does not satisfy any of the following requirements stated below in (a) to (d), a Japanese resident is also proportionally taxed on the retained profits of the foreign corporation; provided, however, that a Japanese resident is not taxed on the retained profits of the foreign corporation if the Tax Burden Rate is 20 per cent or more:
the main businesses of the foreign corporation are not certain types of business, such as holding shares or bonds (business purpose test); 

b the foreign corporation has the business offices necessary for its main business in said foreign country (substance test); 

c the foreign corporation has management and control functions in said foreign country (management and control function test); and 

d the foreign corporation conducts business mainly with unrelated parties (unrelated parties test) or mainly in said foreign country (location test). Whether the unrelated parties test or location test will apply depends on the segments of the foreign corporation’s main businesses that are involved.

If a foreign corporation (which is not a Paper Company, etc.) satisfies all of the requirements stated above in (a) to (d), a Japanese resident is proportionally taxed on only the statutory tainted income of the foreign corporation (such as dividends or interest income); provided, however, that a Japanese resident is not taxed on the statutory tainted income of the foreign corporation if the Tax Burden Rate is 20 per cent or more.

### Transfer pricing

Under Japanese transfer pricing rules, a domestic corporation that transacts with related foreign entities (such as a foreign parent corporation) will, if the transaction involves a non-arm’s length consideration, be liable for tax calculated based on an arm’s-length consideration imputed on the transaction. In calculating the appropriate arm’s-length consideration, the tax authority will apply the most suitable statutory method of calculation available.

Typically, the tax authority will request further information from the taxpayer that will aid the authority to calculate an appropriate arm’s-length consideration. Where a taxpayer fails to adequately respond to such requests, or does not promptly provide such information, the tax authority will have the right to determine such arm’s-length consideration as it deems fit based on reasonable assumptions applicable to the relevant statutory method of calculation.

### Tax clearances and rulings

It is possible to obtain advance rulings from the NTA in respect of actual (as opposed to hypothetical) situations. Trade associations also frequently consult the NTA in advance of the kinds of transaction that are commonly conducted by such trade associations. In addition, advance pricing arrangements are also applicable under the transfer pricing rules. As a general matter, no tax clearances or rulings are required in transactions involving the acquisition of a local business.

### YEAR IN REVIEW

#### Reduction of corporate income tax

Corporate income and effective tax rates in Japan have been lowered in recent years. The following table sets forth recent changes in the tax rates.

<table>
<thead>
<tr>
<th></th>
<th>1 April 2016 to 31 March 2018</th>
<th>1 April 2018 to 31 March 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate income tax rate</td>
<td>23.4 per cent</td>
<td>23.2 per cent</td>
</tr>
<tr>
<td>Effective tax rate for corporations</td>
<td>29.97 per cent</td>
<td>29.74 per cent</td>
</tr>
</tbody>
</table>
The gradual lowering of corporate income tax rates in Japan is in line with the government’s plan to make Japan more competitive in the global economy, considering that Japanese corporate income tax rates are among the highest in the world. This is also consistent with the worldwide trend of lower corporate income tax rates.

ii  Consumption tax

Japan’s national and local consumption tax rates had originally been slated to rise from 8 to 10 per cent in October 2015. However, the date of implementation of this increase has been postponed to October 2019. When the increased tax rate comes into force, reduced tax rates of 8 per cent will at the same time be introduced in respect of certain kinds of food, beverages and daily newspapers, which will for the first time see non-flat consumption tax rates being implemented in Japan.

iii  Court cases

From the beginning of 2017 until October 2018, there were no significant published court cases with regard to M&A transactions or inbound investment in Japan. However, tax disputes in relation to CFC rules are increasing and a supreme court’s decision of the CFC rules, where the ‘main business’ of a regional headquarter subsidiary of a Japanese major corporation was discussed, was rendered in October 2017. In this case, the taxpayer won for the reason that the main business of the company was not holding shares of its various subsidiaries but organising the regional business. Considering the Japanese tax authority has been challenging multinational companies with their subsidiaries in tax haven countries, it is essential to catch up with the recent reform of the CFC rules and court cases, and not only set up but also continuously review foreign subsidiary structures and functions.

XI  OUTLOOK AND CONCLUSIONS

Generally, we expect the tax authorities in Japan to continue keeping pace with developments in international tax laws, and to harmonise Japanese tax principles with such developments through legislative amendments and tax treaties. With regard to more specific issues, the recent reduction in corporate income tax and increase in consumption tax may lead to tax-driven business restructuring, especially in the supply chain and logistics sectors. Additionally, base erosion and profit shifting action plans are expected to be localised over the next few years. These tax reforms are expected to affect business activities in Japan in a way that we hope is conducive to overall economic growth.
INTRODUCTION

Lebanon is a country that, by tradition, remains open to foreign direct investment, and is endowed with several investment-enabling strengths:

- a free market;
- a highly dollarised economy;
- the absence of controls on the movement of capital and foreign exchange;
- limited restrictions on foreign investment; and
- a solid banking sector.

The government encourages foreign investment, and continues to favour a strong role for the private sector in a liberal policy environment while maintaining minimal intervention in economic activities.

The government passed several laws and decrees to encourage investment. The Investment Development Authority of Lebanon (IDAL) was established in 1994, and was considerably remodelled in 2001 to stimulate Lebanon’s economic and social development, and to enhance its competitiveness.

Despite domestic political instability and regional turmoil in past years, which contributed to a decline in capital inflows and a slowdown in new investment, Lebanon has maintained a stable legal and tax environment. The government continues to express a strong commitment to improving the business environment, as well as encouraging domestic and foreign investment and public–private partnerships.

Lebanese law does not differentiate between local and foreign investors, except in sectors with specific requirements and limitations such as real estate, insurance, media (television and newspapers) and banking. Foreign investors can generally establish a Lebanese company, participate in a joint venture, or establish a local branch or subsidiary of their company without difficulty.

Some issues continue to cause frustration among local and foreign business people. Impediments include red tape and corruption, complex customs procedures, some archaic legislation, lengthy judicial procedures and a weak enforcement of intellectual property rights.
II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate
The Lebanese Code of Commerce of 1942 and its amendments (Code of Commerce) distinguish between five forms of business entities, namely:

- joint-stock companies (JSCs);
- limited liability companies (LLCs);
- general partnerships;
- limited partnerships; and
- company partnerships limited by shares.

JSCs and LLCs, along with holding companies and offshore companies recognised as corporate entities since 1983, are the most widely used forms for setting up new companies in Lebanon. All such companies are required to be registered at the commercial registrar, which is overseen by the president of the tribunal of first instance in the corresponding locality.

The liability of the shareholders of a JSC is limited to their contribution to the JSC’s capital. The minimum share capital in a JSC is around US$20,000, and the minimum number of shareholders is three. As per Law No. 75 of 27 November 2016, a JSC (including holding and offshore companies) is prohibited from issuing shares to the bearer, and all shares must be in the registered (nominative) form.

The JSC form is mandatory for certain business organisations such as insurance companies, banks and financial institutions. The JSC is run by a board of directors whose members are collectively responsible for running the JSC’s affairs, while a chair or general manager is responsible for day-to-day matters. The chair or general manager may propose that the board of directors appoints a deputy general manager, but the latter shall act on behalf and under the responsibility of the chair or general manager.

Limitations related to foreign participation in the JSC include:

- a general limitation on management participation (Article 144 stipulates that the majority of the board of directors should be Lebanese);
- an indirect limitation with regard to the guarantee shares held by board members (Article 147);
- a limitation on capital shares with regard to public utilities (Article 78); and
- a limitation on capital shares and management with regard to exclusive commercial representation (Legislative Decree No. 34/67, dated 5 August 1967).

The transfer of shares of a JSC between shareholders or to third parties is unrestricted, subject only to the right of first refusal of the JSC or the other shareholders, or both, if it is expressly provided for in the JSC’s articles of association or in a separate shareholders’ agreement. It is not a requirement that the transfer deed be notarised.

The liability of the partners of an LLC is limited to their contribution to the LLC’s capital. The minimum share capital is around US$3,334, and the minimum number of partners is three. An LLC can be fully non-Lebanese-owned, and the management of the

2 Existing companies with capital constituted in whole or in part of bearer shares are required to convert such shares to registered (nominative) shares within the one-year deadline set out in Law No. 75 of 27 November 2016.
company can be controlled by non-Lebanese parties. The transfer of shares to a non-partner is subject to the approval of partners representing at least three-quarters of the company’s capital. The transfer deed should be notarised and notified to the LLC’s director and to all the partners.

Holding and offshore companies follow the legal form of a JSC and are respectively governed by Legislative Decree No. 45 (on holding companies) dated 24 June 1983 and amended by Law No. 772 dated 11 November 2006, and Legislative Decree No. 46 (on offshore companies), dated 24 June 1983 and amended by Law No. 19 dated 5 September 2008, Decree No. 7861 dated 24 March 2012 and Law No. 85 dated 10 October 2018.

The holding company’s purpose consists of:

a acquiring shares or interests in existing Lebanese or foreign JSCs and LLCs participating in the incorporation of the same;
b managing companies in which it holds shares or interests;
c granting loans to companies in which it holds shares or interests exceeding 20 per cent and guaranteeing said companies towards third parties;
d acquiring patents, licences, registered trademarks and other protected rights, and leasing the same to entities operating in Lebanon and abroad; and
e acquiring chattels or real estate, provided the same are only employed in the context of its activities and subject to the provisions of the law governing the acquisition by foreigners of real estate rights in Lebanon.

The holding company is exempt from income tax and withholding tax on dividend distributions, and is instead subject to a progressive tax rate, depending on its capital, to a maximum of circa US$3,333 per year.

The purpose of the offshore company was considerably extended in 2008 to attract foreign investments and now includes:

a entering into agreements to be implemented outside Lebanon;
b managing other offshore companies;
c carrying out commercial operations overseas;
d acquiring shares in non-resident companies; and
e opening branches and representation offices outside Lebanon.

Following the enactment of Law No. 85, offshore companies can be formed by a sole shareholder, who may be a natural person or a legal entity, Lebanese or foreign.

An offshore company may not perform activities in Lebanon except for opening bank accounts, renting offices and owning Lebanese treasury bills, and may not carry on banking or insurance activities. The offshore company is exempt from income tax and withholding tax on dividend distributions, and is instead subject to an annual lump sum amount of around US$666. A foreign non-resident chair or general manager of a holding or an offshore company is exempt from the obligation to hold a work and a residency permit.

Both holding companies and offshore companies are also exempt from share transfer tax, stamp duty on share transfers, etc., and present other advantages, such as the exemption from having at least two Lebanese members on their boards of directors.
ii Non-corporate

Physical persons may register themselves as traders at the commercial registrar of the locality where their main business is located. Traders may own commercial establishments that are deprived of legal personality. Traders are subject to income tax on their personal income at a progressive rate ranging between 4 and 21 per cent.

The Code of Commerce expressly recognises joint ventures, which are created by virtue of a contract and are deprived of legal personality except if the joint venture itself issues invoices, in which case it shall be subject to paying value added tax. Joint ventures are not subject to registration or publication requirements, and their existence should not be disclosed to third parties. Each partner in a joint venture who deals with a third party is considered to be dealing in his or her own name and for his or her own account, and is solely responsible for the debts incurred in relation to such third party.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

Tax is levied on the net income generated during the previous year. The net income is calculated by deducting all charges and expenses determined in the law from the turnover of the taxpayer.

There are three tax assessment methods: the effective profit method (used mainly for JSCs and LLCs); the lump-sum profit method; and the estimated profit method.

Income tax applies to earnings from business ventures carried out in Lebanon or the taxation of which is attributed to Lebanon pursuant to a double taxation treaty.

Capital and income

Income and capital gains are taxed at different rates according to Income Tax Law No. 144 dated 12 June 1959 and its amendments (Income Tax Law). Income tax applies at a rate of 17 per cent for corporations, and at a progressive rate ranging between 4 and 21 per cent for physical persons. Capital gains resulting from the re-evaluation of assets are subject to a 10 per cent tax (with the possibility of total exemption in certain cases) and those resulting from the transfer of assets are subject to a 15 per cent tax (with partial deductions being allowed when the transferred assets consist of real estate properties).

Losses

Losses may be carried forward for a period of three consecutive years and survive any change of ownership.

Rates

Corporations (JSCs and LLCs) are subject to flat income tax at a rate of 17 per cent. The payment of dividends or any other dividend-like distributions to shareholders is subject to withholding tax at a rate of 10 per cent. The effective tax payable is thus 25.3 per cent.

Branches of foreign companies are subject to income tax at a rate of 17 per cent. According to the Income Tax Law, profits earned by branches of foreign companies are
deemed distributed in full as dividends, and such distribution is subject to a 10 per cent tax on dividend distribution. The effective income tax rate payable by branches of foreign companies is thus 25.3 per cent.

Individuals are subject to a progressive tax rate ranging between 4 and 21 per cent on their income, after deducting around US$5,000 for single individuals, in addition to approximately US$1,700 for married individuals and US$300 for every legitimate dependent child (up to five children), subject to certain conditions.

The reduced tax on dividend of 5 per cent previously given to certain listed companies has been cancelled. The standard tax on dividend rate is 10 per cent for all companies.

**Administration**

Tax returns are due annually, and must be filed before the tax authorities at the Ministry of Finance. The tax authorities may re-audit or reassess the amounts included in the tax declarations. The tax authorities may also challenge any scheme for tax avoidance or any practices contrary to the purpose of the law, in which case the violators may incur substantial penalties.

Guidance and comfort may be sought from the tax authorities regarding the interpretation of taxes and regulations, or regarding factual matters. The decisions of the tax authorities may be subject to an opposition filed by the taxpayer before the tax authorities in cases of an error or an unjustified imposition of additional taxes. The Income Tax Law also provides for a judicial recourse against decisions of the tax authorities.

The statute of limitations on taxes in Lebanon is five years.

**ii Other relevant taxes**

**Lump sum tax**

Law No. 20 dated 10 February 2017 reintroduced a new lump sum tax payable per annum (which was originally provided for in the Budget Law No. 173 dated 14 February 2000 but remained ineffective ever since), as detailed in the table below.

<table>
<thead>
<tr>
<th>Taxpayer*</th>
<th>Tax amount (Lebanese pounds)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Joint-stock company (SAL)</td>
<td>2 million</td>
</tr>
<tr>
<td>Limited liability company (SARL)</td>
<td>750,000</td>
</tr>
<tr>
<td>Partnerships and personal establishments taxed on the basis of real profit</td>
<td>550,000</td>
</tr>
<tr>
<td>Branches of foreign companies</td>
<td>X*†</td>
</tr>
<tr>
<td>Individuals taxed on the basis of ratio profit</td>
<td>250,000</td>
</tr>
<tr>
<td>Individuals taxed on the basis of estimated profit</td>
<td>50,000</td>
</tr>
</tbody>
</table>

* The lump sum tax applies to the head office and each branch of a taxpayer operating in Lebanon. The term ‘branch’ shall be deemed to include, without limitation, offices, shops, points-of-sale, factories that conduct administrative, sales or business activities, and any other location at which the taxpayer conducts activities or receives clients.

† The corporate form of the foreign company is used as a reference to calculate the amount of the lump sum tax payable by the branch.

This lump sum tax was meant to apply irrespective of whether the target company has recorded profits, and was in principle not deductible for income tax purposes.

The application of Law No. 20 was suspended for three years as of 1 January 2018 by virtue of Law No. 108 dated 30 November 2018.
Law No. 108 also provided that taxpayers who had settled the annual lump sum licence fee have the right to apply for a refund, which will be set by a decision from the Ministry of Finance.

**Tax on interest**
Tax on bank interest is currently payable at a rate of 7 per cent.

**Non-resident tax**
Tax on payments made in return for services provided by a non-resident is applied at a rate of 15 per cent on the deemed profits, estimated at 50 per cent of the gross proceeds. Tax on payments made other than for services performed is applied at a rate of 15 per cent on the deemed profits, estimated at 15 per cent of the gross proceeds.

**Value added tax**
VAT is an indirect tax on consumption levied at each stage of the production and consumption process. It is currently applied at a rate of 11 per cent. All companies whose revenues in any given quarter or year exceed approximately US$66,700 are subject to mandatory VAT registration.

Companies located in the Port of Beirut or the Port of Tripoli free zone are exempt from VAT for export purposes.

**Stamp duties**
The standard stamp duty amounts to 0.4 per cent of the amounts provided for in a contract. Specific types of contract are subject to a lump-sum stamp duty ranging between approximately US$0.07 and US$1,334.

**Built property tax**
Built property tax is a progressive tax applied on annual net rental proceeds and ranges between 4 to 14 per cent, according to a progressive tax scheme.

**Municipality tax**
Municipality tax is a flat tax paid annually at a rate of 8.5 per cent of the yearly rent amount or the rental value of premises.

### IV TAX RESIDENCE AND FISCAL DOMICILE

i  **Corporate residence**
Income tax in Lebanon is territorial. Profits realised in Lebanon and profits derived from an activity in Lebanon are subject to Lebanese income tax. Accordingly, profits realised outside Lebanon but generated from an activity executed in Lebanon are subject to Lebanese income tax. On the contrary, profits realised and generated from an activity outside Lebanon are not subject to Lebanese income tax.

ii  **Branch or permanent establishment**
Foreign companies may open branches and representative offices in Lebanon.
Branches of foreign companies are subject to the same income tax rate as Lebanese companies in respect of their profits realised in Lebanon. Representation offices of foreign companies are prohibited from undertaking any commercial activity or from deriving profit in Lebanon.

Foreign commercial companies wishing to operate a branch or a representative office in Lebanon must register at the commercial registrar and at the Ministry of Economy and Trade (MoET). The establishment of a branch or agency in Lebanon is subject to a resolution of the foreign company's board of directors, which should clearly indicate the nature of the prospective business in Lebanon and nominate an authorised representative.

Although registration formalities and tax rates are substantially similar for branches of foreign companies and Lebanese LLCs, rather than an LLC, a branch is the most common form for foreign investments in Lebanon.

Any foreigner who spends more than 183 days per annum in Lebanon shall be considered as a Lebanese resident for taxation purposes.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes

Holding companies are exempt from income tax, withholding tax on dividend distributions, and the lump sum tax on companies introduced by virtue of Minister of Finance Decision No. 993/1 of 31 October 2016. Holding companies are subject to an annual lump sum tax, the amount of which is proportional to their capital and which ranges between approximately US$1,200 and US$3,400.

The Income Tax Law provides that the sale of shares by a holding company is subject to capital gains tax at a rate of 15 per cent if such shares have been held by the holding company for less than 24 consecutive months at the date of transfer. The sale of shares that have been held by the holding company for more than 24 consecutive months is exempt from capital gains tax. As per Instruction 1365/S1 of 31 August 2007, capital gains resulting from the disposal by a holding company of its shares or parts in companies located outside Lebanon are exempt from capital gains tax.

Share sale agreements are exempt from the 4 per mille stamp duty.

A holding company may charge interest on loans given to its subsidiaries (at a rate not to exceed certain limits set under law, depending on the source of the amount given in the loan) and receive management fees from its subsidiary in an amount not exceeding 2 per cent of the subsidiary's annual turnover.

As per Instruction 1365/S1 of 31 August 2007, holding companies are subject to tax at a rate of 10 per cent on interest from loans granted by the holding company to its subsidiaries when the maturity of such loans is less than three years. Interest from loans having a maturity exceeding three years is tax-exempt.

A holding company is liable to pay social security contributions and payroll taxes for its employees. It is also subject to a 5 per cent tax on management fees received from its subsidiaries, and to a 10 per cent tax on royalties received from its subsidiaries from the licensing of trademarks.
ii IP regimes

Existing intellectual property rights laws cover copyright, patents, trademarks and geographical elements. All intellectual property rights registered at the MoET enjoy protection under Lebanese laws. Such registration has to be published in the Official Gazette. There is no special IP tax regime in Lebanon.

iii State aid

Tax incentives are also granted by Investment Development Law No. 360 (Investment Law) dated 16 August 2001 and its subsequent amendments, which instituted IDAL.

IDAL offers a wide range of competitive investment incentives depending upon the qualifications and criteria for each project. These incentives include:
\( a \) exemption from income tax and tax on distribution of dividends for a number of years;
\( b \) grant of work permits for various categories exclusively needed for the project;
\( c \) fee reduction on work permits and residency; and
\( d \) fee reduction on construction permits, if required for the project.

IDAL also offers a business-matching service, a one-stop shop for facilitating administrative formalities and a basket of incentives referred to as the 'package deal', granted after approval by the Cabinet.

The Investment Law divides Lebanon into three investment zones, with different incentives provided in each zone, and encourages investments in the fields of technology, information, telecommunications and media, tourism, industry, and agriculture and agro-industry. The Investment Law also allows for the introduction of tailor-made incentives through package deals for large investment projects, regardless of the project's location, including tax exemptions for up to 10 years, reductions on construction and work permit fees, and a total exemption on land registration fees.

Other laws and legislative decrees provide tax incentives and exemptions depending on the type of investment and its geographical location. Industrial investments in rural areas benefit from tax exemptions of six or 10 years, depending on specific criteria, and exemptions are also available for investments in south Lebanon, Nabatiyeh and the Bekaa Valley.

The 2017 Budget Law No. 66 dated 3 November 2017 introduced a new income tax exemption for a period of five years in favour of new institutions established in one of the areas that the government wishes to promote and develop. The areas to be developed shall be determined by the Council of Ministers, and the exemption shall be granted by the Minister of Finance.

iv General

The following enterprises are exempt from corporate tax: educational institutions, cooperative associations, trade unions and other types of professional associations, Lebanese maritime and airline companies, public institutions, and holding and offshore companies. Moreover, industrial enterprises could benefit from temporary exemptions in the event of the reinvestment of generated profits for the purchase of new industrial assets.

Law No. 296 dated 3 April 2001, which amended the 1969 Law No. 11614, governs the foreign acquisition of property. The new Law eased legal limits on foreign ownership of property to encourage investment in Lebanon, especially in industry and tourism; abolished discrimination for property ownership between Arab and non-Arab nationals; and lowered
real estate registration fees to 5 per cent for both Lebanese and foreign investors. The Law permits foreigners to acquire up to 3,000 square metres of real estate without a permit; acquiring more than 3,000 square metres requires Cabinet approval.

Domestic and foreign investors may benefit from a 4.5 per cent subsidy on interest on new loans granted after 1 January 2012 amounting to up to US$10 million per project (with a ceiling of US$40 million) provided by banks, financial institutions and leasing companies to industrial, agricultural, tourism and information technology establishments. The subsidy extends to a maximum of seven years. Investors can also benefit from loan guarantees from Kafalat, a semi-private financial institution that assists small and medium-sized enterprises (SMEs) in accessing subsidised commercial bank loans.

On 10 February 1981, Lebanon and the United States signed an Overseas Private Investment Corporation (OPIC) agreement in Beirut, but no investment using OPIC insurance coverage was undertaken until 1996. OPIC is currently engaged with Lebanon in three areas: insurance, financing and investment. Since 2006, OPIC has worked with Citibank on a programme that offers loans to the private sector (SMEs, retail and housing) through selected Lebanese commercial banks. This programme began in January 2007, and to date OPIC has provided US$300 million in credit line guarantees.

The government’s National Institute for the Guarantee of Deposits continues to insure new investments against special risks. Other major trade and investment insurance programmes operating in Lebanon include COFACE (France), ECGD (UK), HERMES (Germany), SACE (Italian) and IAIGC (Arab Consortium). Lebanon has been a member of the Multilateral Investment Guarantee Agency, which is part of the World Bank, since 1994.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)

Unless reduced by virtue of a tax treaty:

a dividends paid to a non-resident are subject to a 10 per cent withholding tax; and

b remuneration paid to non-residents is subject to a 7.5 per cent withholding tax.

ii Double taxation treaties

Lebanon has entered into double taxation treaties with the following countries: Algeria, Armenia, Bahrain, Belarus, Bulgaria, Cuba, Cyprus, the Czech Republic, Egypt, France, Gabon, Iran, Italy, Jordan, Kuwait, Malaysia, Malta, Morocco, Sultanate of Oman, Pakistan, Poland, Qatar, Romania, Russia, Senegal, Sudan, Syria, Tunisia, Turkey, Ukraine, the UAE and Yemen.

These treaties are aimed mainly at preventing double taxation. Nationals of the above-mentioned countries benefit from tax exemptions insofar as such exemptions are expressly provided in the treaty between their country of origin and Lebanon.

However, owing to the principle of territoriality applicable in Lebanon, the implementation of double taxation treaties has proven to be difficult, with many impediments arising in this respect.
iii. **Taxation on receipt**

Capital gains derived from the sale of shares held by resident companies are subject to capital gains tax at a rate of 15 per cent.

**VII. TAXATION OF FUNDING STRUCTURES**

Entities are funded either internally through equity financing (capital funding, retained earnings, etc.) or externally through debt (bank loans, debt instruments, etc.). Particular preferences for the mode of financing depend on the business sector and on the investors’ inclination to leverage their business.

i. **Thin capitalisation**

The Code of Commerce does not regulate thin capitalisation or provide for mandatory debt-to-equity ratios, and companies can in principle freely determine their financing scheme as they prefer. However, traders and commercial companies are required to pay their commercial debts as they fall due, and to maintain their creditworthiness, failing which they may be declared bankrupt. Accordingly, any trader who uses unlawful means to sustain its creditworthiness or incurs commercial debts beyond its repayment ability may be declared bankrupt, and, in certain cases, may face criminal charges.

The Code of Commerce also provides that the partners in an LLC should decide to either liquidate it or decrease the capital within four months following the approval of the accounts evidencing a loss of three-quarters of their capital. JSCs are subject to similar conditions following the loss of three-quarters of their capital.

Banks are subject to the circulars of the Central Bank of Lebanon governing their indebtedness, in accordance with the Basel II accords.

ii. **Deduction of finance costs**

The taxable net income of a company is calculated after deduction of all general expenses, financial charges, depreciation and legal reserves. Finance costs are thus taken into account and deducted for the calculation of the net income of the company. No specific scheme governs finance costs *per se*.

iii. **Restrictions on payments**

Pursuant to the Code of Commerce, shareholders decide whether to distribute dividends at the annual general assembly meeting held for this purpose.

The Code of Commerce subjects the payment of dividends to the existence of a net income validly documented in the company’s financial statements, and holds members of the board of directors, as well as auditors, criminally liable in the event of fraud in such financial statements. It also requires companies to make yearly deductions of 10 per cent from their net income to constitute the legal reserve amounting to one-third of the capital of JSCs and half of the capital of LLCs, and the statutory reserve, if any. The payment of fictive dividends engages the liability of board members as well as the liability of auditors.

The Code of Commerce provides for different treatments regarding the redemption of dividends resulting from a fictive income: partners of an LLC are required to return such
dividends without any conditions, whereas shareholders of the other forms of companies (including a JSC) cannot be forced to return such dividends other than in the case of an established bad faith or wilful misconduct.

There are no restrictions on the movement of capital, capital gains, remittances, dividends, or the inflow and outflow of funds.

iv Return of capital
To return part of the capital to their shareholders, JSCs and LLCs may elect to decrease their share capital.

Such a decision must be taken by virtue of an extraordinary general shareholders’ assembly meeting, which shall decide the redemption of part of the capital on a pro rata basis between the shareholders.

In the case of LLCs, the decision of the general assembly to buy back shares and thus reduce the capital should be seconded by a decision to cancel the redeemed shares.

JSCs, holding and offshore companies can decrease their capital through buying back their shares by allocating some of their profits in a special reserve established for that purpose. The shares acquired by the company are in such case replaced by enjoyment shares, which do not entitle their holders to any nominal amount following the subsequent liquidation of the company.

In all cases, the decision to enforce a decision to return part of the capital is subject to the creditors’ approval: a reduction of the capital is often perceived by creditors as a reduction of the commitment of the partners or shareholders, and thus a reduction of the collateral that is meant to protect their rights. Such decision is thus subject to publication requirements, and creditors making no objection thereto within three months for JSCs and within two months for LLCs.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition
Credit is allocated on market terms, and foreign investors can get credit facilities on the local market. The private sector has access to overdrafts and discounted treasury bills, in addition to a variety of credit instruments such as housing, consumer or personal loans, and loans to SMEs.

The Code of Commerce governs the sale and purchase of shares, but does not specifically regulate the acquisition of assets, although the latter may be transferred in accordance with the general principles of law.

There are no entry barriers that would affect or restrict foreign investments, except in certain sectors specified by law (commercial representation, media, aviation, etc.).

The transfer of the shares of JSCs is tax free and exempt from stamp duty. The financing structure is not related to tax considerations but rather to the investor’s entry strategy.

Acquisition transactions are subject to capital gains tax.

ii Reorganisation
Mergers often give rise to a new legal structure, and all asset transfers resulting from such merger are in principle subject to a 15 per cent capital gains tax.
The Code of Commerce does not envisage legal or tax consolidations, but allows financial consolidations. There are no sector-specific laws on acquisitions, mergers or takeovers, except for mergers of banks and insurance companies.

In principle, there are no restrictions on a merger between a local and a non-local entity, as long as the entity resulting from such merger is located in Lebanon.

iii Exit

All companies incorporated and operating in Lebanon should have their head office on the Lebanese territory.

Relocation within Lebanon is possible subject to publication formalities and registration in the commercial registrar.

Relocation to an address outside Lebanon is not allowed, since the Code of Commerce links the nationality of the company to its country of incorporation.

The partners in an LLC can decide to change the nationality of the company by virtue of a resolution that needs to be unanimously approved. The Code of Commerce provides that ‘extraordinary general assemblies [of JSCs] cannot change the nationality of the company’, and this text has been widely interpreted as forbidding any relocation of JSCs outside Lebanon.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

General anti-avoidance rules regarding tax avoidance, consequences and sanctions are tackled in the Income Tax Law and Tax Procedure Law No. 44 dated 11 November 2008 (Tax Procedure Law), Law No. 60 dated 27 October 2016 and the decrees and decisions taken in application thereof.

All companies should file an ‘initiation of work’ application before the Ministry of Finance within two months of their incorporation, failing which they shall be subject to late filing penalties. The Ministry of Finance issues a certificate evidencing such initiation of work, and the company should thereafter comply with periodic tax filing obligations.

All companies should present true, accurate and timely tax filings, and are subject to penalties in the case of false or late declarations, concealment of information, or obstruction of tax controls or tax collections.

The Tax Procedure Law provides for the right of the tax authorities to requalify any operation whenever tax evasion or fraud is suspected. The tax authorities may also reassess the amount of a transaction by application of the arm’s-length principle, especially in the context of related-party transactions.

Tax avoidance may also be subject to criminal proceedings.

Lebanon recognises low-tax jurisdictions and any company incorporated therein without discrimination. However, the tax authorities would always apply Lebanese tax laws to foreign companies deriving profits in Lebanon (in application of the territoriality principle) unless a double taxation treaty exists between Lebanon and the country where the foreign company is incorporated.
ii  Controlled foreign corporations (CFCs)
There are no rules governing controlled foreign corporations per se, but Lebanon allows the incorporation in Lebanon of branches of foreign companies.

iii  Transfer pricing
Transfer pricing is subject to the arm’s-length principle. The tax authorities may interfere and reassess the amount of a transaction, especially if it takes place between related parties. Particular scrutiny takes place whenever tax evasion or a manipulation of accounts is suspected. The tax authorities apply the principle lato sensu, and are usually stringent in its application.

iv  Tax clearances and rulings
The tax authorities regularly deliver tax attestations indicating all due taxes paid by a taxpayer. Such certificates may also be issued following an inspection performed by the tax authorities, or upon a spontaneous regularisation request made by the taxpayer by virtue of a petition requesting the issuance of such a certificate.

X  YEAR IN REVIEW
Apart from the tax amendments outlined in this chapter, the major breakthrough for 2017 remains the enactment by the Lebanese parliament of the Budget Law No. 66, thus ending a lengthy 12-year period during which public finances were managed without proper parliamentary oversight and control. This achievement sets the basis for the sound management of public funds in the future.

XI  OUTLOOK AND CONCLUSIONS
The tax rates in Lebanon remain relatively low and the tax regime relatively stable. Owing to the wide panoply of services offered to foreign investors, Lebanon is perceived as a tax-friendly jurisdiction.

The MoET’s suggested amendments to the Code of Commerce to further streamline business are still pending parliamentary approval.

Despite increasing international and domestic regulations aimed at combating money laundering, banking secrecy remains at the core of the banking system and plays a key role in attracting funds to Lebanon.
I INTRODUCTION

Situated in the heart of Europe, Luxembourg has built its position as a major European financial centre on its political stability, good communication with the market and its actors and powerful service sector. This as well as Luxembourg’s limited dimensions have allowed it to maintain a certain degree of flexibility in its legal system and to cope easily with an ever-increasing volume of inward investments.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

There are several forms of entity with separate legal personality through which business can be carried out in Luxembourg:

a corporate entities:
   • public limited company (SA);
   • private limited company (SARL); and
   • public company with both limited and unlimited liability shareholders (SCA); and

b non-corporate entities:
   • general partnership (SNC);
   • limited partnership (SCS); and
   • special limited partnership (SLP).

The above-mentioned corporate entities (listed under (a)) are fully subject to corporate income tax, municipal business tax and net wealth tax, and can therefore be considered as opaque for tax purposes.

The SARL is the most frequently used corporate form owing to the favourable combination of its limited liability, the flexibility of its by-laws and corporate legal rules, and the limited minimum capitalisation requirements (i.e., €12,000 or its foreign currency equivalent).

Although the above-mentioned partnerships (listed under (b)) have legal personality (with the exception of the SLP), from a corporate income tax perspective they are not separate
from their partners, and are therefore transparent. The partnership is considered as a mere collection of the partners’ individual businesses: even though the taxable commercial income is determined at the level of the partnership, it is attributed and taxed pro quo
da at the level of the partners. Municipal business tax is instead levied directly from the partnerships that carry on a commercial activity or that are deemed to do so by virtue of the commercial nature of the majority of their partners (SNC) or of some partners holding a minimum interest in the partnerships (SCS and SLP). An SNC is deemed to carry on a commercial activity when the majority of its interests are held by a capital company, whereas an SCS or SLP is deemed to carry on a commercial activity when its general partner is a company whose capital is divided into shares holding at least a 5 per cent interest in the SCS or SLP. For the purpose of determining the nature of the activity carried out by a partnership whose interests are (fully or partially) held by another partnership, the latter is considered as a capital company when it carries out a commercial activity or is deemed to do so.

The SLP was introduced in 2013 as a special limited partnership without legal personality that otherwise shares most legal features with the SCS. The same law introducing the SLP modernised the rules concerning the establishment and the management of the SCS. The purpose of this modernisation of the SCS and introduction of the SLP was to better facilitate the establishment of vehicles suitable for the structuring of unregulated funds.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Business income is subject to corporate income tax and to municipal business tax. Since the taxable basis of the municipal business tax is to a very large extent derived from the corporate income tax basis, the rules for their determination are examined together, and the main differences are highlighted where relevant.

Determination of taxable profit

Resident taxpayers are taxed on their worldwide income on a yearly basis, whereas non-resident taxpayers are taxed in Luxembourg only on certain categories of income sourced therein. In principle, income is determined and taxed separately for each category of income, but all of the income2 derived by corporate entities and deemed commercial partnerships is considered to be of a business nature. In general, the business profit of an entity is defined as the increase in value of its net assets over the fiscal year, adjusted for capital contributions, capital repayments and profits distributed. The determination of the net assets’ value is based on the accounts of the entity. Therefore, the taxable profit in principle coincides with the financial result and is determined on an accruals basis, unless specific tax rules expressly deviate from the accounting rules or a special tax regime is in place. For this purpose, a ‘fiscal balance sheet’ is prepared, where the accounting values of the assets and liabilities are replaced by the values of the same that should be used for tax purposes where different.

In broad terms, all the expenses derived by a company that carries on a commercial activity that are related to its business are deductible unless they relate to exempt income. Some expenses are explicitly classified as deductible (e.g., non-creditable foreign taxes and

2 See, however, Section V for a description of the exemption regimes applicable to income derived from qualifying participations and intellectual property rights.
VAT, real estate tax and capital duty, depreciation and amortisation), whereas some expenses are explicitly classified as non-deductible (e.g., corporate income tax, municipal business tax, net wealth tax, directors’ fees referred to supervisory services, fines, non-qualifying gifts, profits distributions).3

For municipal business tax purposes, profits and losses derived through a foreign permanent establishment (PE) are not taken into account and nor are profits and losses that have already been taxed at the level of a (deemed) commercial partnership of which the taxpayer is a member.

**Capital and income**

Capital gains are included in the taxable basis for corporate income tax and municipal business tax, and taxed at the ordinary rates.4

**Losses**

Losses can be carried forward and offset against the taxable income of the same taxpayer that generated them (on the condition that they result from acceptable accounts) for 17 consecutive years. The losses generated before 2017 can be carried forward indefinitely.

When a corporate reorganisation takes place (e.g., merger), the losses generated by an entity that disappears as a consequence of the reorganisation (e.g., the merged company) cannot be carried forward by the company resulting from it (e.g., the merging company).

According to case law from 2013,5 a change in the ‘economic owner’ of the losses (e.g., change in the ownership of the loss-making company) is of no prejudice to the carry-forward of losses unless the abusive intent of the reorganisation that led to a major change in the ownership of the company is demonstrated (in particular when the company’s activities change after the change in ownership). Following the aforementioned case law, an administrative circular was issued by the Luxembourg tax authorities, confirming this analysis.6 No carry-back of losses is allowed.

**Rates**

**Corporate income tax**

The fiscal reform of 2017 reduced the corporate income tax rates. For the fiscal year 2018, the rate is 15 per cent for income not exceeding €25,000, 33 per cent for income between €25,001 and €30,000 and 18 per cent for income exceeding €30,001. For 2019, these rates are expected to stay the same.

A 7 per cent solidarity surcharge applies to the aforementioned rates, leading to an aggregate corporate income tax rate of 19.26 per cent (2018).

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3 See Section V for a more detailed discussion of the deductibility of expenses related to exempt participations and to partially exempt income from intellectual property rights.

4 See Section V for a description of the exemption regime applicable to capital gains on qualifying participations and intellectual property rights.

5 Cour administrative (Luxembourg), 7 February 2013, n°31320C.

6 Circular n°114/2, 2 September 2010, *Report de pertes dans le cas du Mantelkauf*. 

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Municipal business tax

The tax rate is determined every year by each municipality. For Luxembourg City, the rate for 2018 is equal to 6.75 per cent, resulting in a combined corporate income tax and municipal business tax rate of 26.01 per cent (expectedly also for 2019).

Administration

As a general rule, the fiscal year coincides with the calendar year. In such a case, companies have to electronically file the annual corporate income tax, municipal business tax and net wealth tax returns, along with the commercial and fiscal balance sheets, by 31 May of the next year. Under certain conditions and at the request of the taxpayer, this deadline can be postponed.

After a preliminary review of the tax returns, the tax authorities can request further documents and information, or invite the taxpayer to discuss potential adjustments of the returns submitted. A final assessment is then issued: the amounts due, net of the quarterly advance payments made, have to be paid within one month. Alternatively, and at the option of the tax authorities, a self-assessment procedure can apply, whereby an assessment is issued by the Luxembourg tax administration based on the tax returns submitted by the taxpayer requesting the immediate payment of the corporate taxes computed on such basis. The assessment can be reviewed later by the tax administration before the ordinary statute of limitation expires, potentially giving rise to a higher corporate tax liability.

The taxpayer can file an appeal against the final assessment within three months of its receipt, provided that such assessment leads to an actual claim from the tax administration (i.e., following the assessment, the taxpayer is not in a loss position). The taxpayer can lodge an appeal against the decision of the head of the tax authorities with the Administrative Tribunal within three months, while the decision of the Administrative Tribunal can be appealed before the Administrative Court.

The risk of a litigation procedure can be limited by asking for clarification by the tax authorities where there is uncertainty as to a correct interpretation of the tax law applied to specific circumstances (see Section IX.iv).

Tax grouping

If an option thereto is made before the end of the respective calendar year, a fiscal unity regime is available for corporate income tax and municipal business tax purposes to a Luxembourg parent company or to a Luxembourg PE of a foreign company fully subject to a tax comparable to the domestic corporate tax (group parent), as well as to qualified subsidiaries (group subsidiaries, together with the group parent, the group). As of 2016, the fiscal unity regime is also available to the Luxembourg subsidiaries of an EEA country fully subject to a tax comparable to the domestic corporate tax, or to a PE of such corporation in the EEA. Subsidiaries can be included when they are controlled, directly or indirectly, by

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7 The statute of limitation for the assessment and the collection of income tax is generally five years following the end of the calendar year in which the tax liability arose. However, a 10-year limitation period applies in the case of additional taxation owing to failure to file a return, or for an incomplete or incorrect return (with or without fraudulent intent).
the group parent for at least 95 per cent of their capital since the beginning of the fiscal year for which the option is exercised; and have a fiscal year coinciding with the fiscal year of the group parent.

Taxable income and losses of each company pertaining to the group are determined on a stand-alone basis and then aggregated at the level of the group parent, and adjusted to eliminate double taxation and double deduction of the same items of income. As the requirements for the application of the participation exemption regime are less strict than the requirements for the application of the tax unity, inter-corporate dividends paid under a tax unity regime are already fully exempt and do not need to be adjusted when determining the profit of the group. Losses generated prior to the tax unity can be used to offset the income of the group up to the taxable income of the group subsidiary that generated them. Once the regime ends, losses generated during the tax unity have to be left at the level of the group parent.

The tax unity regime lasts for at least five years; termination prior to this five-year period ending leads to a full retroactive denial of the tax unity regime. If after the five-year period the requirements for the application of the fiscal unity regime are no longer met, the benefits obtained during the tax unity are recaptured and the tax liability of each company participating in the consolidation is assessed on a stand-alone basis from the beginning of the fiscal year in which the termination took place.

ii Other relevant taxes

Net wealth tax

Net wealth tax is levied at a 0.5 per cent rate on the estimated net realisable value (unitary value) of the assets of businesses as of the beginning of the fiscal year. A reduced rate of 0.05 per cent applies to taxable net wealth in excess of €500 million. An independent expert’s appraisal is not required for the determination of the unitary value, which is generally determined using the accounting book values, adjusted where necessary. With regard to real estate located in Luxembourg, the unitary value is determined on the basis of cadastral values assessed in 1941, which derives from a law of 1934.8

Assets giving rise to exempt or partially exempt income (i.e., exempt participations and qualifying intellectual property rights) are generally also exempt for net wealth tax purposes, and assets allocated to a foreign PE and foreign real estate are generally exempt by virtue of tax treaties signed by Luxembourg. Liabilities are generally deductible if they do not relate to exempt assets. Provisions for liabilities, the existence of which is not certain (e.g., provisions for risks), are not deductible.

Net wealth tax is not deductible for income tax purposes and is generally not creditable in foreign jurisdictions. Net wealth tax is not due for the first year of existence of the company (as the assets as of 1 January are deemed to be nil).

In 2016, a minimum net wealth tax was introduced (to replace the minimum corporate income tax applicable until then). The minimum net wealth tax can be fixed (€4,815) if the financial assets of the resident corporate taxpayer in a given year exceed (1) 90 per cent of the total balance sheet and (2) €350,000, which is the case for most holding and financing

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8 Bewertungsgesetz, Memorial 902, 3 January 1934, page 9002.
companies. In all other cases, the minimum tax is contingent on the balance sheet total of the resident corporate taxpayer, and varies from €535 to €21,400 (for a balance sheet total exceeding €20 million).

**Capital duty or registration tax**

The proportional capital duty, previously levied on contributions to newly incorporated companies, or upon transfer of the legal seat or of the effective management of a foreign company to Luxembourg or upon the setup of a local branch of a foreign company, was abolished as of 1 January 2009 and replaced by a €75 fixed duty.9

Other ad valorem or fixed registration duties may apply depending on the assets or documents registered.

**Real estate taxation**

A real estate tax is levied annually on the unitary value of real estate properties located in Luxembourg at a rate that depends on the classification and on the location of the property. The unitary value is, as described above, determined by the Luxembourg tax administration, and generally does not exceed 10 per cent of the market value of the property.

**Value added tax (VAT)**

Being an EU Member State, Luxembourg applies EU VAT Directive 2006/112/EC. Luxembourg’s standard VAT rate is the lowest in the EU (17 per cent). Luxembourg also applies reduced rates (3, 8 and 14 per cent) to various goods and services.

Contrary to other Member States, Luxembourg has not implemented the ‘use and enjoyment’ rule that obliges non-registered holding companies to pay the VAT on services received from non-EU suppliers without being allowed to recover it.

Following decisions of the European Court of Justice, Luxembourg strictly limited the use of the VAT exemption for ‘independent group of persons’ (cost sharing) to taxable persons performing activities of public interest. As a counterpart to the virtual disappearance of the cost-sharing exemption for the financial, fund and insurance sectors, Luxembourg implemented the VAT grouping mechanism, relying on Article 11 of the EU VAT Directive.

Luxembourg also has an extensive definition of regulated funds qualifying for the VAT exemption on the management of regulated funds.

**IV TAX RESIDENCE AND FISCAL DOMICILE**

**Corporate residence**

Collective entities are considered resident in Luxembourg for tax purposes if they have their legal seat or their central administration therein. Therefore, for domestic tax law purposes, both collective entities incorporated in Luxembourg, and collective entities incorporated abroad but having their central administration in Luxembourg or having their registered office in Luxembourg, are considered resident therein for tax purposes.

The central administration of an entity is deemed to be located in Luxembourg if the direction of the entity’s affairs is therein concentrated. The central administration should be

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determined on the basis of facts through a substance-over-form analysis; in this respect, the place where the central accounting and archives of an entity, as well as the place where the shareholders’ and board meetings are held, are generally considered relevant.

ii Branch or permanent establishment
A definition of PE is provided by domestic law to determine the minimum threshold of business activity a foreign taxpayer must reach in Luxembourg in order to be taxed therein on the income ‘directly or indirectly realised’ by the PE. The domestic definition of PE is broader than the Organisation for Economic Co-operation and Development (OECD) Model Convention definition, last updated in 2017, as it generally includes a ‘place which serves for the operation of an established business’, and therefore does not require that the business is realised ‘through’ such place. Further, the domestic definition includes places of purchase and sale of goods.

In the absence of specific provisions in domestic law regarding the allocation of profit to a PE (and thus the determination of taxable basis in Luxembourg), a PE should be considered as an entity separate from the foreign head office. OECD guidelines may serve as a source of interpretation there, such that, in a nutshell, the profits attributable to the PE are the profits that the PE would have derived if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the PE and through other parts of the enterprise.

Tax treaties signed by Luxembourg mainly follow the OECD Model Convention and limit the Luxembourg taxing rights of business income derived in Luxembourg by foreign taxpayers to income derived through a local PE. The income taxable in Luxembourg is only the income that is attributable to the PE (i.e., no force of attraction applies) net of the expenses that are thereto allocable. The majority of tax treaties signed by Luxembourg provide for the prohibition of discrimination in the tax treatment of local PEs of foreign taxpayers as compared with domestic companies.

A bill of law proposal is currently pending with the Luxembourg legislator, which, if implemented, could impact the recognition of a PE where a tax treaty is in force between Luxembourg and a foreign country. If the draft law is implemented without changes, the recognition of a taxable presence under the form of a PE in Luxembourg will not require its prior recognition under the domestic criteria. Furthermore, the Luxembourg tax authorities would be entitled to request proof that the source country recognises a PE as well (tax returns, ruling, etc.). The impact of this provision is unclear at this stage.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes
There is no specific holding company regime in Luxembourg. The participation exemption regime is available to both Luxembourg SOPARFIs and to other resident companies, or PEs of non-resident companies holding qualifying participations.
Dividends (including constructive dividends and interest on profit-sharing bonds), liquidation proceeds and capital gains are fully exempt when the participation they refer to: 

a is held, directly or through a transparent entity, in a fully taxable resident company, in a European company meeting the requirements listed in Article 2 of the Parent–Subsidiary Directive or in a non-resident company subject to a tax that is comparable (in terms of rate and taxable basis) to the Luxembourg corporate income tax\(^{10}\) (subsidiary); 

b is held by a fully taxable resident company or by a domestic PE of a EU company meeting the requirements listed in Article 2 of the Parent–Subsidiary Directive, or by a domestic PE of a company resident in a treaty country or in an EEA country (parent); and 

c represents at least 10 per cent of the capital of the subsidiary (or alternatively, has a purchase price of at least €1.2 million – for the exemption of dividends and liquidation proceeds – or €6 million – for the exemption of capital gains) and was held without interruption over the previous 12 months (or alternatively, the parent commits to hold such participation for at least 12 months).

Pursuant to the amendment of the Parent–Subsidiary Directive, with the introduction of an anti-hybrid provision (EU Directive 2014/86/EU) and a minimum common general anti-abuse rule (EU Directive 2015/121/EU), as of 1 January 2016 profit distributions covered by the Parent–Subsidiary Directive received by a Luxembourg company do not benefit from the participation exemption regime to the extent that the same payments were deductible in the country of the payor, or were paid in the framework of an arrangement or a series of arrangements that, having been put in place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purposes of the Parent–Subsidiary Directive, are not genuine.

If the above-mentioned minimum holding requirement under (c) is not met, an exemption of 50 per cent is available for dividends (including constructive dividends and interest on profit-sharing bonds, and excluding liquidation proceeds) distributed by a resident fully taxable capital company, a company covered by Article 2 of the Parent–Subsidiary Directive, or a capital company resident in a state with which Luxembourg has concluded a tax treaty and that is subject in its country of residence to income tax comparable with that of Luxembourg. The exemption applies to the net dividend income (i.e., the dividend income minus directly related costs and write-offs on the participation in connection with a dividend distribution of the same year).

Costs (typically, financing costs), capital losses and write-offs relating to exempt participations are deductible as long as they exceed the exempt dividends received in the same year. Losses resulting from such deduction can also be carried forward for 17 consecutive years. Losses generated before 2017 can be carried forward indefinitely. However, such deductions are recaptured when a capital gain is realised on the disposal of the same participation (i.e., the capital gain is exempt only to the extent it exceeds the amount of the recaptured deductions).

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\(^{10}\) The Luxembourg tax authorities generally consider that a foreign tax is comparable with the Luxembourg corporate income tax if the rate of the foreign tax is at least 9 per cent (i.e., half of the current corporate income tax rate) and the taxable base is computed on the basis of criteria that are comparable to the Luxembourg criteria.
ii  IP regimes

On 22 March 2018, Luxembourg adopted a new IP regime applying to any Luxembourg tax resident carrying out a business activity in Luxembourg and owning qualifying IP.

Eligible net income from qualifying IP assets can benefit from an exemption of up to 80 per cent from income taxes and a full exemption from net wealth tax. The eligible assets must have been constituted, developed or improved after 31 December 2007 and are limited to patents, utility models, supplementary protection certificates granted for a patent on medicine and plant protection, plant variety certificates, extensions of a complementary protection certificate for pediatric use, orphan drug designations, and software protected by copyrights.

The portion of the IP income benefiting from the advantageous tax treatment is calculated based on a ratio taking into account the R&D costs. The ratio corresponds to the eligible R&D costs divided by the overall R&D expenses. Luxembourg allows the eligible R&D costs to be uplifted by 30 per cent insofar as the resulting ratio does not exceed the total amount of expenditure. Expenses must be incurred within the framework of an R&D activity to be eligible, but can be undertaken either by the taxpayer itself or outsourced.

The new IP regime is in line with the recommendations made by the OECD in its base erosion and profit shifting action plan 5 by adopting a nexus approach to ensure that only the R&D activities having a nexus with the Luxembourg taxpayer itself benefit from the new IP regime.

Unlike the previous regime, IP assets of a marketing nature (e.g., trademarks) are excluded from the scope of the proposed regime.

The former IP regime was abolished in 2016 but continues to be applicable to qualifying IP that was created or acquired before 1 July 2016. This grandfathering period started on 1 July 2016 and will end on 30 June 2021. Where the taxpayer is eligible under both regimes, the taxpayer may elect the IP regime to be applied during the grandfathering period. The choice for either option is irrevocable for the entire transitional period.

iii  Tax subsidies

The main subsidies and incentives are mentioned in this chapter. Business investments, professional development and employment are, however, further supported through specific tax credits granted for new investments in qualifying business assets located in Luxembourg and put to use in Luxembourg or in the EEA (with the exception of ships, which benefit from the credit even if operated abroad);11 sustained employees’ training expenses; and hiring employees previously registered as unemployed.

The above-mentioned subsidies are available to all businesses and do not refer to any specific sector of activity.

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11 Following the Tankreederei I SA decision by the European Court of Justice (C-287/10 of 22 December 2010), which ruled that the scope of application of the incentive is contrary to the freedom of movement of capital, a circular issued by the tax authorities (Circular 152-bis/3 of 31 March 2011) and an update of the law clarify that the tax credit is also applicable to new investments in qualifying business assets located in Luxembourg put to use in a state that forms part of the European Economic Area.
VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)
Distributions paid by a resident company to non-resident shareholders are generally subject to a 15 per cent withholding tax. This includes repayments of previously contributed capital, unless such repayment is motivated by sound business reasons.

As a general rule, there is no withholding tax on outbound royalties and interest; however, outbound payments to related parties exceeding the arm's-length measure can be requalified as hidden dividend distributions and be subject to a 15 per cent withholding tax. Furthermore, profit-sharing interest received by a ‘money provider’ as payments on loans represented by securities that, in addition to a fixed coupon, are entitled to a variable coupon that depends on the company’s profit distributions, are subject to a 15 per cent withholding tax.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments
A dividend withholding tax exemption is granted provided that a participation of at least 10 per cent (or alternatively a participation the purchase price of which is at least equal to €1.2 million) was held for an uninterrupted period of at least 12 months for dividends paid to:

a a European company meeting the requirements listed in Article 2 of the Parent–Subsidiary Directive or a Luxembourg PE thereof; pursuant to the amendment of the Parent–Subsidiary Directive with the introduction of a minimum common general anti-abuse rule (EU Directive 2015/121/EU), as of 1 January 2016 profit distributions covered by the Parent–Subsidiary Directive paid by a Luxembourg company do not benefit from the participation exemption regime to the extent they were paid in the framework of an arrangement or a series of arrangements that, having been put in place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purposes of the Parent–Subsidiary Directive, are not genuine;

b a non-resident company resident in a treaty country and subject therein to a tax that is comparable (in terms of rate and taxable basis) to the Luxembourg corporate income tax;

c a company resident and fully taxable in Switzerland not benefiting from any exemption; or

d a fully taxable company resident in an EEA country, or a Luxembourg PE thereof.

iii Double tax treaties
Luxembourg has more than 80 tax treaties currently in force, which are mainly in accordance with the OECD Model Convention, and further treaties are being negotiated. The table in

12 The Luxembourg tax authorities generally consider that a foreign tax is comparable with the Luxembourg corporate income tax if the rate of the foreign tax is at least 9 per cent (i.e., half of the current corporate income tax rate) and the taxable base is computed on the basis of criteria that are comparable to the Luxembourg criteria.
Appendix 1 at the end of the chapter shows for each double tax treaty in force the potential reductions of withholding tax rates applicable to outbound payments of dividends, interest and royalties according to such treaties.

iv Taxation on receipt

Economic and juridical double taxation of foreign profits is generally avoided through a full or partial exemption system. The general conditions for the participation exemption regime are described in Section V.i. When a certain participation threshold is reached in a foreign company, tax treaties signed by Luxembourg generally provide for the exemption of foreign profits as a system to relieve double taxation. When foreign dividends are not exempt, taxes levied by the foreign authority to the Luxembourg recipient can at least be partially recovered, if certain conditions are met, through the domestic foreign tax credit system. Domestic law does not provide for an indirect tax credit system of taxes levied by the foreign authority at the level of the foreign entity.

VII TAXATION OF FUNDING STRUCTURES

Entities are commonly funded with a mix of equity and debt. Whether an instrument should be considered as debt or equity for Luxembourg tax purposes has to be evaluated on the basis of a ‘substance over form’ approach (i.e., taking into account the economic rather than the legal features of an instrument). This prevalence of economic characterisation over legal appearances has been confirmed by both parliamentary history13 and case law14 as a principle underlying Luxembourg tax law.

The equity investment can be represented by different classes of shares that track different income or investments of the same company (or both).

Several financing tools can be created that combine features of debt and equity according to the projected profitability of the investments, and are tailored to the needs of the investors (base reduction in Luxembourg, withholding tax planning, repatriation of profits, flexibility upon exit).

Under certain conditions, hybrid debt instruments may be issued by a Luxembourg company. These hybrid debt instruments (e.g., convertible preferred equity certificates (CPECs)) are normally treated as debt for Luxembourg legal, accounting and tax purposes, but may be treated as equity for tax purposes in the country of residence of the holder of the instrument (e.g., the US). The expression ‘CPECs’ is often used as a general abbreviation. However, the precise terms and conditions may differ on a case-by-case basis. The use of hybrid instruments will be affected by the anti-hybrid rules, described in Section X.

i Thin capitalisation

There are no specific thin capitalisation rules under Luxembourg law. However, when a loan is granted or guaranteed by related parties, and such loan finances assets are different from financing assets (e.g., participations, real estate, intellectual property rights), in practice, a debt-to-equity ratio of at least 85:15 is generally required. The interest payments related to

13 Parliamentary document 571/4, commentary to Article 114 (p. 294).
14 By way of example: Administrative Tribunal, 18 June 2014, nr. 32653, Administrative Court, 26 July 2017, nr. 38357C.
the debt exceeding this ratio may be treated, for tax purposes, as dividends, and, therefore, considered non-deductible for corporate income tax purposes and subject to the 15 per cent dividend withholding tax.

In addition, the Luxembourg transfer pricing rules require intra-group financing companies to avail of an appropriate amount of equity, such that they have the financial capacity to assume the risks they run. Such amount is to be determined on a case-by-case basis.

**ii Deduction of finance costs**

As a general rule, any arm’s-length costs incurred for the purposes of the business activity are deductible to the extent they are not related to exempt income. See also Section V.i.

On 20 June 2018, a bill of law was introduced (and is currently still pending) in the Luxembourg parliament to implement the EU Anti-Tax Avoidance Directive 2016/1164/EU of 12 July 2016. The draft law contains, *inter alia*, an interest deduction limitation rule which is expected to take effect on 1 January 2019. At this time, it is not known whether the draft law will be amended prior to its final adoption. The main elements of the interest deduction limitation rule as contained in the draft law are summarised here below.

The concept of ‘exceeding borrowing costs’ is introduced. It means the excess, if any, of a Luxembourg taxpayer’s deductible interest (and economically equivalent) expenses over such taxpayer’s taxable interest (and economically equivalent) income. As a general rule, the deductibility of a taxpayer’s exceeding borrowing costs in a given fiscal year is capped at the higher of 30 per cent of such taxpayer’s EBITDA in such fiscal year or €3 million. ‘EBITDA’ is defined as the taxpayer’s net income (1) increased by its exceeding borrowing costs, depreciation and amortisation and (2) decreased by tax-exempt income and the expenses attributable to such exempt income.

The draft law contains a grandfathering provision, pursuant to which interest (and economically equivalent) expenses incurred in respect of loans that were concluded prior to 17 June 2016 and that were not subsequently modified are not subject to the interest deduction limitation rules. In addition, the following three categories of Luxembourg taxpayers are, *inter alia*, excluded altogether from the application of the interest deduction limitation rule:

- **a** a taxpayer that constitutes a ‘financial undertaking’, which is, *inter alia*, the case if the taxpayer is an alternative investment fund managed by an alternative investment fund manager as defined in point (b) of Article 4(1) of Directive 2011/61/EU;

- **b** a taxpayer that qualifies as a ‘stand-alone entity’, which means a taxpayer that is not part of a consolidated group for financial accounting purposes and has no associated enterprise and has no PE in another jurisdiction; and

- **c** a taxpayer that is a member of a consolidated group for financial accounting purposes and, in short, the ratio of equity over total assets of the consolidated group does not exceed the same ratio of the taxpayer by more than 2 percentage points.

**iii Restrictions on payments**

Distributions can be made up to the amount of freely distributable reserves as shown in approved financial statements after the accruals to the legal reserve required by the law are thereto allocated. Under certain conditions, interim dividends can be distributed.
iv Return of capital

In principle, repayments of share capital contributions are subject to a 15 per cent withholding tax. However, such contributions can be repaid to the shareholders without triggering any taxation to the extent that the share capital repaid was not formed by allocations of profit reserves to the share capital, which are deemed to be distributed first and the share capital reduction is supported by valid economic reasons. Repayments that correspond to profit reserves allocations to the share capital or that are not supported by valid economic reasons are considered, from the perspective of the shareholders, as income from capital.

The formal repayment of capital (i.e., share capital decrease by way of cancellation of shares) is, however, subject to limits and procedures set by corporate law: the share capital resulting from the repayment cannot be lower than the minimum share capital required by the law (i.e., €12,000 for a SARL and €30,000 for an SA). A higher degree of flexibility can be obtained through the provision of a share premium reserve.

From a tax perspective, the concepts of hidden capital contribution and of hidden capital repayment are applied, under certain conditions. Both hidden capital contributions and hidden capital repayments benefit from the tax treatment of formal contributions and repayments irrespective of their different accounting treatment. As a typical example, a shareholders’ debt waiver could be considered exempt from corporate income taxes if certain features, typical of hidden capital contributions, are present.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

See Section VII for a general comment on funding structures.

ii Reorganisation

As a general rule, the assets of a resident company merged into (or demerged in favour of) another resident company or into a foreign company are deemed realised at market value, and are, therefore, fully taxable in Luxembourg.

Domestic and European reorganisations can be performed tax-neutrally to the extent that, broadly speaking, Luxembourg’s future taxing right on latent gains is not lost because of the reorganisation (e.g., a PE is maintained in Luxembourg to which part or all of the assets incorporating a latent gain are allocated). The taxation can, therefore, be deferred to the future actual realisation of latent gains.

For domestic mergers, tax neutrality is granted if the cash payment does not exceed 10 per cent of the face value of the share capital of the absorbed company; and the merger allows the future taxation in Luxembourg of latent capital gains.

For domestic demergers, tax neutrality is granted if, in addition to the conditions set out above for mergers, the shareholders of the divided company receive, in exchange for their participation, a proportional participation in each beneficiary company (i.e., ‘proportional demerger’); and the assets transferred include at least an autonomous business unit.

If the beneficiary of the merger or of the demerger maintains the book values of the assets and liabilities acquired, the historical acquisition dates can be maintained. Such rule is relevant for the application of the participation exemption regime (e.g., the date of acquisition of the participation can be maintained by the company acquiring it by way of a merger or demerger).
The same neutrality regimes apply to mergers whereby a fully taxable resident company is absorbed by a company resident in a Member State, and to demergers whereby a fully taxable resident company is demerged into companies resident in other Member States.

iii Exit

As a general rule, when a domestic business (in an incorporated or unincorporated form) leaves Luxembourg tax jurisdiction, exit taxation applies. Under the current law provisions, a deferral for transfers to an EU or EEA jurisdiction is under certain conditions available indefinitely (i.e., until alienation of the relevant asset); after implementation of the EU Anti-Tax Avoidance Directive however, such deferral would be limited to a five-year period.

When a resident company transfers its legal seat and its central administration abroad, the company is deemed liquidated, and capital gains accrued on its assets and liabilities are subject to tax. The migration can, however, be performed at book values, thereby deferring the capital gain taxation, when the assets of the migrating company are attributed to a domestic PE.

When a non-resident company disposes of or transfers abroad a domestic PE, the capital gains accrued on its assets and liabilities are subject to tax. A tax deferral can be obtained if the PE is transferred to a company resident in a Member State by way of a going concern contribution, merger or demerger; and the book values of the PE transferred are maintained by the acquiring company.

When the foreign PE of a domestic company is disposed of, the accrued capital gains on the assets and liabilities of such PE are subject to tax unless a tax treaty providing for the exemption of foreign PEs is in force with the country where the PE is located.

When an asset is attributed to a foreign (exempt) PE, it is debatable whether the Luxembourg head office is taxable on the deemed capital gain realised. The main position of the doctrine is that, even if the attribution of the asset should be booked at fair market value according to the 'separate entity approach', the resulting capital gain is taxable only once the asset is actually disposed of by the PE and to the extent a capital gain is actually realised.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

The taxpayer is free to choose the structure or the transaction that allows the most tax-efficient results. Nonetheless, the law provides that the tax benefits deriving from the use of forms and constructions that, even though formally permitted, are aimed at mitigating or evading taxes and lack further economic reasons, cannot be recognised. In such cases, taxes will be levied that correspond to the form or to the construction that would be reasonable and appropriate in consideration of the economic reality.

It is expected that the above-described general anti-abuse rule will be amended effective 1 January 2019, following the implementation into Luxembourg law of the EU Anti-Tax Avoidance Directive. As mentioned above, on 20 June 2018, a bill of law was introduced to that effect, including a new general anti-abuse rule. It will suffice for a tax advantage to be one of the main purposes of the arrangement to be caught under the general anti-abuse rule. The wording of the new rule remains, however, close to the existing wording and will require case law to further refine its interpretation.
The civil law concept of simulation can also be used by the tax authorities to deny the tax benefits deriving from a certain transaction if it can be proved that the intention of the parties is to put in place a different, hidden transaction. In such a case, the tax effects of the latter will be applicable.

In an international setting, the applicability of some tax regimes (e.g., participation exemption) is conditional to the proof of a minimum level of effective taxation of the foreign entity involved.

ii  Controlled foreign corporations (CFCs)

The draft law published on 20 June 2018 and providing for the implementation of the EU Anti-Tax Avoidance Directive includes CFC rules. If adopted, such rules will provide that where a CFC has been put in place essentially for the purpose of obtaining a tax advantage, Luxembourg corporate taxpayers will be taxed on the undistributed net income of a CFC, pro rata to their ownership or control of the foreign branch or the (directly and indirectly held) subsidiary, but only to the extent such income is related to significant functions carried out by the Luxembourg corporate taxpayer. To the extent that a Luxembourg company can establish, on the basis of adequate documentation of its activities or functions, or both, that it does not perform significant functions related to the CFC’s activities, the CFC rules, when introduced, should not have an adverse tax impact.

It should be noted that the above-mentioned CFC rules will only apply for corporate income tax purposes and not for purposes of the municipal business tax.

iii  Transfer pricing

In 2015, the arm’s-length principle, already applied in practice, was codified in Luxembourg tax law, and in 2016, a new article dealing with the main principles on which a transfer pricing functional analysis should be based (i.e., the commercial and financial relations between affiliated companies and the economically significant circumstances of these relations) was introduced.

In addition, an obligation was included in the law for taxpayers to be able to present transfer pricing documentation upon request of the tax authorities, substantiating the arm’s-length character of related-party transactions. The burden of proof therefore lies with the taxpayer in that respect.

A circular letter issued on 27 December 2016 (the Circular) by the Luxembourg tax authorities officially clarifies the criteria to be followed for the determination of arm’s-length remuneration on intra-group financing transactions. The Circular applies to group companies whose principal activity other than holding activities consists of intra-group financing transactions, which are defined as the granting of loans or advances to associated companies financed by any financial means. While the Circular does not address other intra-group situations, such as borrowing from an affiliate to acquire receivables in the market, the principles set out in it should also be largely relevant to those transactions.

Inter alia, the Circular highlights the main substantive requirements that a group financing company established in Luxembourg is required to meet to be able to enter into an

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15 Article 56 LIR.
16 Article 56 bis LIR.
17 Article 171(3) Abgabenordung.
advance pricing agreement (APA) with the tax authorities. In this respect, and among other substance requirements, the financing company should be adequately capitalised to face the functions performed and the risks assumed in connection to its financing activity. As such, the amount of equity that a financing company needs should be benchmarked.

Pursuant to the Circular, it is specified that the APA procedure will only be available for intra-group financing companies that have sufficient substance in Luxembourg and bear the risks linked to the financing activities. A Luxembourg company will be considered as having sufficient substance if, broadly summarised:

- the majority of its directors or managers are Luxembourg residents and have the capacity to take binding decisions for the company;
- personnel should have the understanding of risk management in relation to the transactions carried out;
- the key decisions regarding its management are taken in Luxembourg, and at least one shareholders’ meeting a year takes place there;
- it has a bank account in Luxembourg;
- it is not considered as tax-resident in another country;
- its equity should be sufficient for the functions it performs, the assets used and the risks it assumes; and
- the financing company should have fulfilled its obligations regarding the filing of tax returns at the time when it requests an APA.

iv Tax clearances and rulings

On the basis of a written and motivated request by any taxpayer, the competent tax office will issue an advance decision regarding the application of the Luxembourg tax laws to certain operations described by the taxpayer (ATA). Such decision would bind the tax office, albeit only with respect to the requesting taxpayer and limited to the concrete case described by the latter. The decision of the tax office will be taken on the basis of a uniform interpretation of the tax laws and the principle of equality. An administrative fee applies, ranging between €3,000 and €10,000, determined by the Luxembourg tax authorities on the basis of the complexity of the case concerned.

On 13 July 2016, a law on the mandatory automatic exchange of information in the field of taxation, implementing EU Council Directive 2015/2376 extending the scope of mandatory exchange of information on cross-border ATA and APA, was approved. As a consequence, the Luxembourg tax authorities will, as from 1 January 2017, exchange information on ATA and APA with other Member States of the EU with retroactive effect (the exchange applies to ATA and APA amended or renewed as from 1 January 2012, provided they were still valid on 1 January 2014). ATAs and APAs that involve only individuals or taxpayers with a low turnover (i.e., less than €40 million in the year preceding the issuance of the ATA or APA) are excluded.

X YEAR IN REVIEW

A relatively large number of changes were made to the Luxembourg tax laws in 2018, or are expected to still be adopted before year-end. In addition, it is expected that in 2019, further changes will be adopted, mainly following implementation of the EU Directive. To the extent not mentioned above, these changes include, for instance:
a Following implementation of the EU Anti-Tax Avoidance Directive, an anti-hybrid rule will apply to intra-EU hybrid mismatches resulting from differences between two EU Member States in the characterisation of a financial instrument or an entity, which give rise to double deductions or a deduction without a corresponding inclusion. In 2020, these anti-hybrid rules are expected to be extended to hybrid mismatches with non-EU countries.

In addition, while outside of the scope of this chapter, it should be noted that the 2017 US Tax Cuts and Jobs Act and in particular the anti-hybrid rules contained therein are also expected to have a substantial impact on the use of hybrid instruments such as CPECs.

b As a result of the implementation of the EU Directive into the laws of the EU Member States introducing mandatory disclosure rules, advisers, other intermediaries and taxpayers may be legally required to disclose information to the EU Member States’ tax authorities on certain advice given and services rendered regarding cross-border tax planning arrangements that qualify as ‘reportable cross-border arrangements’. The domestic law (which is not yet available in Luxembourg) relating to the Mandatory Disclosure Directive will enter into force on 1 July 2020; nevertheless, cross-border arrangements that are reportable under the new rules and of which the first step of implementation takes place from 25 June 2018 to 1 July 1 2020 should be reportable ultimately on 31 August 2020.

XI OUTLOOK AND CONCLUSIONS

Luxembourg is committed to continuing and extending its role as a major European financial centre, ensuring at the same time the transparency and, in general, the compatibility with EU laws and principles of its own tax law. Outside the taxation arena, major initiatives are being undertaken in other fields, notably that of investment funds, one of the other main drivers in the financial area.
Appendix I: Domestic and treaty rates for dividend, interest and royalty payments

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It is not uncommon for a tax treaty to establish more than one highest withholding tax rate applicable to the same item of income (e.g., dividends, interest or royalties). For instance, dividend withholding rates generally decrease when certain participation thresholds are reached. At the same time, interest paid by or to the government of one contracting state is frequently exempt from withholding tax. However, since each treaty is the result of the negotiation between Luxembourg and the relevant contracting state, it is not possible to define a common rule on the application of treaty rates. For more information, reference should be made to the specific tax treaty.  

On 7 June 2017, Luxembourg (together with 67 other jurisdictions) signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI). On 3 July 2018 the Luxembourg government submitted the bill for ratification of the MLI to the Luxembourg parliament. In terms of timing, owing to the required national ratification procedure in both jurisdictions that are party to a matching treaty, as well as the timetable provided in the MLI, it is unlikely that for taxes levied at source the MLI provisions will come into effect before 1 January 2020 for companies whose fiscal year coincides with the calendar year. With respect to other taxes covered by the double tax treaties, the MLI provisions would apply as from the taxable year beginning on 1 January 2020.

The purpose of the MLI is to introduce the BEPS principles in double tax treaties. Luxembourg declared that all the signed tax treaties currently in force will be seen as covered tax treaties for the purpose of the MLI. However a large number of treaty partners have not signed yet the MLI (including the United States). Even though Luxembourg has made several reservations about the application of the MLI, which in most instances will be applied only as far as the ‘minimum standards’ are concerned, certain MLI provisions (e.g., the principal purpose test) will affect the application of the current double tax treaties.

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Source: IBFD, Amsterdam, based on information available on 21 November 2018

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18 See www.impotsdirects.public.lu/conventions/conv_vig/index.html.
Chapter 20

MALTA

Juanita Brockdorff and Michail Tegos

I INTRODUCTION

Malta has been experiencing strong and consistent growth in its financial services industry and is fast becoming the jurisdiction of choice for setting up business with access to the EU’s Single Market, especially in the light of the OECD’s base erosion and profit shifting (BEPS) project and Brexit. Economically, Malta has continued to build on the success of previous years, posting an exceptionally strong performance; the real economy grew by 6.7 per cent in 2017 and positive results have been achieved in various sectors, including local and foreign investment, tourism and exports. The public debt target of 60 per cent of GDP has been surpassed and stands at around 47 per cent, and is projected to continue to reduce to 43.8 per cent in 2019.

Malta’s tax system is based on UK principles, and enjoys the approval of the European Commission and Code of Conduct Group following Malta’s EU accession. In addition, Malta is a BEPS-compliant jurisdiction, being an associate in the OECD’s inclusive process and signatory to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI). It is only through the application of its imputation tax system and tax refund system that Malta offers the lowest effective tax rate in the EU, without resorting to rulings, harmful tax practices, hybrid entities or structures, or stateless companies. Such transparency and compliance has resulted in numerous multinationals setting up operations in Malta to enjoy a tax and cost-efficient onshore jurisdiction. The application of the refund system is buttressed by a flexible participation exemption that ensures that dividends derived from qualifying entities (companies, limited partnerships and collective investment vehicles satisfying the necessary conditions) will be exempt in Malta. Malta’s tax system allows for peace of mind and tax-neutral repatriation, given that there are no withholding taxes on dividend distributions to non-residents (as well as on interest and royalty payments). Over and above this, Malta enjoys a wide and favourable treaty network based on the OECD Model, with full exchange of information provisions. Malta is a transparent and cooperative jurisdiction, having implemented the automated exchange of information standard on tax matters as promoted by the OECD and adopted by the EU, namely the Common Reporting Standard (CRS), in its domestic law. It is also one of the first jurisdictions to have issued tax guidelines clarifying the tax treatment of transactions in distributed ledger technologies and cryptocurrencies.

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II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate
As a general rule, businesses in Malta adopt a corporate form. The most frequently used forms are private and public limited companies. Such entities have a separate legal personality and are taxed as separate legal entities. The main difference between these two corporate forms is that the private limited company is designed for a limited number of shareholders, while the public company is not. In addition, shares in a private limited company may not be freely transferred to third parties and a private limited company may also not issue shares to the public, unlike a public company.

ii Non-corporate
Limited partnerships are becoming more popular. Legislation provides for a general and a limited partnership. While a general partnership is suitable where all partners or members expect to be involved in the management of the business, a limited partnership is more commonly used when one partner (the general partner) manages the business and the other partners are passive investors. A limited partnership, the capital of which is divided into shares, is considered to be a separate legal entity. Malta has legislation that permits certain partnerships (including foreign partnerships) to opt for transparent or opaque treatment. Limited partnerships are popular for asset management structures. Foundations are becoming increasingly popular for holding business interests.

III DIRECT TAXATION OF BUSINESSES
A Maltese company or its equivalent, including a foreign company with a permanent establishment in Malta, pays tax in Malta on its profits at a rate of 35 per cent.

Should it be profitable and distribute dividends, following the distribution of dividends from taxed profits, shareholders (without distinction as to the nature of such members) are entitled to claim a partial tax refund by virtue of the operation of the imputation credit system. The most common tax refund consists of six-sevenths of the tax charge borne on the distributed profits before deducting any relief of foreign tax. This translates to an effective tax leakage of 5 per cent. Although the quantum of the tax refund depends on the nature of the income and whether double tax relief is claimed, the overall tax in Malta after tax refund will be between zero and 5 per cent.

For partnerships that opt to be treated as look-through, tax is levied on the partners at their rates reaching a maximum of 35 per cent, and subject to treaty protection.

i Tax on profits

Determination of taxable profit
Taxable profits are based on accounting profits, consisting of the profits reported in the company’s audited financial statements following adjustment for non-deductible expenses and non-taxable income. Business profits are taxed on an accruals basis, while investment income is taxed on a receipts basis.

Expenses wholly and exclusively incurred in the production of income are deductible from the taxable base. In general, business expenditure of a revenue or recurrent nature is normally deductible, while that of a capital nature is not (with the exception of depreciation
for plant and machinery and industrial buildings and structures). A minimum number of years for tax depreciation and amortisation rates are established by statute and vary according to the estimated useful life of, and hence the nature of the asset, used in the business.

While a company incorporated in Malta is taxable in Malta on its worldwide income, companies incorporated outside Malta that have their tax residence in Malta when the control and management of their business are exercised in Malta (known as resident but not domiciled companies) are subject to tax in Malta on income or capital gains arising in Malta, and income arising outside Malta is taxable in Malta to the extent that it is received in Malta, whereas capital gains arising outside Malta are not taxable.

**Capital and income**

Capital profit is not taxed generally, but only specific items of capital gains are subject to tax, namely such as derived from the transfer of real estate and real rights, securities, business, goodwill, business permits and intellectual property; and interest in a partnership.

In general, a company’s gains on the transfer of capital assets are aggregated with its other income, and the total income and capital gains are charged to income tax at the standard rate. The basic rules for the computation of capital gains and losses require the determination of the gain realised on the transfer by deducting from the actual consideration received or deemed to have been received the cost to the transferor for the acquisition of the asset being transferred.

**Losses**

Trade losses may be set off against income and carried forward indefinitely and set off against the income of the following years (with the exception of losses arising due to depreciation, which can only be set off against the profits of the same and continuing trade), but no carry-back of losses is allowed. Capital losses may be set off only against capital gains. Losses can survive a change in ownership on condition that the same business is continued and no abuse is contemplated.

**Rates**

A Maltese company or its equivalent, including a foreign company with a permanent establishment in Malta, pays tax in Malta on its profits at a rate of 35 per cent, as explained above.

**Administration**

Company tax returns must typically be submitted within nine months from the financial year-end or 31 March of the following year, whichever date is the later. Companies must retain proper and sufficient records of their income and expenditure, and are required to submit together with their tax return a balance sheet and profit and loss account accompanied by a report made out by a certified public auditor. Financial statements are prepared in accordance with international financial reporting standards or the local generally accepted accounting principles.

Malta operates a self-assessment tax return regime for all taxpayers. The degree of scrutiny of returns and the likelihood of investigation will be affected by the tax authorities’ risk assessment of the taxpayer rather than by a defined cycle of enquiry.
Appeals against assessments are made by means of an objection in writing to the Commissioner for Revenue, to be submitted within 30 days from the date on which a notice of assessment is served on the taxpayer. If no agreement is reached between the taxpayer and the Commissioner for Revenue at objection stage, an appeal may then be lodged with the Administrative Review Tribunal within 30 days of the service of the notice of refusal. An appeal may be made to the Court of Appeal within 30 days from the date when the Tribunal’s decision was notified to the parties and may only be made on a point of law.

It is pertinent to note that rulings are not and cannot be obtained to establish the tax base or to negotiate a transfer price, and thus cannot be used to harmful ends. Malta also exchanges its rulings under the EU’s relevant legislation. It is possible to obtain clearance as to the law’s interpretation by means of an advance revenue ruling, which is valid for five years and can be renewed for another five-year period. A ruling will remain binding on the tax authorities for a period of two years from the time of any change in legislation affecting the ruling.

**Tax grouping**

Group relief provisions allow for the surrender of tax losses between group companies. Two companies are considered to be members of a group of companies if they are both resident in Malta and not resident for tax purposes in any other country, and where one company is the 51 per cent subsidiary of the other or both companies are 51 per cent subsidiaries of a third company resident in Malta and not resident for tax purposes in any other country.

Intra-group transfer of capital assets is governed by a tax deferral until final disposal to unrelated parties. Dividends move intra-group in a tax-neutral fashion attracting no double or multiple economic taxation owing to the full imputation system.

**Other relevant taxes**

Malta, as an EU Member State, is part of the harmonised EU VAT system. Malta’s standard VAT rate is 18 per cent. Malta also applies reduced rates (5 and 7 per cent) to various goods and services. With effect from 1 June 2018, Malta introduced VAT grouping, whereby two or more legal persons, at least one of which operates within the financial or gaming sectors, may opt to be treated as a single taxable person for VAT purposes.

Malta has stamp duty legislation. However, exemptions are available, for instance, for intra-group transactions. Maltese stamp duty consists of a tax on documents evidencing transfers of real estate and real rights, securities or an interest in a partnership. Duty is chargeable on the higher of the amount of consideration and the market value.

There are no capital duties, net wealth or turnover taxes for incorporated businesses in Malta.

**IV TAX RESIDENCE AND FISCAL DOMICILE**

**Corporate residence**

While companies that are incorporated in Malta are considered to be resident in Malta, companies that are not incorporated in Malta are considered to be resident in Malta when the control and management of their business are exercised in Malta. While the terms ‘management and control’ are not defined in Maltese law, on the basis of UK jurisprudence, which is generally followed in Malta, a company is regarded as being managed and controlled in Malta if key strategic or commercial decisions are made in Malta. Thus, where a company...
would prefer avoiding becoming fiscally resident in Malta it would not hold board meetings in Malta. From a Maltese tax perspective, it is possible to transfer the tax residence of an entity by changing the place of control and management of the entity. It is also possible to transfer the legal seat in and out of Malta. On taking up tax residence in Malta or redomiciling to Malta, an entity is allowed to increase the tax base cost of its assets up to market value.

ii  

Branch or permanent establishment

A foreign entity can establish a tax presence in Malta where it creates a branch, agency or similar permanent establishment in Malta, in that the general rule is that income derived from trading in Malta is taxable, while trading with Malta is not. Generally, income and gains arise from trading in Malta where they are derived from the carrying on of some activity in Malta, such as providing services in, negotiating a transaction in or renting property situated in Malta. While the term permanent establishment is referred to, it is not defined under domestic law, and as such, taxation is governed by the source basis as indicated above subject to the protection and application of tax treaties. Most of Malta’s treaties currently adopt the OECD Model Tax Convention (2014) definition of the term permanent establishment with certain variations, and thus afford the corresponding protection of the permanent establishment threshold and tiebreakers for establishing treaty residence.

V  TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i  

Holding company regimes

Malta is a popular holding domicile because of the fact that it adopts a flexible 100 per cent participation exemption on profits derived from a qualifying company (namely dividends) and from the transfer thereof (namely gains). To benefit from said participation exemption, the Maltese company’s holding must entitle it (in substance or form) to any two of the following rights (known as ‘equity holding rights’): a right to vote; a right to profits available for distribution; and a right to assets available for distribution on a winding-up of such company. Typically, as with most participation exemption jurisdictions, Malta has an ownership test that is set at 5 per cent. However, such test does not require a minimum holding period. Furthermore, where the ownership test is not fulfilled, the participation exemption may be acceded by satisfying alternative conditions, including a holding with an acquisition value of €1.164 million held for an uninterrupted period of 183 days, or one that entitles the holder to a right to sit upon, or appoint a director to, the board, or to a right to purchase the remainder of the capital.

While the participation exemption is typically available where a Maltese company holds shares in a subsidiary (or a foreign partnership that opts to be treated as a company for Maltese tax purposes), it may also be availed of when the Maltese company is a partner in a limited partnership similar to a Maltese limited partnership, or where the Maltese company is an investor in a collective investment vehicle that provides for limited liability of its investors.

With respect to dividends, the participation exemption is applicable where the qualifying company is resident or incorporated in the EU, or is subject to a 15 per cent minimum tax rate, or has a maximum of 50 per cent its income derived from passive interest or royalties, or is not held as a portfolio investment and it would have been subject to tax at a rate of at least 5 per cent. The exemption on dividends received from participating holdings in an EU Member State is available to the extent that such dividends would not have been tax-deducted by the relevant subsidiary in that other Member State.
The exemption method is extended equally to income attributable to a permanent establishment outside Malta of a Maltese company and gains derived from the transfer of such permanent establishment.

No withholding tax is levied on dividends paid to non-resident shareholders, who in addition may dispose of their shares in the holding company without incurring a tax liability where the holding company does not own, directly or indirectly, real estate in Malta.

ii  IP regimes
Royalties and similar income can obtain the equivalent of an innovation or patent box exemption where by being subject to the general tax system such income is subject to tax at the standard rate, and any profits derived therefrom distributed to the company’s shareholders would benefit from the tax refund system. Such refund would allow for an ordinary foreign tax credit such that no tax leakage would occur where withholding taxes suffered on such income would amount to 5 per cent or more. In the light of the BEPS project’s modified nexus approach, it is advisable that development, enhancement, maintenance, protection, and exploitation of intangibles functions are performed in Malta. In the 2019 Malta budget speech, the introduction of a patent box regime based on the modified nexus approach and therefore in line with the EU’s Code of Conduct on Business Taxation and the OECD BEPS Action 5 standard was announced.

iii  State aid
To promote innovation, special R&D incentives are aimed at providing assistance to enterprises in respect of eligible expenditure incurred on industrial research and experimental development projects to develop innovative products and solutions. Eligible expenditure includes personnel costs, costs of instruments and equipment, costs of building, and costs of contractual research, technical knowledge and patents. The maximum level of assistance that may be provided varies from 25 to 70 per cent depending on the size of the company and the nature of the R&D project in line with the EU’s state aid guidelines.

On 17 December 2017, the European Commission conditionally approved the Maltese tonnage tax rules for a period of 10 years. The compatibility of the Maltese tonnage tax rules with EU state aid rules will further strengthen the reliability and confidence of shipowners and ship managers towards the Maltese flag and its supporting legislative framework. Such rules bring clarity with respect to those activities eligible under the tonnage tax exemption, now distinguishing shipping activities from ancillary services. Moreover, further clarity is brought with respect to ship management activities through the possibility for these to operate non-EU flagged vessels from the EU. The activity of dredgers and tonnage boats together with a definition of intra-group bareboat out activities was an additional novelty. The Maltese flag of confidence, and not convenience, at present has the largest fleet in Europe and the sixth-largest worldwide.

iv  Blockchain and cryptocurrencies
The government of Malta created the Malta Digital Innovation Authority for robust and investor-friendly oversight in relation to blockchain, distributed ledger technology and artificial intelligence. The Maltese tax authorities have issued guidelines to address and clarify the income tax, VAT and stamp duty implications arising in connection with digital assets and cryptocurrencies. Foundations established in Malta may as of 2018 issue and deal in digital tokens.
v Insurance and funds
Malta has a long history in the insurance business dating to covering maritime risks, and in more recent times it has become a domicile of choice for setting up insurance undertakings, serviced by global insurance managers present locally, especially in the light of Brexit. Similarly it is a preferred domicile for investment funds, be they retail funds or alternative investment funds. Besides the fact that funds invested overseas are completely exempt from tax, Malta does not impose any tax on the net asset value of the fund. In addition, the licensing procedure, which is based on EU norms, is mindful and reactive to clients’ needs. Securitisation vehicles are growing in number, with the special vehicle being recognised and not requiring a licence while having equal access to tax neutrality. Indeed, Malta is reportedly the fastest-growing securitisation jurisdiction within Europe, with key benefits including, inter alia, bankruptcy remoteness, limited litigious recourse, and privileged claims of investors and securitisation creditors by operation of law, not merely contract.

vi Notional interest deduction
Notional interest deduction (NID) was introduced on 5 October 2017 and came into force with effect from the 2018 year of assessment. The NID was introduced to achieve an equal treatment of debt and equity financing, by granting an additional deduction for the return on equity financing. In addition, the NID may simplify matters within Malta’s full imputation system in view of the resulting reduction in the imputation credits resulting from claiming the NID.

The NID is optional and can be claimed by companies and partnerships resident in Malta (including Maltese permanent establishments of foreign entities) against their chargeable income for the year. The NID is calculated by multiplying the deemed notional interest rate by the balance of risk capital that the undertaking has at year-end. The notional interest rate is the risk-free rate set on Malta government stocks with a remaining term of approximately 20 (which is currently approximately 2 per cent) years plus a premium of 5 per cent. The NID would thus currently be expected to be about 7 per cent. Risk capital includes share capital, share premium, reserves, interest free loans and any other item that is shown as equity in the financial statements as at year end. The maximum deduction in any given year cannot exceed 90 per cent of chargeable income before deducting the NID. Any excess can then be carried forward to the following year. Any remaining chargeable income is subject to tax at the standard rates. When a company or partnership claims a NID, the shareholder or partner is deemed (for tax purposes) to have received the corresponding notional interest income from the company or partnership. Distribution of profits relieved from tax by the NID, however, will not be charged to tax. The legislation includes an anti-abuse provision to prevent abuses of the NID. Malta’s NID has been declared as not constituting a harmful practice by the EU’s Code of Conduct Group (Business Taxation).

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS
i Withholding on outward-bound payments (domestic law)
There are no domestic law withholding taxes for payments of dividends, interest or royalties to a non-resident to the extent that the non-resident does not have a taxable presence in Malta.
(either in the form of the management and control being in Malta or having a permanent establishment in Malta) and the non-resident is not owned and controlled by, directly or indirectly, or acts on behalf of, a person who is ordinarily resident and domiciled in Malta.

**ii  Domestic law exclusions or exemptions from withholding on outward-bound payments**

Relief from withholding taxes emanates from domestic law and is not dependent on tax treaties. Nevertheless, Malta has adopted the EU Parent–Subsidiary Directive and Interest and Royalties Directive.

**iii  Double tax treaties**

Malta has around 75 tax treaties currently in force, which are mainly drafted in accordance with the OECD Model Tax Convention (2014), while further treaties are being negotiated. Malta has signed the MLI, with the date of effectiveness not having being announced as yet. Given that Malta does not have withholding taxes on outbound investment income, the withholding tax rate in such treaties invariably will be zero. While Malta provides domestically for an ordinary foreign tax credit (in addition to a participation exemption where applicable), treaties will operate so as to match double tax relief on non-local withholding on inward payments of dividends, interest and royalties to a resident.

**iv  Taxation on receipt**

Malta has a full imputation tax system that completely eliminates the economic double taxation of company profits. Shareholders in receipt of dividends are entitled to a tax credit equal to the tax borne on the profits out of which the dividends are paid. Although Malta is a credit country, economic double taxation relief has been extended to foreign dividends received. In addition, principles of exemption have been used as explained in the holding company regime.

Thus, Maltese tax law provides for three main forms of double taxation relief of foreign-source income, available in the following order: treaty relief, unilateral relief and flat rate foreign tax credit.

Treaty relief takes the form of a tax credit granted for foreign tax paid on income received from a country with which Malta has signed a tax treaty. The amount of the credit is the lower of Maltese tax on the foreign income and the foreign tax paid. Unilateral relief operates in a similar way to treaty relief, but it only applies where treaty relief is not available. The rationale of the full imputation tax system is also extended in relation to foreign companies by extending the unilateral relief to the underlying tax borne by the foreign company on the profits out of which dividends are paid to a Maltese resident (economic double tax relief). Relief for such underlying tax is available in respect of dividends received from any shareholding in a foreign company and also in respect of the underlying tax paid by any subsidiaries in which the foreign company holds, directly or indirectly, at least 5 per cent of the voting rights. The flat rate foreign tax credit is another form of unilateral relief available to companies, taking the form of a tax credit for foreign taxes deemed to have been suffered on qualifying income and equal to 25 per cent of the net amount received.

2 For more information on Maltese withholding tax rates, see home.kpmg.com/mt/en/home/insights/2016/02/malta-double-tax-treaties.html.
Malta

VII TAXATION OF FUNDING STRUCTURES

In Malta, both equity funding and debt funding are beneficial from a tax perspective. Equity funding (including non-statutory equity such as shareholders’ contributions) will maximise the notional interest deduction, while debt funding (including profit-participating loans, which are regarded as pure debt for Maltese tax purposes) will allow the deduction of actual interest expenses. Entities are commonly funded with a mix of equity and debt.

i Thin capitalisation

Malta has a general anti-avoidance rule, and while it does not have transfer pricing legislation, on loan-in, loan-out arrangements a tax-profitable margin is expected aligning the Maltese entity’s return with the business or entrepreneurial risks it assumes. Malta implemented the EU’s Anti-Tax Avoidance Directive (ATAD, 2016/1164), and specifically the interest limitation rules came into force on 1 January 2019. Exceeding borrowing costs shall be deductible in the tax period in which they are incurred only up to 30 per cent of the taxpayer’s earnings before interest, tax, depreciation and amortisation (EBITDA). Exceeding borrowing costs refer to net interest expense (broadly interest income less interest expense on all forms of debt and other costs economically equivalent to interest and expenses incurred in connection with the raising of finance).

The legislation includes opt outs in relation to a de minimis threshold (exceeding borrowing costs up to €3 million can be deducted), a stand-alone entity exemption (not being part of a group of companies), grandfathering of loans concluded before 17 June 2016, an exclusion from scope of long-term infrastructure projects that are considered to be in the general public interest, as well as allows a group to equity ratio carveout. This limitation will also not apply to financial undertakings (credit institutions, insurance and reinsurance companies, occupational retirement pension funds, EU social security pension schemes, AIFMs, AIFs, UCITS funds, OTC derivative counterparties).

Taxpayers may carry forward, without time limitation, exceeding borrowing costs and, for a maximum of five years, unused interest capacity, which cannot be deducted in the current tax period.

ii Deduction of finance costs

Finance costs can be deducted in that interest incurred in obtaining capital to generate income will be tax-deductible against the income so generated. The general rule is that expenses wholly and exclusively incurred in the production of income are deductible from the taxable base. Hence, business expenditure of a revenue or recurrent nature is normally deductible, while that of a capital nature is not.

iii Restrictions on payments

A Maltese company is only able to distribute dividends to its shareholder or shareholders if it has enough distributable reserves in terms of company law – that is, if after the distribution the company would still be solvent.

iv Return of capital

A reduction of share capital is tax-neutral in Malta; however, company law requirements need to be adhered to (a lapse of three months from publication of reduction being a main requirement). Equity funding can also be achieved with other means that do not require reduction of share capital, such as a shareholders’ capital contribution.
VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Typically, acquisitions are structured as asset or share purchases, which have different tax consequences for the seller and purchaser. In a share deal involving a company that does not own non-business Maltese real estate, a seller who is not resident in Malta has no exposure to tax on capital gains. By contrast, an asset deal involving a Maltese business owned by a company resident and domiciled in Malta normally exposes the company to tax on capital gains from the transfer of the business and the recapture of previously claimed tax depreciation. For the purchaser, an asset deal generally may present advantages in that the tax depreciation is calculated on the amounts at which assets are acquired, avoiding the need to undertake extensive due diligence regarding the assets, liabilities and obligations inherent in acquiring a company.

ii Reorganisation

Mergers, both domestic and cross-border in the EU, allow for tax deferral. Maltese legislation provides for an exemption from capital gains tax where assets are transferred between companies that are deemed to be a ‘group of companies’. A ‘group of companies’ is defined to include companies that are controlled and beneficially owned directly or indirectly as to more than 50 per cent by the same shareholders. This is further qualified for intra-group transfers of immovable property situated in Malta or securities in a property company (essentially defined as a company that owns immovable property in Malta, directly or indirectly, through its shareholdings in other bodies of persons). In this case, the ultimate beneficial shareholders of the transferor and transferee companies must be substantially the same, with only a 20 per cent variance in each individual’s shareholding in the two companies. Where the applicable conditions are met, no loss or gain is deemed to have arisen from the transfer. The cost base of the assets does not increase for tax purposes, but the tax on the capital gain is deferred until a subsequent transfer outside the group.

iii Exit

There are no exit taxes in Malta. Therefore, transfer of tax residence, transfer of legal seat and liquidation can be done tax neutrally in Malta. However, ATAD contains exit tax rules and Malta introduced the same to come into force on 1 January 2020. The rules provide the taxation of capital gains arising upon the transfer of assets, and the subsequent loss of right to tax any arising capital gains, in the following circumstances:

a a transfer of assets from a head office located in Malta to a permanent establishment in another jurisdiction and vice versa;

b a transfer of residence of a Maltese resident entity to another jurisdiction (to the exclusion of assets that remain effectively connected to a Maltese permanent establishment); and

c a transfer of business carried on in Malta by the taxpayer’s permanent establishment, to another jurisdiction.

The transposed law, in an identical manner to ATAD, prescribes an immediate payment of the due tax with the possibility of payment in instalments over the period of five years in cases of transfers to an EU Member State or to a party to the European Economic Area Agreement, which might possibly require providing a guarantee.
The introduction of exit taxation in Maltese corporate income tax law is novel; however, coupled with the application of the step up of the value of assets at time of transfer to or from Malta, there should be no resultant double taxation.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance
The taxpayer is free to choose the structure or the transaction that allows the most tax-efficient results subject to the Maltese anti-avoidance rules, which are statutory rather than judicial. A general anti-abuse rule (GAAR) is intended to preserve the integrity of the Maltese income tax base by vesting the Commissioner for Revenue with broad discretion to disregard certain schemes and transactions that reduce the amount of tax payable by a taxpayer. Additionally, should a taxpayer implement any scheme with the sole or main purpose of avoiding, reducing or postponing liability to Maltese tax, or of obtaining any refund or set-off of tax, the Commissioner for Revenue is entitled, by an order made in writing, to subject the taxpayer to tax so as to effectively nullify or modify the scheme and the consequent advantage. Several specific anti-abuse provisions are found throughout the Maltese legislation in an attempt to prohibit very specific or particular forms of activity.

The transposition of ATAD has widened the application of the existing GAAR by including an additional rule, addressing any arrangements that are put into place with the main purpose or one of the main purposes of obtaining a tax advantage which defeats the object or purpose of the applicable tax law and are thus not genuine when having regard to all the relevant facts and circumstances. The ATAD GAAR will therefore target all non-genuine transactions (to the extent that they are not put in place for valid commercial reasons that reflect economic reality) performed in a domestic or a cross-border situation.

Albeit the wording of the ATAD GAAR is broader, reflecting the wording used in the long-standing GAAR in the Merger Directive, an analysis of case law construing the latter conveys that the Court of Justice of the EU has applied a strict interpretation thereof, requiring an essential or sole purpose. The result is that such interpretation may assimilate its effect to that under the current existing GAAR at least to the extent coupled with economic substance.

ii Controlled foreign corporations (CFCs)
In view of ATAD, Malta introduced CFC rules entering into force on 1 January 2019. Based on the CFC rules, income derived by subsidiaries or attributed to permanent establishments may in certain circumstances be taxed in Malta as the jurisdiction of the parent or head office. The formal cumulative conditions for the CFC rule to apply are:

a in the case of an entity, where the Maltese taxpayer alone or together with associated entities holds a direct or indirect participation of more than 50 per cent of the voting rights, or of the capital or is entitled to receive more than 50 per cent of the profits of such entity;

b the corporate income tax (CIT) paid by the non-resident entity or permanent establishment is less than 50 per cent of CIT payable if it were resident in Malta; and

c exceeding the minimum thresholds (non-resident entity or permanent establishment with accounting profits less than €750,000 or with accounting profits equal to less than 10 per cent of its operating costs).
If the above-mentioned conditions are fulfilled, the non-distributed income of the CFC may be included in the tax base of the Maltese parent, or Maltese head office, where the income arises from non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage. There should be no CFC charge where there are no significant people functions in Malta that are instrumental in generating the income of the CFC.

iii Transfer pricing
To date Malta does not have transfer pricing legislation.

iv Tax clearances and rulings
Rulings are not and cannot be obtained to establish the tax base or negotiate a transfer price, and thus cannot be used to harmful ends. Although tax principles are well founded on UK tax principles, it is possible that the tax treatment of transactions and structures be confirmed in writing by the Maltese tax authorities. This is especially useful for somewhat complex transactions and structures, since it provides certainty of the tax treatment that will be adopted. An advance revenue ruling is valid for five years and can be renewed for another five-year period. A ruling will remain binding on the tax authorities for a period of two years from the time of any change in legislation affecting the ruling.

X YEAR IN REVIEW
When considering anti-BEPS rules, Malta considers that before bringing in further new rules (which are changing the international tax systems), sufficient time ought to be dedicated to test the operation of these new rules, as otherwise Malta and the EU run a substantial risk of having a disjointed system that ultimately will not work and will divert businesses to third countries. Similarly the EU’s proposed digital services tax is deemed deleterious to Europe’s information technology industry.

XI OUTLOOK AND CONCLUSIONS
Malta is committed to continuing and extending its role as a major European financial centre, ensuring at the same time transparency and compatibility with EU laws. Discussions have started on the implementation of the Anti-Tax Avoidance Directive 2 (2017/952) into Maltese legislation.
I INTRODUCTION

Mexico’s federal tax system is principally based on two taxes: income tax and value added tax (VAT). Other taxes exist, but these two taxes constitute the principal source of tax revenue for the government, which is significantly supplemented with oil-related revenue.

While aspects, some significant, naturally change over time, this system has generally been consistent in its structure and the key content of the relevant tax laws, Mexico’s Income Tax Law (MITL) and VAT Law. In this chapter, we focus on those consistent characteristics as of 2018, and also refer to recent changes over the past few years.

Mexico has a significant double taxation agreement (DTA) network. Additionally, it has 30 agreements in force for the reciprocal protection of investments and free trade agreements with 46 countries, and has been active in the negotiation of the Trans-Pacific Partnership Agreement. These conditions, and its geographic proximity with the United States, have allowed the country to perform industrial hub functions, with particular success in the automotive industry.

Mexico is predominantly a capital-importing country, and its tax system (including common characteristics of its DTAs) reflects this. However, over recent years leading Mexican business groups have consistently looked for opportunities abroad, therefore outbound capital movements have also become relevant.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate

From a commercial perspective, the stock company (SA) has prevailed for a long time now over other commercial company types established in Mexico’s General Law of Commercial Companies. This type of company requires a minimum of two shareholders, can be administered through a board of directors or a sole administrator, and requires an internal audit organ. A minimum paid-in capital is no longer established, although a minimum of 20 per cent of that established in the company’s by-laws must be effectively paid in at the time of incorporation.

More recently, the investment-promoting SA (or SAPI), introduced as part of the Law of the Stock Exchange in December 2005, gained favour as a versatile vehicle for co-investing
parties. In particular, the SAPI allows for shareholders’ agreements and concepts such as tag-along and drag-along rights and obligations, series of shares with special or restricted rights, and special rules regarding entry and exit of shareholders. Shareholder rights are not opposable to the share-issuing company as a third party, although this situation may be altered if the company itself is a party to the shareholders’ agreement.

Given the SAPI’s success, the traditional SA was overhauled through amendments published in June 2014, and a number of the SAPI’s more attractive aspects, such as those mentioned above, are now statutorily available for the ordinary SA, although differences remain.

For closely held commercial companies, an attractive alternative, given its easier corporate compliance requirements and simpler company statutes, is the limited liability company (SRL). As in the case of the SA, a minimum of two partners is required; however, a maximum of 50 partners applies. SRLs cannot issue shares, although they can issue non-negotiable certificates reporting participation in the company. Unlike the SA, the SRL’s members may decide whether the company will have an internal audit organ. As a matter of law, and not of special by-law rules or shareholders’ agreements, the members of an SRL have a say on who may become a new member in the SRL, as well as a correlative right of first refusal. By-laws can regulate the payment of supplementary capital contributions to the company.

As regards commercial activities, the SA, SAPI and SRL can carry out the same acts and activities; however, for certain areas, such as the financial sector, an SA may be required.

Nonetheless, for companies planning to carry out financial activities, a multiple object financial company (SOFOM) can grant credit to the public from various sectors and perform operations of financial leasing and factoring through obtaining funding resources by financial institutions or by issuing public debt, or both. Since 2006, a SOFOM can opt to become a non-regulated entity, which has some limitations on the activities it may carry out but it is subject to a reduced regulatory burden.

Regarding company incorporation and organisation, Mexican companies are governed by their contractual by-laws. These are established by the shareholders, so there are not different instruments such as articles of incorporation and by-laws. Such contractual by-laws cover all aspects of corporate acts and organisation, and are different from the shareholders’ agreements mentioned above.

Again regarding organisation, while the administrative organ (board or single member) is the organ charged with legally representing the company, the maximum authority within the company is the partners’ or shareholders’ assembly.

In the case of companies in which different capital groups invest, shareholders generally speaking, and non-residents in particular, should take special care with shareholder assembly convening rules to guarantee that they have a good arrangement protecting their right to be convened.

All such commercial companies can take the variable capital modality; this is reflected in the corporate denomination used, for example, Co X, SA de CV, instead of Co X, SA. This modality allows for flexible rules governing the increase and decrease of contributed capital without modifying the company’s social statutes.²

We can also add that, while the General Law on Commercial Companies establishes a type of company akin to the incorporated limited partnership, with unlimited liability for the

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² The tax authorities have on occasion taken the position that such capital contributions not recorded with a commercial or civil notary cannot be considered by them as capital contributions, although such
administrative partner and limited liability for the passive partners, this type of company has truly fallen into disuse, has some dated aspects – including restrictive rules on member entry and exit – and, even if used, would not be a pass-through but rather a taxed entity.

The typical entity for independent professional services is the civil partnership (SC). In this respect, it can be noted that Mexico's legal system does differentiate between commercial and entrepreneurial acts with which business profits identify, and lucrative civil activities, such as the rendering of professional services; therefore, the use of the word 'business' does not necessarily comprehend both activities, and it is sometimes difficult to draw a distinction between a commercial act and a profitable civil act. This differentiation can be relevant for tax treatment purposes.³

Foreign investment in Mexican companies must be reported to the competent federal authority.

ii Non-corporate

A non-corporate entity often used both for carrying on business activities or for administrative or collateral control purposes is the trust. A trust must typically be established with a bank acting as trustee or fiduciary, which implies a minimum administrative cost for using this vehicle. This cost increases if the trust in question is used to develop business activities.

The trust is a transparent vehicle for tax purposes, so the person to whom the trust property may revert (whether the settlor or the beneficiary) is deemed to be the owner for tax purposes.

When business activities are carried on through a trust, it must be registered with the tax authorities. A taxable profit or loss will be determined for the activity; provisional tax payments made through the same; and then the annual tax profit or loss will be assigned to the beneficiaries, who may proportionally apply the provisional tax payments made by the fiduciary. Tax losses from the trust can only be amortised from tax profits generated through the trust activity, except when the trust is wound down, in which case, for the amount of unrecovered resources contributed to the trust, the losses can be deducted from other taxable income. A non-resident carrying on a business activity through a trust shall have a permanent establishment (PE) in Mexico for those activities.⁴

Another vehicle is the association in participation (AenP), similar to the unincorporated limited partnership contract found in some common law countries. The associating party carries out the activities in its own name, using the cumulative resources contributed to the partnership by that party and by the associated parties; the associating party has unlimited liability for the activities carried out and the associated parties are only liable to that party for the amounts of their contributions. One defect is that associated parties' contributions are exposed to the associating party's liabilities, even if derived from activities not associated with

³ Business or entrepreneurial activities are defined by the Federal Fiscal Code as industrial, commercial, livestock, agricultural, fishing or forestry activities; personal independent services are defined by the VAT Law as those that do not fall within such business activity definitions.

⁴ Although some passive investment activities are excluded through administrative rules, we are critical of this rule as being overbroad, since a truly passive investor in a trust with entrepreneurial activities is more easily assimilated to a shareholder than a person with active business activities, and shareholders in Mexican companies do not constitute a PE in Mexico for having such quality.
the AenP activities. Given its nature, this vehicle should be fiscally transparent; unfortunately, a narrow-sighted tax policy has prevailed regarding the AenP and the vehicle is taxed as if it were an incorporated person.

iii Brief comments on private equity investment

Private equity is relatively new to Mexico. According to a number of annual surveys, a certain notable presence as a financing source commenced around 2001, although it has grown steadily since and is now a relevant source of financing. Perhaps as a consequence, Mexico’s tax system has lagged behind this phenomenon and is ill equipped to deal with some private equity situations.

As noted above, what would otherwise be a natural vehicle for private equity investment, the AenP, is not tax-transparent, thus subjecting its profits to the general income tax rate, and to interest and dividend withholding taxes for non-residents commented on further below. The trust, in turn, with exceptions irrelevant for private equity purposes, creates a PE situation even for passive investors. The incorporated limited partnership is very dated in its statutory regulation, is no longer common and would not be transparent for tax purposes.

There is one trust vehicle established in the tax incentives section of the MITL that aims to facilitate private equity-type investment into Mexico. This trust will allow the equity and finance resources pooled for various financing projects, and the dividend and interest income generated for the investors through those projects, to flow transparently through the trust; DTA benefits would apply individually to such investors. This instrument is designed with financing involving numerous projects in mind. However, this vehicle does not solve essential withholding tax problems arising when a non-resident collective investment vehicle amalgamates private equity funds coming from a multitude of jurisdictions, and identification of withholding tax rates and DTA benefit purposes is required for each and every fund source.

Thus, Mexico’s tax system is still missing a vehicle that both minimises taxable stages for financial resources being provided by private equity and stabilises withholding rates for foreign private equity sources.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

The MITL essentially taxes resident corporations and individuals, non-resident corporations or individuals with a PE in Mexico, and non-residents with taxable income coming from a source of wealth found in Mexico; it is divided into Titles I to VII, each of which respectively governs the following:

a general aspects;
b corporate taxation (residents and PEs);
c non-lucrative corporate entities;
d individuals (residents and PEs);
e non-residents (source income not attributable to a PE);
f controlled foreign corporations (CFCs) and multinational companies (transfer pricing); and
g fiscal incentives.

In this chapter we concentrate on corporate taxation and outbound income taxation.
Determination of taxable profit

The MITL applies a worldwide taxation principle for residents. Corporate income is taxed on an accrual basis\(^5\) regardless of where the source is found. Taxable income and deductions follow the MITL's special rules, so different items' treatment may vary from their financial accounting reporting treatment.

Regarding deductions, the concepts of expenses, cost of goods sold and investments are deductible, and deductions are also provided for items such as returns, discounts and rebates, non-collectible accounts receivable, and certain losses deriving from the loss or sale of deductible property. Deductions of interest, social taxes and contributions to certain pension and retirement funds are specially regulated.

Allocation of expenses under the MITL is literally provided for only in certain cases of PEs, and is expressly barred in the case of expenses made abroad and shared with persons that are not corporate or individual regime income tax subjects in Mexico. Denying proration shared with non-residents not subject to taxation in Mexico covered by a DTA is potentially discriminatory. However, a new 2014 administrative rule, following a Supreme Court precedent, now allows for such deductions, although the compliance burden is relevant, and includes meeting transfer pricing parameters and keeping proof of the expense made abroad on file in Mexico.

The concept of deductible investments includes fixed assets, deferred costs and expenses, and certain preoperative outlays. These items are deductible by applying the maximum authorised annual depreciation or amortisation percentages; the taxpayer has a limited ability to apply lesser percentages from time to time. Special percentages have been established for the generation of clean-sourced, renewable energy as well as for certain oil and gas industry cases established in the Hydrocarbons Revenue Law.

A peculiarity of the system is that an inflationary effect is given to the difference between cumulative qualified credits and debts by considering the tax year's inflation rate: when the credits exceed the debts, a deductible inflationary adjustment is allowed by applying the inflationary effect to such difference; when debts are the greater of the two, a taxable value is likewise determined on the difference.

The tax is paid on an annual basis; the fiscal year is necessarily identified with the calendar year.

Capital and income

No differentiation is drawn between taxation of ordinary income and of capital gains; both are taxed within the same taxable base. It should be noted that, while capital gains generated through the transmission of shares are accumulated as income together with other income, and subject to other deductions, losses coming from transmission of shares may only be deducted in the measure that taxable gains from the transmission of shares are accumulated as income in the current tax year or in the 10 following tax years.

Losses

Tax losses determined as per the MITL rules may be offset from tax profits of the following 10 years. There is no carry-back rule. A special 15-year rule exists for deepwater oil exploration and production operations.

\(^5\) However, SC-type company income is taxed on a receipt-basis, and some items, for example, certain payments to individuals, also generate their tax effects on a receipt basis.
Tax losses may not be transferred by merger, although they may be allocated between the relevant companies in the case of split-offs. In the case of a merger where a loss-sustaining company subsists after another company is merged into it, such subsisting company may only offset its losses existing before the merger from tax profits generated by the same lines of business as those that generated the losses.

Regarding change of controlling ownership, limitations allowing for the amortisation of losses apply that in general terms can be described as follows. Specifically, losses can only be offset from tax profits generated from the same lines of business as those that generated the losses when income as shown in the annual financial statements over the past three years is less than the cumulative tax losses amortisable and there is a change of controlling ownership in the company. Change of controlling ownership is defined as a change in ownership of more than 50 per cent of direct or indirect ownership of voting right shares over the past three years.

Rates
The corporate income tax rate is 30 per cent.

Administration – federal
Provisional income tax payments are made on a monthly basis by applying the profit quotient of the previous tax year (the taxable profit divided by all income, both corresponding to the previous year) to the income obtained in the year through to the month to which the provisional tax payment refers; tax losses from previous years may be subtracted from the provisional tax profits determined for the monthly instalment payments; and prior provisional tax payments are creditable against the resulting tax.

The annual tax return may be filed in January, February or March of the tax year following that to which the return refers.

A distinguishing feature of the Mexican tax system is the requirement to obtain a digital internet tax receipt (CFDI) to support any deduction. These receipts are digitally stamped upon issue by the tax authorities’ IT platform. The regulations regarding the issuance and requirements for CFDIs have gradually been updated. Some of the most significant changes include invalidation of bank statements as sole support for deductions, formal requirements that must be included in the CFDI and, most recently, the issuance of a supporting tax receipt upon payment.

The authority charged with designing legislative tax policy for consideration by Mexico’s Congress is the Undersecretary of Revenue. The authority charged with revenue collection and auditing taxpayers is the Tributary Administration Service; however, state tax authorities may have coordinated powers to audit federal taxpayers.

Rulings can be sought from the tax authorities; negative replies cannot be challenged until applied as part of an assessment issued to the taxpayer’s detriment. Favourable rulings are binding on the tax authorities as long as the facts argued are correct.

Audits principally come in the form of requests for taxpayer information and documentation to be filed at the tax authorities’ offices, or domiciliary visits where the tax authorities conduct the audit at the taxpayer’s address. The time limit for conducting the audit is, as a general rule, one year. The ongoing pattern is that, in the current year, the tax authorities initiate the audit of the fourth or fifth previous tax year.
Official letters of observations are issued before an assessment is made; observations are likewise directly notified to corporate administrative organs (if no member of a board is designated to such effect, in the specific case of SAs, the president of the board of directors is the legal representative of the same).

Assessments may be challenged through an administrative appeal (within a term unfortunately reduced, as of 2014, from 45 to 30 working days) or through a tax lawsuit before the Federal Tribunal of Fiscal and Administrative Justice (within 45 working days). Final appeals (amparo) may be made to the federal judiciary.

Directly settling controversies with the federal tax authorities is legally not provided for; however, the Taxpayers’ Attorney General’s Office (Prodecon) does have powers to oversee settlements in certain cases (see Section XI).

Local taxation
Each of Mexico’s 32 federative entities has its own tax system. Commonly, there is a revenue collection administrative split of powers between municipal authorities and state authorities. Real estate property acquisition or sale taxes, property taxes, payroll taxes and other like items are common state taxes. Some states may have a local tax on gross income coming from independent personal services or leases.

Tax grouping
Authentic tax consolidation – where taxable profits and losses for a single capital group are combined as a single tax base – was suppressed in Mexico as of 2014. As of this year, a minimal group ‘integration regime’ exists. In essence, this regime allows an integration factor to be determined in function of the percentage of group results that represent losses and, in application of such factor, companies within groups can defer a part of their individual tax for three years. Tax so deferred must be paid at the end of a three-year period, adjusted for inflation.

ii Other relevant taxes
In addition to income tax, the other relevant federal tax contributing significantly to tax revenue is VAT. VAT taxes sales, the rendering of services (which includes allowing the use of intangibles), the temporary use of tangible property and the importation of such items. The rate is 16 per cent. Certain foods and medicines, as well as the exportation of goods and a limitative list of intangibles and services, are taxed at a rate of zero per cent.

A change for 2014 was the elimination of the VAT exemption for temporary imports by what are referred to as maquiladora or IMMEX (in-bond) companies, together with other industry-specific programmes such as the automotive, aimed at promoting foreign trade. However, to avoid the cash outflow that will otherwise result from such importations (recoverable through accreditation upon the exportation of the transformed goods), companies can apply for certification (this requires fulfilling sundry requisites, with tax-compliant suppliers being one of them). Such certification grants this type of company the possibility of applying a credit against the importation VAT for the account of the taxpayer. Uncertified companies may opt to guarantee payment of the import VAT.
Another relevant change for 2014 was the elimination of Mexico’s flat tax, a receipt-based tax, which operated as a minimum alternative tax to income tax. This became the first time since 1986 that Mexico has lacked an alternative minimum tax.⁶

A special tax on goods and services exists, and taxes such sundry items as fuel, tobacco products, alcoholic beverages and high-calorie foods.

Payroll taxes are a common feature of the Mexican tax landscape, yet these are local taxes, not federal. Tax rates are usually found in the 2 to 3 per cent rate range.

Another relevant tax bill put forward owing to 2018 being an election year in Mexico was the issuance of a tax law on income derived from the rendering of digital services; although this initiative has not been approved by the Congress, it is expected that this topic will remain on the tax agenda for Mexico.

iii Employee profit-sharing
Another feature of investing in Mexico is worker profit sharing (PTU), a constitutionally established right for workers. As a general rule, profits to be distributed to workers are 10 per cent of the taxable profit. Such amount is payable in April or May of the year following that to which the profits refer. PTU effectively paid out in the year may be decreased from the taxable profit of the year before tax loss amortisation (and can also increase the amount of a tax loss). Unpaid PTU accrues to the following year’s PTU.

Over the years, a common practice to mitigate the PTU impact and other labour and social security taxes by corporate groups was the establishment of service companies to render all human resource services to the operative companies; thus, the employees share only in the service company’s profits. Amendments to Mexico’s Federal Labour Law towards the end of 2012, amendments to tax legislation, and the issuance of judicial precedents and authorities tax criteria on outsourcing have put a question mark over the effectiveness of such arrangements, which continue to be used.

IV TAX RESIDENCE AND FISCAL DOMICILE
i Corporate residence
Incorporated persons that have established ‘the principal administration of the business or their effective seat of direction’ in Mexico are deemed tax residents in the country. Problems with such residency rules have been known to arise from time to time, for example when a company incorporated abroad has its board integrated by Mexican residents and no proof can be obtained about the board acting outside of Mexico.

DTA double taxation rules may deny any DTA benefits to the dual-resident corporation or subject a case to the mutual agreement procedure.

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⁶ While the appropriateness of having a flat tax coexist with the income tax was often called into question by relevant taxpayers, it was never evaluated as a simple-to-administer, viable alternative to the income tax for micro, small and medium-sized businesses, which very often lack the time, resources and sophistication necessary to adequately comply with the MITL.
ii Branch or permanent establishment

Mexico follows traditional OECD PE rules in the legislative design, therefore PE taxation of business income or professional service income can arise from the following, general hypothesis:

a when a place of business is found in the country through which entrepreneurial activities or professional services are performed;

b when the non-resident has an agent, different from an independent agent, who has powers to enter into contracts in the name of or on behalf of the non-resident attending to the carrying on of the non-resident’s activities in the country; and

c when the non-resident habitually acts through an independent agent that is not acting within the ordinary framework of his or her activities.

Specific rules refer to:

a PEs arising for insurance companies when collecting premiums or insuring against risk within the national territory through an agent that is not an independent agent (excluding reinsurance);

b trusts with entrepreneurial activities, for the settlor or beneficiary carrying on the activities through the trust; and

c services relative to construction works, demolition, installation, maintenance or erections on real estate, or for projection, inspection or supervision activities related to the same, when the activity lasts longer than 183 calendar days, whether consecutive or not, within a 12-month period.7

The MITL enumerates cases considered places of business; cases where an independent agent is not considered to act within the ordinary course of their business;8 and cases where no PE is deemed to arise – for example, places of business to store or exhibit goods, or to procure goods for the non-resident, or through which auxiliary or preparatory activities are performed.

As a general rule, income attributable to the PE includes that deriving from the carrying on of the business activities. The sale of goods or real estate within the national territory by the central office or another PE of the person shall also be attributable to the PE. Income obtained by the central office, in the proportion in which the PE contributed to the expenses necessary to obtain the income, shall likewise be attributable to the PE.

Flow of after-tax profits from the PE to the taxpayer abroad is subject to the 10 per cent dividend tax. To identify the nature of the cash flow, a PE will also have both an after-tax net profit account (CUFIN), further commented on below, and a capital allotment account; the presumption is that the last cash flows out are capital reimbursements.

Additionally, a special case of PE is established in the Hydrocarbons Revenue Law to the effect that a PE arises when a non-resident carries out oil and gas activities referred to by such law in national territory or within Mexico’s exclusive economic zone for a period of more than 30 days in a 12-month period.

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7 Special rules have been established in the Hydrocarbon Revenue Law for certain oil and gas industry cases, but DTA benefits should still apply to those cases when covered.

8 Essentially taken from the Commentary on Paragraph 6 of Article 5 of the OECD’s Model Tax Convention on Income and on Capital, as explained up to the July 2010 version.
**DTA modifiers**

Regarding scenarios where no PEs arise, Mexico’s DTAs typically include the case of a place of business solely engaging in the delivery of goods for the account of the non-resident, an exemption case not provided for by the MITL. Usually contained in the DTAs is the standard OECD rule considering that no income can be attributable to the mere purchase of goods.

Likewise, Mexico’s DTAs usually contain the rule of determining the taxable income of the PE as if it were a separate independent entity operating at arm’s length.

A few DTAs follow some aspects of the UN Model Double Taxation Convention (i.e., those with India and Hong Kong) and will allow a continuing presence in a source country to render services to be constitutive of a PE. However, it is questionable whether this premise for a PE can be derived from the MITL’s own PE rules to start with, although the tax authorities have taken up such positions on a number of occasions in the past.

**Case of maquiladoras**

Under both the MITL and the DTA with the United States, when an agent different from an independent agent transforms an inventory of goods owned by the non-resident utilising assets also owned by the non-resident, a PE is deemed to arise. Specifically, the PE is deemed to exist when the economic and legal conditions existing in the relationship between the two parties is different to that which would be carried out by two independent parties.

Safe harbour rules exist in the MITL according to which even in these cases no PE shall be deemed to arise if either of the following two requisites are met: that the taxable profit be at least 6.5 per cent of costs and expenses, or 6.9 per cent of the value of most assets used to carry on the activity; and that an advanced pricing agreement be obtained from the tax authorities regarding the maquiladora’s consideration.

Up to 2013, a third safe harbour provision existed, but has been suppressed as of 2014: it involved the parties stipulating their mutual consideration at arm’s-length values, as supported through transfer pricing information.

Among other requirements and restrictions, the current safe harbour rules also require that at least 30 per cent of the assets used be owned by the non-resident or a related party, and that the maquiladora obtain its income exclusively from the transformation of the non-resident’s inventory.

## V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

### i Holding company regimes

No special holding company regimes, such as those with participation exemptions, withholding exemptions or exemptions for receipts of non-local dividends or income, exist; likewise, no special IP regimes, such as the patent box regime, exist.
ii  **State aid**

Depending on the sector or activity, some federal or local donations, grants or subsidies may be available. An amendment to the Income Tax Law for 2017 regulates when such government grants or economic aid shall not accrue as taxable income.

### VI  WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i  **Withholding on outward-bound payments (domestic law)**

To tax income obtained by non-residents, other than income attributable to a PE, Title V of the MITL taxes specifically identified types of income tax, as well as the cases in which such types of income are deemed to come from a source of wealth found in Mexico.

Specifically with respect to dividend, interest and royalty income, the following can be briefly noted.

Regarding dividends, the source of wealth is considered to be found in Mexico when the person distributing the income is a resident of Mexico. A 10 per cent withholding rate was established as of 2014 for dividends distributed to non-residents and individuals, regardless of their residency. This is a somewhat unfortunate development, as there was no income tax withholding for the account of non-resident shareholders for a significant number of years and, given Mexico’s considerable DTA network, the resulting new situation will be one of quite disparate taxation (exemptions, and 5, 8 and 10 per cent rates) for non-resident shareholders.

In the case of royalties (the same set of rules taxes technical assistance and publicity), the source of wealth is deemed to be found in Mexico when the intangibles or technical assistance is beneficially used in Mexico, or when the party paying the royalties or for technical assistance or publicity is a resident of Mexico or the PE of a non-resident found in Mexico. A 25 per cent withholding rate is applicable.

In the case of interest, the source of wealth is defined as being found in Mexico when the capital is placed or invested in Mexico, or when the interest-paying party resides in Mexico or is a PE of a non-resident found in Mexico. Exemptions exist for governmental entities, and withholding rates vary from 4.9 to 35 per cent depending on the nature of the beneficiary or of the financial agreement.

ii  **Capital gains on traded securities**

Beginning from 2014, capital gains deriving from the sale of listed securities may be subject to the 10 per cent withholding rate on the gain from the alienation. These were exempted items of income before 2014.

iii  **Double tax treaties**

Mexico has numerous DTAs in place as noted in the table below, and is negotiating other double tax agreements. In addition, it has information exchange agreements with a number of jurisdictions.
The following table outlines the usual maximum withholding rates allowed under each DTA; however, special rules, requirements (including effective beneficiary requirements) or exceptions may apply in all cases:

<table>
<thead>
<tr>
<th>Country or jurisdiction</th>
<th>Dividends</th>
<th>Interest</th>
<th>Royalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>10 per cent if share ownership exceeds 25 per cent; 15 per cent in other cases</td>
<td>Zero per cent for qualifying financial institutions or certain government entities</td>
<td>10 per cent in the case of copyright royalties for certain artistic works; 15 per cent in other cases</td>
</tr>
<tr>
<td>Australia</td>
<td>Zero per cent if share ownership exceeds 10 per cent; 15 per cent in other cases</td>
<td>10 per cent for qualifying creditors, debtors or securities; 15 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Austria</td>
<td>5 per cent if share ownership exceeds 10 per cent; 10 per cent in other cases</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Bahrain</td>
<td>Zero per cent</td>
<td>4.9 per cent in the case of interest paid to banks; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Barbados</td>
<td>5 per cent if share ownership exceeds 10 per cent; 10 per cent in other cases</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Belgium</td>
<td>Zero per cent in the case of 10 per cent or greater participation; 10 per cent in other cases</td>
<td>5 per cent for interest paid to financial institutions or derived from qualified securities; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Brazil</td>
<td>10 per cent if share ownership exceeds 20 per cent; 15 per cent in other cases</td>
<td>15 per cent</td>
<td>10 per cent under the protocol to the treaty</td>
</tr>
<tr>
<td>Canada</td>
<td>5 per cent if share ownership exceeds 10 per cent; 15 per cent in other cases</td>
<td>10 per cent</td>
<td>Zero per cent in the case of copyright royalties for certain artistic works; 10 per cent in other cases</td>
</tr>
<tr>
<td>Chile</td>
<td>5 per cent if share ownership exceeds 20 per cent; 10 per cent in other cases</td>
<td>5 per cent to banks under the protocol to the treaty; 10 per cent to insurance companies, qualifying and sales credit under the protocol to the treaty; 15 per cent in other cases</td>
<td>10 per cent under the protocol to the treaty</td>
</tr>
<tr>
<td>China</td>
<td>5 per cent</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Colombia</td>
<td>Zero per cent</td>
<td>5 per cent for interest paid to financial institutions; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>10 per cent</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Denmark</td>
<td>Zero per cent for corporate beneficial owner with at least 25 per cent participation; 15 per cent in other cases</td>
<td>5 per cent for interest paid to financial institutions; 15 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Ecuador</td>
<td>5 per cent</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Estonia</td>
<td>Zero per cent</td>
<td>4.9 per cent for interest paid to financial institutions; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Finland</td>
<td>Zero per cent</td>
<td>10 per cent for banks, qualifying securities and operations; 15 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>France</td>
<td>5 per cent if 50 per cent of the capital of the Mexican entity is held by a French resident; 15 per cent on other cases</td>
<td>5 per cent for banks and insurance companies under the protocol to the treaty; 10 per cent in other cases under the protocol to the treaty</td>
<td>10 per cent under the protocol to the treaty</td>
</tr>
<tr>
<td>Germany</td>
<td>5 per cent if the effective beneficiary of the dividends is German resident and owns more than 10 per cent of the Mexican entity; 15 per cent in other cases</td>
<td>5 per cent for financial entities; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Greece</td>
<td>10 per cent</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Country or jurisdiction</td>
<td>Dividends</td>
<td>Interest</td>
<td>Royalties</td>
</tr>
<tr>
<td>-------------------------</td>
<td>-----------</td>
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<td>-----------</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>Zero per cent</td>
<td>4.9 per cent for financial institutions; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Hungary</td>
<td>5 per cent in the case of 10 per cent or greater participation; 15 per cent in other cases</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Iceland</td>
<td>5 per cent in the case of 10 per cent or greater participation; 15 per cent in other cases</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>India</td>
<td>10 per cent</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Indonesia</td>
<td>10 per cent</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Ireland</td>
<td>5 per cent in the case of 10 per cent or greater participation; 10 per cent in other cases</td>
<td>5 per cent for financial institutions; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Israel</td>
<td>5 per cent in the case of 10 per cent or greater participation; 10 per cent in other cases</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Italy</td>
<td>15 per cent</td>
<td>10 per cent under the protocol to the treaty</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Jamaica*</td>
<td>5 per cent in the case of 25 per cent or greater participation; 10 per cent in other cases</td>
<td>Zero per cent for qualifying financial institutions or certain government entities</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Japan</td>
<td>5 per cent in the case of 25 per cent or greater participation; 15 per cent in other cases</td>
<td>10 per cent for interest paid to financial institutions and qualifying securities markets; 15 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Korea</td>
<td>Zero per cent in the case of 10 per cent or greater participation; 15 per cent in other cases</td>
<td>5 per cent for interest paid to financial institutions; 15 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Kuwait</td>
<td>Zero per cent</td>
<td>4.9 per cent for interest paid to financial institutions; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Latvia</td>
<td>5 per cent in the case of 10 per cent or greater participation; 10 per cent in other cases</td>
<td>5 per cent for interest paid to and by financial institutions; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Lithuania</td>
<td>Zero per cent in the case of 10 per cent or greater participation; 15 per cent in other cases</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>8 per cent in the case of 10 per cent or greater participation (in the case of Mexico); 5 per cent in the case of 10 per cent or greater participation (in the case of Luxembourg); 15 per cent in other cases</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Malta</td>
<td>Zero per cent</td>
<td>5 per cent for financial institutions; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Netherlands</td>
<td>5 per cent in the case of 10 per cent or greater participation; 15 per cent in other cases; exemption for Dutch entities if, under the local laws of Netherlands, dividends are exempted</td>
<td>5 per cent for financial institutions and qualifying securities markets; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>New Zealand</td>
<td>5 per cent in the case of 10 per cent or greater participation; zero per cent with respect to specific participations of at least 80 per cent of the voting power for at least 12 months before the date the dividend is declared; 15 per cent in other cases</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Country or jurisdiction</td>
<td>Dividends</td>
<td>Interest</td>
<td>Royalties</td>
</tr>
<tr>
<td>-------------------------</td>
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<td>-----------</td>
</tr>
<tr>
<td>Norway</td>
<td>Zero per cent if share ownership exceeds 25 per cent; 15 per cent in other cases</td>
<td>10 per cent for interest paid to financial institutions; 15 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Panama</td>
<td>5 per cent in the case of 25 per cent or greater participation; 7.5 per cent in other cases</td>
<td>5 per cent for interest paid to financial institutions; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Peru</td>
<td>10 per cent in the case of 25 per cent or greater participation; 15 per cent in other cases</td>
<td>15 per cent</td>
<td>15 per cent</td>
</tr>
<tr>
<td>Philippines**</td>
<td>5 per cent in the case of 75 per cent or greater participation; 10 per cent in the case of 10 per cent participation up to the aforementioned 75 threshold; 15 per cent in other cases</td>
<td>12.5 per cent</td>
<td>15 per cent</td>
</tr>
<tr>
<td>Poland</td>
<td>5 per cent in the case of 25 per cent or greater participation; 15 per cent in other cases</td>
<td>10 per cent for financial institution and qualifying securities; 15 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Portugal</td>
<td>10 per cent</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Qatar</td>
<td>Zero per cent</td>
<td>5 per cent for interest paid to financial institutions; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Romania</td>
<td>10 per cent</td>
<td>15 per cent</td>
<td>15 per cent</td>
</tr>
<tr>
<td>Russia</td>
<td>10 per cent</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Saudi Arabia***</td>
<td>5 per cent</td>
<td>5 per cent for interest paid to financial institutions; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Singapore</td>
<td>Zero per cent</td>
<td>5 per cent for interest paid to financial institutions; 15 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>Zero per cent</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>South Africa</td>
<td>5 per cent in the case of 10 per cent or greater participation; 10 per cent in other cases</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Spain</td>
<td>Zero per cent in the case of 10 per cent or greater participation; 10 per cent in other cases</td>
<td>4.9 per cent for banks, insurance companies or qualifying securities; 10 per cent in other cases</td>
<td>Zero per cent in the case of copyright royalties for certain artistic works; 10 per cent in other cases</td>
</tr>
<tr>
<td>Sweden</td>
<td>5 per cent in the case of 10 per cent or greater participation; zero per cent in the case of 25 per cent or greater participation if at least 50 per cent of the voting power of the shareholder is owned by residents of Sweden; 15 per cent in other cases</td>
<td>10 per cent for interest paid to financial institutions; 15 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Zero per cent in the case of 10 per cent or greater participation or to pension funds; 15 per cent in other cases</td>
<td>5 per cent for financial institution or qualifying securities; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Turkey</td>
<td>5 per cent in the case of 25 per cent or greater participation; 15 per cent in other cases</td>
<td>10 per cent for interest paid to banks; 15 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Ukraine</td>
<td>5 per cent in the case of 25 per cent or greater participation; 15 per cent in other cases</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>Zero per cent</td>
<td>4.9 per cent for interest paid to banks; 10 per cent in other cases</td>
<td>10 per cent</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Zero per cent for dividends paid to pension funds; 15 per cent in other cases</td>
<td>5 per cent for banks, insurance companies and qualifying securities; 10 per cent for other qualified loans by financial institutions of operations; 15 per cent in other cases</td>
<td>10 per cent</td>
</tr>
</tbody>
</table>
iv  Multilateral Instrument

In 2014, the Organisation for Economic Co-operation and Development (OECD) issued its report on Action 15 of the Base Erosion and Profit Shifting (BEPS) plan, in which the convenience and the viability of adopting a multilateral mechanism to level the use and prevent the abuse of double tax treaties is thoroughly discussed. As a result, the tax authorities of more than 80 countries have signed the Multilateral Instrument (MLI) with the completion of Action 15 of the BEPS plan, with Mexico being a signing party thereof.

The MLI intends to include and extend the application of the provisions of BEPS Actions within bilateral tax treaties. Likewise, it will give greater certainty regarding the application of the agreements covered by the MLI. It is important to mention that the MLI does not directly modify the text of the bilateral treaties, but its provisions apply in conjunction with the existing provisions of such treaties.

Through the MLI, Mexico will adopt the minimum standard on anti-abuse rules for its entire double taxation treaty network. Among the alternatives to do so, Mexico opted for the inclusion of a simplified limitation of benefits test, which means that a non-Mexican resident claiming treaty benefits would only be able to do so if it is a qualified tax resident. In general terms, a tax resident of a treaty partner country would be considered a qualified tax resident through a test of its ownership chain. If its ultimate shareholders are also tax residents of the same jurisdiction or a publicly traded entity, treaty benefits should be available. Otherwise, a test on the substantial presence of such tax resident in the relevant jurisdiction would need to be evaluated.

Nevertheless, if the treaty partner jurisdiction choice for the adoption of the minimum standard is not compatible with the position of Mexico in the MLI (i.e., the principal purpose test), then a more subjective test would need to be done through the principal purpose test of the relevant structure or arrangement, in order to define whether treaty benefits would be applicable.

The following jurisdictions have also opted for the simplified limitation of benefits test: Argentina, Armenia*, Bulgaria*, Chile, Colombia, India, Indonesia, Kazakhstan*, Russia, Senegal*, Slovakia and Uruguay.9

Although already in force for the first five signatories, Mexico has not yet ratified the MLI. Thus if Mexico ratifies the MLI in 2019, the treaty shall enter into force on the first day of the month following the expiry of a period of three calendar months beginning on the

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The asterisk indicates jurisdictions with which Mexico does not have a DTT in force.

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date of the deposit by such signatory of its instrument of ratification, acceptance or approval, but, the provision applicable to the withholding of taxes shall enter into force on the first day of the next calendar year (i.e., 1 January 2020).

v Taxation on receipt

As a general rule, income tax paid abroad, including withholding tax, is creditable against the income tax determined as per the MITL rules. This requires accumulation as taxable income of the gross income amount before taxation abroad.

In the case of dividends, in comparison to those received by a resident corporation from other resident companies, which are not taxable income, dividends coming from non-residents are taxable income. However, tax paid abroad on the profits from which the dividend distribution came is creditable against Mexican income tax. Given a greater flow of capital investment abroad by Mexican companies, this same system of accreditation was streamlined as of 2014. Currently, the characteristics of this accreditation system are as follows.

Taxes paid abroad by foreign companies, both first corporate tier and second corporate tier, can be creditable. Formulae are established in the MITL to determine the proportion in which the income tax was paid by such companies with regard to the profits distributed directly or indirectly to the Mexican resident company.

Regarding foreign tax credits, the following additional aspects may be noted.

A limit to the creditable amount is established in function of the corporate tax rate applicable in Mexico, wherefore any tax paid above that rate on the gross profits in question is not creditable.

For direct income, a taxable profit to determine the limit of the creditable tax is established that takes into account deductions totally or partially identified with obtaining such income.

Regarding dividend income, an accounting entry system is established to identify each tranche of income taxed abroad and the corresponding tax credit limit per year, in order to not commingle foreign tax credits applicable to such income. Failure to register with this system impedes accreditation from applying.

Taxpayers must keep on file documentation proving the payment of the tax to be credited abroad, although for jurisdictions covered by a broad agreement for the exchange of tax information, the certificate of withholding shall suffice.

When tax paid abroad cannot be credited against the income tax payable in Mexico for such income, a 10-year term over which such accreditation can take place is granted. The omission to apply the foreign tax credits when the taxpayer is in a position to do so will cause the credits to be lost in the measure that they were not applied.

VII TAXATION OF FUNDING STRUCTURES

Unlike other Latin American countries, Mexico does not have exchange controls or any similar restrictions to prevent or restrict cash flows into or out of the country. Exchange rates are defined by the open market, and almost all forms of hedging for currency fluctuation are available.

Under these circumstances, entities are commonly funded with a combination of equity and debt. Depending on the type of business, inbound financing may take place through a simple internal loan or a more sophisticated structured financing, for example, in the case of infrastructure development businesses.
i  Thin capitalisation

Thin capitalisation rules are included in the MITL seeking to prevent companies from using debt as a means to distribute profits to shareholders through interest payments.

Interest paid on interest-bearing loans granted in cash by related parties in excess of three times shareholders’ equity may not be deducted. These rules are, however, not applicable to taxpayers that obtain an advanced pricing agreement from the tax authorities, to financial institutions, or to infrastructure investments linked to strategic economic areas or to the generation of electric energy.10

ii  Deduction of finance costs

The definition of interest under the MITL is rather exhaustive and most likely will include any type of revenue derived from financing operations. Interest, discounts, premiums, commissions and guarantee fees would be considered an interest expense, among other concepts, together with the gain on transfer of financial instruments.

Interest expense, together with other costs related to securing financing, would be generally deductible. Currency fluctuation would be considered interest for tax purposes; this means that the revaluation or devaluation of debt will have a tax effect that could either result in additional taxable income or deductions depending on the specific situation.

The MITL has rules on back-to-back loans related to transactions between related parties. Interest deriving from triangular financing arrangements among related parties shall be treated as dividends for income tax purposes when the interest proceeds from back-to-back credits, including credits granted through a financial institution residing in this country or abroad.

In general terms, back-to-back credits are deemed to consist of:

a. operations whereby a person furnishes cash, assets or services to another that in its turn furnishes cash, assets or services directly or indirectly to the former or to a related party of said person or former person; or

b. operations in which a person grants financing and the credit is guaranteed with cash, a cash deposit, shares or debt instruments of any nature of the creditor or a related party of said creditor are also deemed back-to-back credits for such purposes to the extent of such guarantee.

An exception to this rule applies in operations whereby financing is granted to a person and the credit is guaranteed by shares or debt instruments that are the property of the borrower or of a related party residing in Mexico, if the borrower is unable lawfully to dispose of such shares or instruments, unless the borrower defaults on any obligation contracted under the respective credit agreement.

iii  Restrictions on payments

Tax

Mexican legislation provides for a 10 per cent withholding tax on dividends paid to non-residents and individuals, regardless of their residency, from profits generated from

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10 The MITL that came into effect in 2014 did not expressly consider the exception for the generation of electricity until an amendment for 2016; as per a transitory rule, this exclusion shall apply retroactively even as of 2014.
2014. Additionally, dividends are taxed at the level of the paying company on a grossed-up basis at the corporate tax rate in the year of payment, if the dividend does not come from the CUFIN balance (net after-tax profit account). In such a scenario, the income tax paid can be credited by the Mexican company against its income tax liability of the current year or of the next two years.

The CUFIN concept is similar to the earnings and profits statement. It attempts to reflect the true economic earnings of the company for tax purposes that have already been subject to corporate taxation.

The CUFIN balance shall be increased by the taxable profits of the year (minus paid income tax and non-deductible expenses), the amount of dividends received from other companies that are residents in Mexico, and with the income, dividends or profits generated or distributed by investments made in a preferential tax regime; and shall be reduced by any dividend or profit paid out during the year.

**Corporate**

Regarding corporations, rules in the General Law of Commercial Companies require financial statements approved by the shareholders’ or partners’ assembly showing the retained profits for dividends to be payable. Losses from prior tax years must be redeemed or absorbed through other shareholders’ equity items or capital reductions before the dividends can be paid. Supreme Court precedent would require profits to be determined once each fiscal year closes. A capital reserve (20 per cent of contributed capital stock) is also needed, which is built up through 5 per cent of each year’s profits.

**iv Return of capital**

Mexican entities can repay capital to their stakeholders as long as they comply with corporate law and the legal entity’s own by-laws. A two-prong test is necessary to determine if a capital redemption should give place to taxation.

For this purpose, taxpayers must keep a record of the effectively paid-in contributed capital for tax purposes through the capital contributions (CUCA) account. It will register all capital contributions made to the Mexican entity by its shareholders and its balance is restated by inflation on an annual basis.

Capital redemptions out of the CUCA balance can be paid with no further Mexican tax consequences. However, capital redemptions in excess of CUCA would be considered a deemed dividend and, therefore, subject to CUFIN-related consequences (if the CUFIN balance is insufficient, then the gross up and tax determination mentioned above occur). A first test compares CUCA per share to reimbursement per share, and a second test compares the CUCA balance to the shareholder equity value to determine whether, for tax purposes, profits are being distributed to the shareholder.

**VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES**

Mexico has one of the largest networks of DTAs in its region, with over 50 treaties in force and a handful of treaties under negotiation and renegotiation.

This fact brings an extensive array of options to define an appropriate and efficient corporate structure. However, although some treaties can bring significant benefits over
others in the specific cases of capital gains and interest withholding rates, attention must be paid to the substance of the structures and the anti-abuse rules that each DTA or applicable legislation may impose.

i  Acquisition
Stamp duties or direct taxes on equity are not applicable in Mexico. This fact gives a lot of flexibility to either setting up operations or acquiring operating businesses in Mexico. When setting up in Mexico, companies should focus on a structure that allows for certainty while doing business in Mexico and a flexible and efficient exit in the future.

This is normally achieved through application of DTAs. As mentioned above, capital gains are taxed under the general tax regime. However, in the case of non-Mexican residents, direct or indirect disposal of Mexican shares may be taxed at a 25 per cent rate over the gross proceeds of a disposal of shares, or at a 35 per cent rate over a net gain if certain requirements are met, such as appointing a Mexican legal representative, not residing in a low taxation jurisdiction and filing a special report before the Mexican tax authorities containing tax calculations certified by a third-party registered CPA.

Nevertheless, depending on the structure of the non-Mexican investor, they may be able to claim a reduction on the 35 per cent statutory rate through the application of a DTA.

In addition to capital gains, as mentioned above, as of 2014 Mexico incorporated a 10 per cent withholding tax on dividend payments to non-residents and individuals. Owing to the fact that this tax was not previously part of Mexican legislation, most Mexican treaties include the approach suggested by the OECD on a dividend’s tax reduction or even elimination in the case of countries with a capital exemption regime, adding another ingredient to corporate structuring from a tax perspective.

Finally, it is uncommon to see non-residents establishing entrepreneurial activities directly in Mexico. Although in theory any activity undertaken in the form of a taxable branch or PE should be subject to the same tax regime as a Mexican legal entity, this is a figure that is perhaps not very frequently used because of the practical complexity of profit attribution and the inability to limit responsibility for legal purposes.

ii  Reorganisation
Mexican legislation provides the possibility of transferring Mexican shares with a deferral of the corresponding tax, to the extent that certain requirements are met. The transfer of shares must be done within the same group and the consideration must be in the form of shares of the acquiring entity. The tax deferral is only possible with the authorisation of the tax authority, which may be a time-consuming process.

Similar restructure operations are contemplated in some DTAs, as in the case of the convention between the US and Mexico, the main difference being that the transaction can be carried out under an exemption through the application of the DTA; therefore, an authorisation from the tax authorities is not necessary, although certain formalities may apply.

In addition, mergers and spin-off transactions are allowed under Mexican corporate law.

Mergers between Mexican corporations can be carried out under tax-free circumstances if certain requirements are met, which consist of having business continuity over the activities of the merged entities with some exceptions; filing certain notifications to the tax authorities after the operation takes place; and ensuring compliance with the residual tax obligations for the entities that may have ceased to exist in the event.
Similarly, a tax-neutral demerger or spin-off of a Mexican corporation may be carried out to the extent that the shareholders in the new and spun-off entities remain the same for three years (one year prior to and two years following the transaction) and comply with residual tax obligations for a demerger entity in the event that it disappears after the transaction; and if the transaction is duly notified to the tax authorities.

A test on the monetary assets position also needs to be done. In cases where any of the entities’ monetary assets result in more than 51 per cent of its total assets, a capital redemption may need to be recognised over the demerged entity and the tax-free treatment may be partially or totally lost.

If a merger takes place within five years following another merger or a spin-off, then additional information may need to be filed before the relevant tax authorities to obtain an authorisation for tax-neutral effects.

iii Exit

Although ‘exit taxes’ as such do not exist within the Mexican tax regime, when the restructuring of a business results in the relocation of functions, assets or risks from Mexico to another jurisdiction, a transaction may be deemed to exist and should be valued under transfer pricing regulations so that if any tax consequence is identified, it can be considered for tax purposes.

Migration of legal entities is also a possibility to relocate business activities from Mexico to another country. This can be done through a change in the place where its management is executed to another jurisdiction.

In any of those cases, a deemed liquidation for income tax purposes would take place. Although the rules are not very clear, the Mexican company would need to determine if a tax should be recognised considering the fair market value of its total assets against the tax basis that may apply.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

Mexican tax regulation does not include a general anti-avoidance rule.

However, there is a provision applicable to cross-border transactions involving low-tax jurisdictions that gives the tax administration the possibility of recharacterising transactions entered into by taxpayers under the assumption that a simulation of acts took place. Although this disposition has been available for tax administration since 2008, it has not been extensively used in tax assessments, which is starting to change and perhaps will be more common as base erosion and profit shifting (BEPS) regulations set in.

It is worth mentioning that tax authorities have attempted to include additional rules into the Mexican tax system that could allow the analysis of the substance over form of transactions, but such attempts have failed in obtaining approvals in the legislative processes.

ii Controlled foreign corporations (CFCs)

CFCs and entities or contractual arrangements obtaining passive revenues that are subject to a low tax rate will be subject to taxation in Mexico, regardless of the moment at which such profits are actually taxed. However, the tax paid abroad could be credited against Mexican income tax generated for those activities.

For the purposes of Mexican CFC anti-deferral rules, passive revenue would include that obtained from interest, dividends, royalties, services, and even trade revenue in some
cases, especially when the origin or destination of the traded goods involves Mexico. It is understood that passive revenue is subject to a low tax rate when it is either not taxed at all or when taxed at a rate lower than 75 per cent of the tax that would have applied had such revenues been taxed under Mexican tax legislation.

Therefore, as a general rule, income from this kind of activity that is subject to taxation at a rate lower than 22.5 per cent would be subject to anti-deferral rules; however, some exceptions may also be applicable.

iii Transfer pricing

Mexican regulation on transfer pricing is rather mature and must be observed for transactions with related parties, whether they reside in Mexico or abroad. It follows OECD guidelines and is generally harmonised with other jurisdictions. However, there are certain topics that are relevant to the Mexican approach.

This first point can be found on the definition of related parties. A party would generally be considered related when there is a participation in the control, capital or administration of another, or when a party in common has a participation in such elements. Under this definition, one party having a single share in another party makes them related, even if from a factual analysis it can be concluded that they operate at arm’s length, which can result in unnecessarily onerous compliance issues.

The ‘best method rule’ under Mexican tax legislation indicates that transactional methods are preferred over general profit-based methods, as opposed to OECD guidelines, which suggest the use of the method that best adapts to the circumstances under analysis. As such, a comparable uncontrolled price method should be applied whenever possible, and then the gross profit-based methods would be preferred over the transactional net margin or profit-split methods.

As per the use of statistical methods to perform as transfer pricing analysis, the Mexican approach is also aligned with global practices of building a range with comparable transactions data; however, and although not stated in Mexican regulations, Mexican tax authorities do not necessarily accept the comparison of multiple year data for the corresponding tested party. In other words, the Mexican taxpayer information from a single year would need to be compared against multiple-year data of comparable transactions, which in some cases can create distortions in the analysis.

As of 2016, country-by-country reporting is considered for companies belonging to certain multinational groups qualified by level of consolidated income, to which effect three different returns shall have to be filed: a master informative return of related parties within the global group, a country-by-country informative return for the multinational group and a local informative return for the local related parties. These returns must be filed by 31 December of each year. Fines in the range of US$10,000 to US$20,000 are established for an omission in filing or incorrectly filed information.

In 2018 a series of tax rules for transfer pricing adjustments were amended to provide clarity to the recognition of income and the deduction of the corresponding adjustments that may derive from a transfer pricing self-evaluation. Furthermore, additional requirements and supporting documentation would need to be provided when such adjustment yields a deduction for Mexican tax purposes.
iv  **BEPS-inspired limitations to deductions**

As of 2014 there are new BEPS-inspired rules that can limit deductions in the case of payments to hybrid entities or in the case of double non-taxation.

v  **Informative returns**

The following returns are mandatory under Mexican legislation, and each entity could be subject to certain filings under certain scenarios.

DISIF is mandatory for entities falling within any of the following scenarios:
1. entities earning taxable revenues in the year exceeding 644,599,005 pesos;
2. entities that are part of the optional group regime under MITL;
3. entities that are part of the federal public administration;
4. foreign residents with a permanent establishment in Mexico; and
5. entities resident in Mexico that carry out transactions with foreign related parties (subject to certain thresholds). DISIF is due by 30 June of the following year to that in which the taxpayer falls within any of the scenarios listed above. Note that this return could not be filed if a taxpayer elects to file instead a statutory tax report of its financial statements (also due by 30 June of the following year) per Article 32-A of the Federal Tax Code.

In addition, the 2016 Mexican tax reform amended the Income Tax Law to implement the transfer pricing (master file/local file) documentation requirement. Mexican companies must submit the required documents by the end of the year (i.e., 31 December) following the fiscal year. This reform also introduced country-by-country reporting by large multinational enterprises based in Mexico.

Filing Form 76 is mandatory whenever an entity performs transactions under the scope of such form. Among others, the following could trigger such obligation:
1. financial operations;
2. transfer pricing adjustments;
3. equity participation and tax residency;
4. reorganisations and restructurings; and
5. other relevant operations. All of the above are pursuant to the thresholds stated by the law and the regulations issued by tax authorities.

X  **YEAR IN REVIEW**

Although the current federal administration commenced in December 2012, it was tax year 2014 that saw the proposal and implementation of the administration's tax policy, including the issuance of the current MITL. It is worth keeping in mind that 2018 is both an election year and the takeover of the new administration, thus certain tax reforms might apply in the following years.

XI  **OUTLOOK AND CONCLUSIONS**

Certain notable amendments were approved for 2018, as follows:

a  the issuance of a supporting CFDI upon payment;

b  incentives for the use of clean energy;

c  regulations on outsourcing entities for authorised deductions;

d  further regulations were established for the recovery of creditable VAT generated during a preoperative stage;

e  special rules were established for the oil and gas sector: notably, for the production sharing model, the portion of the production received as consideration is not taxable income, but does not generate cost for cost of goods sold purposes, therefore such value
is registered as income only once the production received is sold by the party in the production sharing agreement. The annual deduction rates for certain assets have also been amended;

- new fiscal stimuli have been established, including for fuel and diesel, tolls on national highways, deductions for salaries paid to certain qualifying persons;
- the rules on electronic auditing by the tax authorities have been refined; and
- tax rules regarding the recognition of income and the deduction of transfer pricing adjustments were amended.

Another notable development since 2015 has been the introduction of a publicly traded security that will allow certain businesses of the oil and gas, electric energy and infrastructure sectors to partially divest shares of special purpose vehicles placed in a trust, which in turn will place certificates on the stock exchange, and a transparent tax regime for investors following the master-limited partnerships models found in the US. It has generally been referred to by the misnomer Fibra E, as the acronym Fibra refers to the Mexican version of a real estate investment trust, whereas the new investment security actually relates to very different businesses and risks. 2016 saw adjustments to the model that make it more competitive; notably, gains on the sale of shares by a sponsor to a trust can be deferred up to 15 per cent per annum if paid with tradable certificates issued by the trust.

Regarding the tax authority–taxpayer relationship, we note the following: a hallmark of the current administration continues to be to audit in depth all VAT refund requests. This continues to cause significant delay in the payment of such refunds.

Regarding taxpayer audit planning, supply chain tax planning and, generally, transnational companies with excessively low taxable profits as compared to their overall income, continue to be targeted for audit.

The ability of Prodecon to mediate settlement efforts between the tax authorities and taxpayers on substantive issues involving the interpretation of laws and rules continues to represent an opportunity to lessen the pressure on a tax system in which the tax authorities do not have powers to settle directly with taxpayers and are under the strict scrutiny of an internal control organ, to the degree that such authorities often take a questionable pro-government stance for fear of incurring personal liability. However, an increasing demand for the settlement mechanism, even in cases that may not warrant its use, has put a new strain on this option.

11 Amendments to the administrative appeal a few years ago lessened this problem to a minor degree, but did not generally resolve it.
Chapter 22

NETHERLANDS

Jian-Cheng Ku and Rhys Bane

I INTRODUCTION

For many years, the Netherlands has been considered the gateway to Europe for non-European companies and investors. The certainty provided by advance tax rulings (ATRs) and advance pricing agreements (APAs), the country’s extensive participation exemption regime, the excellent Dutch network of tax treaties and bilateral investment treaties, flexible corporate law and the country’s business-friendly infrastructure are all key elements in this respect.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate

Dutch (holding) companies are generally organised as limited liability companies or as cooperatives.

Limited liability companies

Limited liability companies come in two forms: private limited liability companies (BV) and public limited liability companies (NV).

Both types of companies have legal personality and capital that is divided into shares. As the NV and BV both have limited liability, their shareholders are not liable for the company’s debts. While NVs are typically used for companies going public (i.e., listed on a stock exchange), BVs are generally used for smaller businesses or as a holding or finance vehicle.

NVs and BVs in principle pay Dutch corporate income tax (CIT) on their worldwide profits, with a branch exemption and participation exemption regime to eliminate international double taxation. Both types of companies are considered to be Dutch tax residents by virtue of being incorporated under Dutch law. Dividend distributions by NVs and BVs are subject to Dutch dividend withholding tax, with reductions and exemptions pursuant to domestic law and the application of a tax treaty.

Cooperatives

The Dutch cooperative is a special form of association. By and large, the general Dutch CIT rules governing associations also apply to cooperatives. However, in addition to these general rules, certain specific rules apply to cooperatives only. Like all associations under Dutch law,

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a cooperative must have a board of directors and members and, if the articles of association allow, a supervisory board. Moreover, the cooperative regime is quite flexible: no minimum capital requirements apply, only two members (at least) are required and dividends may be distributed freely.

In accordance with Dutch law, a cooperative’s objective (as formalised in its articles of association) must state that it provides for specific material needs of its members pursuant to agreements that are not insurance contracts and that have been concluded with those members as part of the cooperative’s business or causes that benefit the members.

Cooperatives have historically (up to 31 December 2017) been an attractive legal form for international holding companies, in that, as a rule, the members were not subject to Dutch dividend withholding tax (subject to specific anti-abuse rules). This general exemption, however, has lapsed as of 1 January 2018 for cooperatives of which the main (≥70 per cent) activities consist of holding participations or intercompany financing. Holding and financing cooperatives are now, in principle, subject to Dutch dividend withholding tax.

ii Non-corporate

Pursuant to Dutch law, partnerships are formed by means of a partnership agreement that governs the long-term cooperation between two or more partners. A partnership is not a separate legal entity; however, Dutch partnerships can sue and be sued, and can enter into contracts in their own name.

Dutch partnerships come in the form of a general partnership (VOF), a limited partnership (CV) or a professional partnership. The most important differences between these forms are expressed in how they interact with third parties, including representation, liability and the right of recourse. Whereas general and limited partnerships are considered to be subcategories of professional partnerships, the statutory provisions for a professional partnership essentially apply by analogy to general and limited partnerships. An important consideration is that the liability of general partners in a VOF and general partners in a CV is unlimited, while the liability of limited partners in a CV is limited to the amount of their respective capital contributions.

Dutch domestic tax rules distinguish between ‘closed’ and ‘open’ CVs. An open CV is regarded as non-transparent (opaque) for the limited partner interest, and is, therefore, (partly) a taxpayer for Dutch tax purposes; conversely, closed partnerships are transparent. A look-through approach applies to these closed CVs, meaning that only the partners in the CV may be subject to tax. The ‘consent requirement’ is a crucial factor in determining whether a CV is regarded as an open or closed partnership. A CV qualifies as open if limited partners can join and exit the partnership – except by bequest or inheritance – without unanimous consent from all other partners (i.e., both general and limited partners).

Upon implementation of the EU Anti-Tax Avoidance Directive II (ATAD II; with anticipated effective date being 1 January 2020), deductible payments made to a closed CV that are not taxed in the hands of the closed CV or the partners due to a difference in the qualification of the partnership (transparent versus opaque; hybrid mismatch), would no longer be deductible if the payor is a Dutch (or other EU) resident company. With the anticipated effective date being 1 January 2022, ATAD II prescribes that closed CVs should become subject to tax if the income of the closed CV is not taxed in the hands of its partners as a result of a hybrid mismatch.
III DIRECT TAXATION OF BUSINESSES

i Tax on profits

General

Dutch CIT is levied on Dutch and non-Dutch tax residents. Dutch tax residents are in principle subject to Dutch CIT on their worldwide income. Non-residents are subject to CIT only insofar as they enjoy Dutch-source income, which falls into two categories:

a taxable profits derived from a business that is conducted through a permanent establishment (PE) or a permanent representative in the Netherlands (see Section IV.ii); or

b taxable income derived from a substantial interest in a company that is a resident of the Netherlands, provided that:

- the main purpose (or one of the main purposes) for holding the interest is to avoid Dutch personal income tax in the hands of another person (subjective test); and
- an arrangement (or a series of arrangements) is in place that is not genuine (objective test).

For purposes of condition (b), an arrangement or a series of arrangements is considered not genuine if and to the extent it is not based on valid commercial reasons that reflect the economic reality.

Whether an arrangement has been put into place for valid commercial reasons may depend on the substance at shareholder level. Valid commercial reasons may be present if, inter alia, the shareholder conducts a material business enterprise and the shareholding is part of the business enterprise’s assets; the shareholder is a top holding company that performs material management, policy and financial functions for the group; or the shareholder functions as an intermediate holding company within the group structure. Intermediate holding companies are subject to an additional requirement pursuant to which the holding company must satisfy the Dutch minimum substance requirements. In addition to the minimum substance requirements, the Netherlands has introduced a wage sum criterion (in general, a wage sum of €100,000) and an office space criterion (office space for at least 24 months), that would apply to intermediate holding companies.

Determination of taxable profit

Dutch CIT is levied on a taxpayer’s taxable profit, being the net income earned and capital gains less deductible losses, as determined annually in accordance with the principles of sound business practice. Under this general principle, which has been widely developed under Dutch case law, profits and losses are attributed to the years based on principles of realisation, matching, reality, prudence and simplicity. In principle, all business expenses may be deducted from the taxable profit, including interest on loans (subject to interest deduction limitation rules), and annual amortisation and depreciation on assets used for the taxpayer’s business.

Losses

In general, tax losses can be carried back to be offset against the previous year’s taxable profits, and can be carried forward for nine years (six years for losses made in fiscal years starting on or
after 1 January 2019). Loss carry-backs and carry-forwards are applied in the order in which the losses arose (meaning that a loss will first be offset against the previous year’s profits, and then against future profits).

However, special rules for loss relief may apply to holding companies and direct (or indirect) financing companies (for holding and financing losses incurred prior to 2019) as to the trade in ‘loss-making companies’. In the latter scenario, a company’s losses may not be offset against future profits if 30 per cent or more of the ultimate interest in that company changes among the ultimate beneficial owners or is transferred to a new shareholder. This rule offers a number of exceptions, however (the going-concern exception, for example).

In view of the Dutch participation exemption regime (see Section V.i), taxpayers may not deduct losses on the disposal of a qualifying participation from their taxable profit. In addition, a write-off of the cost price of a participation is not deductible. However, liquidation losses, whether foreign or domestic, may be deducted from the taxable profits, provided that certain requirements are met. The liquidation loss amount is determined on the basis of the difference between the liquidation proceeds and the cost price of the participation.

**Rates**

The standard CIT rate is 25 per cent. The first €200,000 of annual taxable profit is taxed at a step-up rate of 20 per cent. To further bolster the investment climate, legislation has been adopted to lower the CIT rates, including a top bracket CIT rate reduction to 20.5 per cent in 2021 (2018: 25 per cent, 2019: 25 per cent, 2020: 22.55 per cent) and a lower bracket CIT rate reduction to 15 per cent in 2021 (2018: 20 per cent, 2019: 19 per cent, 2020: 16.5 per cent).

**Administration**

Taxpayers must file annual CIT returns with the Dutch tax authorities within five months of the end of their financial year. It is possible to apply for an extension of this filing deadline.

Dutch taxpayers are allowed to file their returns in a functional currency (i.e., a foreign currency other than the euro) if their annual reports are drawn up in the same foreign currency. As such, a Dutch taxpayer can ensure that fluctuations between the euro and the functional currency do not lead to taxable profits (e.g., foreign exchange results on outstanding debt or receivables).

**Tax grouping**

The Dutch consolidation regime (fiscal unity) offers the possibility for taxpayers to opt for treatment as a single taxable entity for Dutch CIT purposes. A Dutch resident parent company and its Dutch resident subsidiaries may form a fiscal unity if certain requirements are satisfied, the most important being that the parent company, directly or indirectly through other fiscal unity members, must hold at least 95 per cent of the legal and economic title to the shares issued by the subsidiaries. As a result, the assets and liabilities of the entities included in the fiscal unity are consolidated, meaning that intercompany transactions are eliminated and that the business income of the fiscal unity members is balanced for CIT calculation purposes. Although each member of the fiscal unity remains jointly and individually liable for the CIT due by the entire fiscal unity, the CIT assessments are only imposed on the parent company. A fiscal unity (for Dutch CIT purposes) is optional (i.e., it is not formed by operation of law), and therefore requires a prior request to that effect.
Following the judgment of the European Court of Justice (ECJ) in *SCA Group Holding*, the Dutch court of appeal ruled on 16 December 2014 that by disallowing a fiscal unity between a Dutch parent company and an indirect Dutch subsidiary held through an EU or EEA intermediate subsidiary, or a fiscal unity between two Dutch ‘sister’ companies held through a joint EU or EEA parent company, the Dutch fiscal unity regime conflicts with the European principle of freedom of establishment. In accordance with this decision, the Dutch Ministry of Finance issued a decree providing for an extra statutory consent for such European cross-border fiscal unities. Moreover, a legislative proposal codifying these changes to the fiscal unity regime into the Dutch Corporate Income Tax Act (CITA) entered into force as of 1 January 2017.

Following the judgment of the ECJ in *X BV* of 25 October 2017, in which the ECJ declared the Dutch fiscal unity regime (partially) breaches the freedom of establishment, the Dutch government announced emergency reparatory legislation to bring the fiscal unity regime in line with the EU freedom of establishment. The emergency reparatory legislation proposal will have retroactive effect up to 1 January 2018. The legislation would decrease the scope of the consolidation of the Dutch fiscal unity regime for a number of Dutch CIT rules that affect non-Dutch resident companies (which could not be included in the Dutch fiscal unity due to not being a Dutch tax resident), where these rules do not affect Dutch resident companies that are a part of a Dutch fiscal unity. The legislative proposal is currently still pending before Dutch parliament.

### ii Other relevant taxes

**Value added tax (VAT)**

VAT is charged on supplies of goods and services in the Netherlands and is based on the various EU VAT Directives. The standard VAT rate is 21 per cent. A reduced rate of 6 per cent (9 per cent as of 2019) is charged on designated supplies, while a zero per cent rate applies to supplies related to international trade. In addition, various VAT exemptions exist in the Netherlands, pursuant to which no VAT is charged (although it is important to bear in mind that in some cases the corresponding input VAT cannot be deducted).

The Dutch VAT Act provides for a deferment system for VAT, under which taxpayers must declare import VAT in their periodic tax returns but simultaneously deduct it, meaning that on balance no VAT is actually paid.

**Excise and import duties**

Excise duties, being a consumption tax, are levied on alcoholic products, tobacco and mineral oil products. Import (or customs) duties are levied on various products that are imported into the Netherlands from outside the EU. The Netherlands does not impose export duties.

**Real estate transfer tax (RETT)**

The acquisition of the legal or economic ownership of real estate (or rights relating thereto) located in the Netherlands is subject to real estate transfer tax at a rate of 6 per cent (2 per cent for residential properties). Various exemptions may apply in situations involving mergers or reorganisations.

Moreover, the acquisition of shares in a real estate company, being a company where real estate assets make up more than 50 per cent of the assets, of which at least 30 per cent consists of real estate located in the Netherlands, is also subject to Dutch RETT.
Wage tax and social security contributions

In principle, individuals in employment are subject to wage tax, which the employer withholds from their wages and remits to the tax authorities. This applies not only to wage tax on salary payments, but also to social security contributions. Dutch wage tax is considered to be an advance levy, meaning that individuals may credit it against their Dutch personal income tax due.

Highly skilled expatriates may claim a special tax facility, known as the ‘30 per cent ruling’. The 30 per cent ruling is a tax-free reimbursement of 30 per cent of an employee’s (gross) salary, which may be applied if the employee has been recruited or assigned from abroad and has specific expertise that is difficult to find in the Dutch labour market.

Other

The Netherlands does not levy any stamp or capital duties.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

Pursuant to Dutch tax law, the place of residence of a corporate entity is determined on the basis of all relevant facts and circumstances, in particular taking into account the place of effective management.

However, the CITA provides an important exception to this principle by applying the ‘incorporation fiction’. Pursuant to this fiction, entities such as NVs and BVs are deemed to be tax residents of the Netherlands by virtue of being incorporated under Dutch law. Accordingly, an entity incorporated under Dutch law is in principle fully liable to Dutch CIT regardless of its taxable place of residency, except limited by a bilateral tax treaty.

ii Branch or permanent establishment

Taxable profits from a business that is conducted through a PE or a permanent representative (referred to as a ‘Dutch business’) in the Netherlands are in principle subject to Dutch CIT.

In addition to the generally accepted Dutch PEs (the Netherlands typically follows the PE definition under the OECD Model Convention), the CITA explicitly states that a Dutch business is deemed to include:

a income and gains derived from real estate located in the Netherlands, including direct and indirect rights in Dutch real estate and rights to explore and commercially operate Dutch natural resources;

b profit-sharing rights in, or entitlements to, the net value of a business that is effectively managed in the Netherlands, except insofar as those rights or entitlements are not derived from securities;

c receivables on companies that are residents of the Netherlands, provided that the lender holds a substantial interest in the company concerned; and

d activities performed by a member of the management or supervisory board of an entity that is a resident of the Netherlands, even if the authority is restricted to those parts of the business that are located outside the Netherlands.
In determining the profits attributable to a PE, the Netherlands follows the authorised OECD approach, which has been largely incorporated into the Dutch PE profit allocation decree of 2011.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes

Participation exemption regime

Under the Dutch participation exemption regime, all benefits (i.e., dividends and capital gains) derived by a Dutch company from a qualifying participation in another entity are exempt from Dutch CIT.

The Dutch participation exemption applies if the following conditions are both met: the Dutch company holds 5 per cent or more of the nominal paid-up share capital of a company whose capital is divided into shares (the ‘5 per cent ownership condition’); and the entity in which the Dutch company participates is not held as a portfolio investment (the ‘motive test’ or ‘non-portfolio investment condition’).

This means that for purposes of the Dutch participation exemption regime the taxpayer must own a 5 per cent (or greater) interest in a subsidiary whose capital is divided into shares.

The non-portfolio investment condition implies that the participation exemption does not extend to subsidiaries that are held as portfolio investments (the ‘motive test’). A subsidiary is considered to be held as a portfolio investment if the Dutch resident company’s only object is to obtain returns that may be expected from normal active asset management. If the taxpayer has a mixed motive, the predominant motive is decisive. According to legislative history, a subsidiary that is engaged in a business and that is owned by an intermediate Dutch holding company linking the subsidiary’s activities and those of the larger group is not considered to be a portfolio investment. However, the motive test is deemed not to be met if more than 50 per cent of the subsidiary’s consolidated assets consist of a shareholding (or shareholdings) of less than 5 per cent; or the subsidiary’s predominant function – together with the functions of its lower-tier subsidiaries – is to act as a passive group finance, licensing or leasing company.

On 1 January 2016, the Netherlands introduced an anti-hybrid rule implementing the amendments to the PSD. Under this new rule, income that would normally fall within the scope of the Dutch participation exemption regime is no longer exempt if and insofar as the payment is legally or effectively tax-deductible at the level of the subsidiary. Although the anti-hybrid rule was prompted by changes to the PSD, it extends to distributions or payments by non-EU subsidiaries. Further changes to the Dutch participation exemption regime are anticipated as of 1 January 2019 to bring the regime in line with ATAD, as adopted in the course of 2016 (ATAD I) and further expanded in May 2017 (ATAD II).

ii IP regimes

The Netherlands offers a favourable tax regime for profits from qualifying IP developed by a Dutch taxpayer. Under this ‘innovation box’ regime, profits from the research and development (R&D) of qualifying assets are taxed at a lower CIT rate of 7 per cent (instead of 25 per cent) to the extent that the R&D profits exceed a threshold equal to the sum of the costs incurred to develop the IP.
As of 1 January 2017, the Dutch innovation box regime became aligned with the OECD’s base erosion and profit shifting (BEPS) Action 5 (countering harmful tax practices more effectively, taking into account transparency and substance). Pursuant to Action 5, states are required to modify their IP regimes in terms of accessibility and their economic substance. Consequently, the Netherlands incorporated the ‘modified nexus’ approach into the CITA, pursuant to which only intangible assets developed by the taxpayer itself will qualify for the application of the amended innovation box regime. A nexus formula will determine what portion of the R&D income will qualify for the innovation box regime.

### iii  State aid

The ECJ is currently handling an appeal lodged by the Netherlands regarding the decision of the European Commission in the *Starbucks* case. On 27 June 2016, the EC published the non-confidential version of its decision in which it held that an APA between the state and Starbucks Manufacturing BV (SMBV) constituted illegal state aid. Consequently, the Netherlands was ordered to reclaim the illegal state aid.

Although the Netherlands imposed a tax assessment on Starbucks to claim back these funds in accordance with the EC’s decision, it nonetheless lodged an appeal with the ECJ. Its argument was that the ruling issued by the Dutch tax authorities was compliant with internationally accepted transfer pricing methods, and that the EC had applied an interpretation of the OECD transfer pricing guidelines that did not match the general internationally accepted view.

The EC disputed various aspects of this ruling, which was concluded in 2008 and was based on a transfer pricing report that applied the transactional net margin method. According to the EC, the comparable uncontrolled pricing method should have been the most appropriate method and, moreover, SMBV should not have been considered the ‘least complex enterprise’ for the relevant transactions.

Moreover, the APA confirmed a mark-up of 9 to 12 per cent of SMBV’s operating expense to determine SMBV’s arm’s-length remuneration. Excess profits were transferred to Alki LP, an associated UK limited partnership, as a royalty deductible for Dutch tax purposes. The EC argued that the licence for using the Starbucks IP should have been valued at zero given that SMBV did not derive any benefit from it. By approving the incorrect methodology in the pricing agreement, the Netherlands granted a selective advantage to SMBV that should be considered illegal state aid according to the EC.

On 18 December 2017, the European Commission announced it had opened an in-depth investigation into the Netherlands’ tax treatment of Inter IKEA. The case revolves around two APAs concluded between Inter Ikea Systems and the Dutch tax authorities.

### iv  General

In addition to the participation exemption regime and the innovation box regime, Dutch tax law provides for many other attractive tax incentives, such as a R&D wage tax credit, a tax relief scheme for environmentally friendly investments and a sustainable energy investment allowance.
VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)

Dividend withholding tax is levied at a rate of 15 per cent from those persons – whether resident or non-resident – who are entitled (either directly or through depositary receipts) to proceeds from shares or profit-sharing certificates in a Dutch resident entity. The actual amount of dividend withholding tax due is calculated on the basis of the proceeds of such shares or profit-sharing certificates.

The Netherlands does not impose any withholding tax on (outgoing) interest or royalty payments, except for interest on certain hybrid loans.

Historically, cooperatives were generally not obliged to withhold dividend tax upon distributing profits to members, subject to anti-abuse rules (see Section II.i). As of 1 January 2018, the general exemption from dividend withholding tax for members of cooperatives has largely been eliminated if the cooperative is classified as a 'holding cooperative'. This would be the case in all situations where the activities of the cooperative consist, in short, subject to all relevant facts and circumstances, for more than 70 per cent of holding and finance activities. Only less-than-5 per cent membership rights continue to benefit from an unconditional exemption from dividend withholding tax.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

Dutch tax law provides for various statutory exemptions from dividend withholding tax on dividend distributions, such as the Dutch participation exemption regime (see Section V.i) and the fiscal unity regime (see Section III.i).

Generally, Dutch dividend withholding tax is an advance levy that may be credited against the Dutch CIT due the level of the shareholder. In addition, several special tax regimes are adopted into the Dutch Dividend Withholding Tax Act pursuant to which no (owing to an exemption) or less (owing to a refund or reduction) Dutch dividend withholding tax is levied.

For example, an exemption may apply if the beneficiary of the dividends is an EU resident and its shareholding in the distributing company would have qualified as a participation under the Dutch participation regime if it had been a Dutch resident company. Under certain conditions, it is also possible for non-European companies with investments in Dutch companies, such as pension funds, to claim back the tax withheld.

As of 1 January 2018, the Netherlands unilaterally applies a zero per cent rate for all distributions to qualifying (>5 per cent) corporate shareholders in the EU/EEA and entities tax resident in a country that has concluded with the Netherlands a double taxation treaty with a dividend clause (irrespective of whether than treaty itself provides for a zero per cent rate). A new anti-abuse rule also applies, denying the exemption if the shareholding is both held with the principal purpose, or one of the principal purposes, of avoiding the levy of dividend withholding tax and the shareholding is part of an artificial (non-genuine) structure or transaction or series of transactions.
iii  Double tax treaties

The Netherlands has one of the most extensive treaty networks in the world (currently standing at around 100 bilateral tax treaties), providing for, *inter alia*, beneficial allocation of the taxing rights on capital gains and reduced withholding tax rates.

Moreover, the tax treaties concluded by the Netherlands typically protect against discriminatory taxation by any state other than the resident state of the taxpayer. Most bilateral tax treaties concluded by the Netherlands provide for a reduction of dividend withholding tax (down to 5 or even zero per cent).

As an OECD member state, the Netherlands also supported the development of the Multilateral Convention to Implement Treaty Related Measures to Prevent BEPS, more commonly known as the MLI. The Netherlands co-signed the MLI, which will see most of the Dutch bilateral treaties changed (subject to reciprocity) to include the (mostly anti-abuse) measures introduced by the MLI. The Netherlands endorsed all MLI features without opting out. The main anti treaty-abuse rule elected by the Netherlands is the principal purposes test (PPT).

iv  Taxation on receipt

Dividends, interest and royalties received by resident companies are generally included in the taxpayer’s tax base with the exception of dividend distributions that qualify under the participation exemption regime (see Section V.i).

Moreover, given the extensive tax treaty network, Dutch-resident companies can generally avoid double taxation on foreign-sourced income by claiming relief in respect of incoming dividends, interest and royalties. If no tax treaty is available, relief from double taxation is usually provided under the Dutch unilateral rules for the avoidance of double taxation.

VII  TAXATION OF FUNDING STRUCTURES

i  Thin capitalisation

The Netherlands does not have debt-to-equity rules or similar anti-interest stripping provisions.

ii  Deduction of finance costs

*General*

Pursuant to settled case law by the Dutch Supreme Court, the characterisation of a financing arrangement as debt for Dutch tax purposes in principle follows the characterisation of such arrangement for civil law purposes. In this respect, a repayment obligation is considered to be an essential element for the financing arrangement to qualify as debt for civil law purposes. However, there are three exceptions applicable to this general rule, pursuant to which the debt is reclassified as equity for Dutch tax purposes, namely in cases of:

a  a sham loan (where the parties only created the appearance of a loan, while in fact intending to realise an equity contribution);

b  a loss financing loan (where it is immediately clear from the terms of the loan that the claim resulting from the loan is (in part) worthless, because the loan cannot be repaid and, as result of which, the funds have permanently left the taxpayer’s capital); and
a hybrid financing (or participating) loan (where, based on the terms of the loan, the lender in fact is participating in the borrower’s capital. In this scenario, debt is reclassified as equity if:

- the duration of the loan is perpetual (i.e., more than 50 years), or the loan is repayable only in the event of the debtor’s bankruptcy or liquidation;
- the consideration payable on the debt is entirely or almost entirely contingent on profits; and
- the loan is subordinate to all other creditors.

As a consequence, interest payments on a reclassified loan qualify as dividend distributions for Dutch tax purposes and are treated accordingly (i.e., subject to Dutch dividend withholding tax and – for qualifying participations – exempt under the participation exemption regime).

If none of these exceptions apply, the arm’s-length interest expense should be deductible for Dutch CIT purposes (subject to any interest deduction limitation rules). In this regard, the Dutch Supreme Court has developed the concept of ‘non-businesslike loans’. A loan between related parties is considered to be non-businesslike if the loan is granted under terms and conditions that would not have been agreed upon by independent (unrelated) parties in similar circumstances.

However, if it is not possible to determine a businesslike interest (by doing so, the loan in essence would become profit-sharing or deviate from the parties’ original intentions), the loan is considered to carry a non-businesslike risk of default. These loans generally lack a loan agreement, a repayment schedule or any security. As a result, write-down losses on these loans are non-deductible. Using the ‘suretyship analogy’ method, as developed by the Dutch Supreme Court, the interest rate can be determined by considering the rate that a third party (i.e., a bank) would charge if the parent company put itself forward as guarantor.

A final factor in establishing whether the interest expense on a financing arrangement is deductible for Dutch CIT purposes is the existence of various specific interest deduction limitation rules.

**Anti-base erosion**

Dutch tax law provides for an anti-abuse provision that specifically targets situations that can be described as ‘base erosion’. The common feature of such structures is that (group) equity is converted into debt using transactions that have a somewhat artificial character (and are not based on valid business reasons). Interest on and fluctuations in the value in respect of loans that are legally or de facto, directly or indirectly, owed to related entities, are not deductible to the extent these loans relate legally or de facto effectively, directly or indirectly, to one of the following transactions: distributions of profit or repayments of capital by the taxpayer (or an affiliated entity or individual) to a affiliated entity; capital contributions by the taxpayer (or an affiliated entity or individual) in a affiliated entity; or acquisitions or increases by the taxpayer (or an affiliated entity or individual) of an interest in an entity that becomes an affiliated entity as a result of the acquisition or increase.

However, this anti-abuse provision does not apply if the taxpayer can demonstrate that the debt and tainted transaction are predominantly motivated by business reasons (business motive exception), or the interest is taxed at the level of the recipient at a rate of (at least) 10 per cent (subject-to-tax exception).
**Participation debt**

Pursuant to the bad debt rules, it must be determined whether the acquisition price (i.e., cost price) of the subsidiary exceeds the Dutch company’s equity for tax purposes. If it does, a ‘participation debt’ is present, and as a result, the excessive interest expense incurred on the participation debt is in principle non-deductible. The excessive interest is calculated by multiplying the interest expense for a particular year by the fraction of the average amount of participation debt divided by the average amount of total debt.

However, for reasons of practicality, the first €750,000 of interest expense per year is not affected by this rule. Moreover, an exception is provided for companies that can demonstrate that the acquisitions of, or capital contributions to, participations constitute an increase in the operating activities of the group as a whole. Interest expenses relating to such an increase of operational activities remains deductible. However, this exception does not apply in the case of a double-dip structure or a hybrid financing structure, or if it is unlikely that the taxpayer’s operating activities would have been increased if the interest deduction were disregarded. As of 1 January 2019, the specific participation debt is anticipated to be eliminated in compensation of the 30 per cent EBITDA threshold to be introduced pursuant to the ATAD.

**Acquisition debt**

The third rule limiting interest expense deductions applies to any debt attracted for the acquisition of a Dutch target company that is subsequently joined into a fiscal unity with the acquiring entity. The interest expenses on these acquisition loans are only deductible if the profits of the target company are disregarded. In other words, the interest expense may only be deducted from ‘own’ profits of the acquiring entity. However, two safe harbour rules exist: *a de minimis* rule pursuant to which the first €1 million paid of interest on acquisition loans is not affected; and the interest is only non-deductible to the extent there is excess acquisition interest expense.

Regarding the second safe harbour, acquisition loans are considered excess acquisition loans only if the total outstanding amount of the acquisition loans in a given year exceeds a fixed percentage of the total amount of the acquisition prices. This percentage is initially 60 per cent in the year during which the target company is consolidated into the CIT fiscal unity with the debtor, and is reduced in annual steps of 5 per cent until it reaches 25 per cent after seven years.

Effective 1 January 2017, this interest limitation rule for acquisition debt was slightly adjusted to prevent tax avoidance schemes. As a result of these changes, debt pushdown schemes will no longer frustrate the limitation of deduction, and financing schemes can no longer be rebooted. As of 1 January 2018, further technical changes are anticipated to render these rules more effective. As of 1 January 2019, however, the specific acquisition debt rule is anticipated to be eliminated in compensation of the 30 per cent EBITDA threshold to be introduced pursuant to the ATAD.

**Earnings stripping**

As of 1 January 2019, the earnings stripping rule is anticipated to replace the participation debt and acquisition debt rules. Under the earnings stripping rule, net interest expenses is fully deductible up to the higher of 30 per cent of the EBITDA and €1 million. Any interest that was non-deductible owing to the application of the earnings stripping rule can be carried forward indefinitely.
iii Restrictions on payments

Pursuant to the Dutch Civil Code, a company limited by shares may make distributions to its shareholders and other entitled persons only to the extent its net assets exceed the sum of its called-up and paid-up capital and the reserves as required by law or the company's articles of association.

Moreover, a distribution test applies to BVs pursuant to which the company may only distribute profits to its shareholders (and other entitled parties) to the extent this does not interfere with the company's ability to pay its exigible and current debt.

iv Return of capital

A repayment of capital has no adverse tax consequences from a Dutch CIT perspective. However, a repayment of capital recognised as paid-up capital for Dutch dividend withholding tax purposes will trigger dividend withholding tax if and to the extent the taxpayer has net profits, unless the general meeting of shareholders has resolved in advance to make the repayment and the articles of association have been amended to reduce the nominal value of the ordinary shares by an equal amount. The capital recognised as paid-up capital for dividend withholding tax purposes may consist of formal capital, informal capital and share premium.

Hence, to repay capital (recognised as paid-up capital for Dutch dividend withholding tax purposes) without triggering Dutch dividend withholding tax, the nominal value of the ordinary shares must first be reduced by amending the articles of association.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Share deal

A share deal, in which the shares in a Dutch entity are acquired, may be conducted either directly by a foreign entity or indirectly through a Dutch (acquisition) entity. In this respect, cooperatives are frequently used as shareholders for Dutch acquisition entities, given that Dutch cooperatives are in principle not subject to Dutch dividend withholding tax, provided that they comply with the anti-abuse rules (see Section I.i).

If the shares are purchased indirectly (i.e., through a wholly owned Dutch acquisition entity), a fiscal unity may be formed between the acquiring entity and the Dutch target company subject to certain requirements. Accordingly, interest expense on the acquisition debt at the level of the Dutch acquisition entity may be offset against the profits of the target entity (subject to the limitations on interest deduction for acquisition debt: see Section VII.ii).

If the shares are acquired directly (i.e., by a foreign company), the foreign shareholder may become liable to Dutch CIT pursuant to the non-resident taxation rules for foreign substantial shareholders if it does not satisfy the anti-abuse rules (see Section III.i).

Asset deal

An asset deal can be executed either directly by a foreign entity or indirectly through a Dutch entity that acquires the Dutch business or assets. In principle, the gains realised upon the sale of the assets is subject to Dutch CIT. However, provided that certain requirements are met, it is possible to defer the CIT due by applying a 'reinvestment reserve' that provides for a rollover mechanism for Dutch CIT due in respect of the gains realised.
ii  Reorganisation

Dutch civil law offers various possibilities for mergers and demergers: a stock merger, business enterprise merger, a legal merger or demerger, and a legal spin-off. The CITA provides for several facilities – subject to certain conditions – by allowing a rollover of book values for the assets and shares transferred. In these cases, the transfer is effected on a non-recognition basis.

iii  Exit

Dutch tax residents relocating their businesses to outside the Netherlands are in principle subject to Dutch CIT in respect of their realised and unrealised profits (i.e., hidden reserves and goodwill). Similarly, for entities migrating into the Netherlands, a step-up of all assets and liabilities applies.

If certain conditions are satisfied, the CIT due may be deferred if the taxpayer’s new place of residence is an EU or EEA Member State.

IX  ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i  General anti-avoidance

In principle, Dutch tax law allows taxpayers to arrange their affairs so as to minimise the amount of tax payable. However, they may not initiate actions intended predominantly to reduce the amount of tax they that would otherwise pay. Although no statutory anti-abuse provisions exist under the CITA, various different doctrines can be seen in Dutch case law, which are sometimes used interchangeably. However, these doctrines are not panaceas, and they may only be applied by the Dutch tax inspector as a final resort.

The doctrine of ‘independent determination (or reclassification) of the facts for tax purposes’ describes the process in which the court labels a fact or set of facts from a Dutch tax perspective. The court may go beyond the formal paperwork and evaluate the ‘substance’ of a transaction (e.g., the proper classification of debt versus equity, sale versus lease and compensation versus disguised dividend).

The non-statutory concept of fraus legis (‘abuse of law’) gives the tax authorities the possibility to challenge the validity of a transaction if the decisive motive for entering into the transaction is to avoid taxes (subjective element), and the transaction is in breach of the purpose and intent (objective element). The transaction will then be considered abusive and will be treated differently from its legal form.

ii  Controlled foreign corporations (CFCs)

The CITA does not provide for any specific CFC rules. However, subsidiaries are subject to an annual mark-to-market requirement if the taxpayer together with its affiliates holds at least 25 per cent of the shares in a subsidiary that is held as a portfolio investment and moreover is subject to a low-tax regime (where the indicative threshold is a rate of 10 per cent), and 90 per cent of the subsidiary’s assets (including its lower-tiered subsidiaries) consist of low-taxed passive assets.

If a subsidiary fulfils these criteria, its profits are taxed at the level of the Dutch shareholder. However, a credit system is in place to prevent double taxation on these profits.

As of 1 January 2019, the Netherlands is expected to introduce the ATAD ‘Model A’ CFC rules (which have an income-based approach) for CFCs in low-tax jurisdictions.
(jurisdictions that are listed on the EU list of non-cooperative jurisdictions or that have a CIT rate of less than 9 per cent). In other situations, the Netherlands takes the position that the Netherlands already has CFC rules in the form of the arm’s-length principle.

iii Transfer pricing

The Netherlands has incorporated the arm’s-length principle into the CITA. It forms the legal basis for the Dutch tax authorities to adjust intercompany transfer prices in cases where related parties have entered into a transaction for a price or conditions that would not have been agreed upon between independent parties. This provision defines the term ‘related parties’ and describes the transfer pricing documentation requirements. Moreover, the provision includes specific rules for financial services companies (e.g., substance and real-risk requirements).

Generally, the Netherlands follows the OECD transfer pricing guidelines and has largely incorporated these guidelines into a transfer pricing decree. It has also incorporated the country-by-country reporting rules into the CITA as of 1 January 2016. These rules correspond to OECD BEPS Action 13 (i.e., applying the three-tiered documentation approach using a country-by-country report, master file and local file).

iv Tax clearances and rulings

The Netherlands is well known for the cooperative and constructive attitude of the tax authorities, and the possibility to discuss the tax treatment of particular operations or transactions in advance (upfront certainty) in an ATR or APA. An ATR provides the taxpayer with certainty regarding the tax treatment of international structures (e.g., the applicability of the Dutch participation exemption). An APA provides upfront certainty in respect of the transfer prices for intra-group transactions.

Both types of ‘settlement agreements’ are concluded by the Dutch ruling team working in close liaison with the Central Point for Potential Foreign Investors. This department provides foreign investors advance certainty on the tax treatment of their prospective investments in the Netherlands. An ATR or APA is typically valid for four years.

Further guidance is provided by the State Secretary of Finance through several decrees that govern Dutch ATR and APA practice. For example, a Dutch top or intermediate holding company in an international structure seeking to obtain an ATR should fulfil the minimum Dutch substance requirement if the group does not have any operating activities in the Netherlands.

Moreover, Dutch taxpayers that satisfy certain conditions may apply for ‘horizontal monitoring’, a form of cooperative compliance for which they sign a covenant with the Dutch tax authorities based on trust, transparency and mutual understanding. With a horizontal monitoring agreement, the tax authorities provide the taxpayer certainty on tax issues as early as possible, to minimise the administrative checks and audits afterwards.

Recently, the Dutch government announced it is reviewing the Dutch ruling practice. It is expected that changes will be made to the Dutch ruling practice, taking effect mid 2019. Rulings will still be granted to companies that have economic nexus with the Netherlands.
X YEAR IN REVIEW

Dutch legislative changes over 2018 have been large in quantity. Early in 2018, a large number of changes to the Tax Code were announced. On Budget Day 2018, the ATAD implementation proposal (which the Netherlands is bound to implement) and a proposal to further bolster the investment climate were proposed.

Initially, the Dutch government had the intention to abolish the dividend withholding tax in its current form. The abolishment of the dividend withholding tax would be accompanied by the introduction of a conditional withholding tax on dividends, interest and royalties paid to group companies in low-tax jurisdictions and in abusive situations.

Owing to pressure from opposition parties, the proposal to abolish the dividend withholding tax was replaced by a number of alternative measures to further improve the Dutch investment climate. The most important alternative measure is the (further) lowering of the CIT rates to 15 per cent (lower bracket) and 20.5 per cent (top bracket) by 2021.

The conditional withholding on dividends is currently being reconsidered, whereas the proposal to introduce a conditional withholding tax on interest and royalty payments to low-tax jurisdictions or in abusive situations is expected to be published by year-end 2019 (with the expected effective date being 1 January 2021).

XI OUTLOOK AND CONCLUSIONS

Both the OECD and European anti-BEPS projects continue to be key topics in the Netherlands. Owing to pressure from the EU, the Netherlands is taking stricter measures against tax avoidance. However, the Netherlands keeps the business climate in mind when designing the measures against tax avoidance. The lowering of the CIT rate to a level below the EU average underlines the continued commitment of the Netherlands to a climate favourable to foreign direct investment.

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Chapter 23

NIGERIA

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I INTRODUCTION

Nigeria’s population of over 190 million and its continuously expanding consumer market have made it an investment destination of interest to foreign investors for some time. Nigeria is the largest economy in Africa, with a GDP of US$375.8 billion as at December 2017. The establishment of democratic structures during the past 19 years and the efforts of the government towards entrenching the rule of law may have improved the country’s political risk profile. Some potential investors may see the country’s relatively low corporate tax rates as a good incentive to do business in Nigeria, in spite of tremendous infrastructure deficits and the multiplicity of taxes at the different tiers of government, which can make running a business in Nigeria quite challenging.

The country is a federation of 36 states and 774 local government areas, each with power to impose tax on specified activities. Lagos State, one of the 36 states, is the fifth-largest economy in Africa.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate

The most common form of corporate business organisation is the private limited liability company. This may not have more than 50 shareholders and must restrict the transfer of its shares. There is also the public limited liability company (plc), which can have any number of shareholders starting from two. This is the required form for companies listed on the stock market. The unlimited liability company is also an available form, but is rarely used.

Finally, there is the open-ended investment company, which is allowed to buy its own shares.

Most enterprises can only be carried on using a corporate vehicle. For instance, banking, and crude oil exploration and production, can only be carried out by registered companies. The company itself (not its owners) is taxed on its profits.
**Non-corporate**

Many small-scale businesses and petty traders carry on as unincorporated enterprises. Besides sole proprietorships, the most commonly used form of non-corporate business entity is the general partnership. Partnerships are not liable to tax – their profits are shared among the partners and taxed in the partners’ hands.

### III DIRECT TAXATION OF BUSINESSES

#### i Tax on profits

There are two corporate income taxes: companies’ income tax (CIT) pursuant to the CIT Act (CITA) and petroleum profits tax (PPT) pursuant to the PPT Act.

**Determination of taxable profit**

CIT is chargeable on the profits of all companies apart from those engaged in oil exploration and production. Expenses are deductible if they are ‘wholly, exclusively, necessarily and reasonably’ incurred in the making of profits. Donations to charities and educational institutions are deductible up to a prescribed limit. Instead of depreciation, capital allowance is allowed annually at specified rates that can be as high as 95 per cent in the first year.

PPT is chargeable on the profits of any company engaged in the exploration and production of petroleum (or crude oil). Under the PPT Act, expenses are deductible if they are ‘wholly, exclusively and necessarily’ incurred in the making of the profits. The test for deductibility does not include reasonableness as is the case with companies in other sectors. In addition, instead of depreciation, capital allowance is allowed annually at specified rates. For the purposes of both CIT and PPT, taxable profits are arrived at by aggregating all trading income and then deducting exempt income, allowable expenses, capital allowance and carried-forward losses.

For the purposes of CIT, profits are taxed on an accrual basis. The tax is paid after the tax year (that is, on a preceding-year basis). PPT, however, is paid in advance, in monthly instalments based on forecasts of year-end profits and tax; in other words, PPT is paid on a current-year basis with reconciliation made at the end of the tax year to reflect actual profits made in that year. Profits of a Nigerian company are deemed to accrue in Nigeria regardless of where they arise. Nigerian companies are therefore subject to CIT on worldwide profits. Profits of a non-Nigerian company are taxable in Nigeria to the extent that they arise (or are deemed to arise) in Nigeria – the CITA prescribes various tests for determining this (see Section IV).

The CITA also sets out rules for taxation of a company at commencement of business, change of accounting date and cessation. The commencement rules and change of accounting date may lead to double taxation on a company.

**Capital and income**

Taxable profits consist solely of income or trading profits – these are profits that arise from business or trade. Profits that arise from the disposal of a capital asset are not included in income tax computations but are chargeable to tax under the Capital Gains Tax Act (CGT Act).
**Losses**

A company that makes trading losses is entitled to treat them as tax-deductible and to carry forward unrecovered losses indefinitely, even if the ownership of the company changes. Losses cannot, however, be carried back or offset against capital gains.

**Rates**

The CIT rate is 30 per cent of profits. Companies engaged in crude oil exploration and production are subject to PPT at rates that vary between 50 and 85 per cent depending on the nature of the taxpayer's operations. The CGT rate is 10 per cent.

**Administration**

Corporate taxes are administered by a single tax authority, the Federal Inland Revenue Service (FIRS). Every company is required to file a self-assessment return with the tax authority at least once a year. The filed return must contain the company’s audited accounts, tax and capital allowances computation, and a duly completed self-assessment form. The company may pay the tax due and forward evidence of payment along with its return. For PPT purposes, at least two returns must be filed. The first is filed early in the tax year and is based on forecasts of profit and tax. The second is filed after the end of the tax year and reflects actual profits and tax. If forecasts change during the year, a company may amend the first returns from time to time.

Education tax of 2 per cent of assessable profits is imposed on all companies incorporated in Nigeria. Assessment and payment of education tax are done together with the assessment and collection of the CIT or PPT, whichever is applicable.

The Industrial Training Fund Act requires every employer with a staff strength of 25 or more to contribute 1 per cent of its annual payroll to the fund established by the Act. An employer may be refunded up to 60 per cent of the amount contributed if the Industrial Training Fund Governing Council is satisfied that the employer’s training programme is adequate.

The Employees’ Compensation Act directs every employer covered by the Act to make a minimum monthly contribution of 1 per cent of its monthly payroll. The scope of the Act extends to both the public and private sectors with the exception of members of the armed forces; however, staff of the armed forces employed in a civilian capacity are covered by the Act.

The Niger Delta Development Commission (Establishment) Act mandates every oil or gas company to pay 3 per cent of its annual budget to the Commission for tackling ecological problems in the Niger Delta, where most of Nigeria’s oil is produced.

The National Information Technology Development Agency (NITDA) Act mandates telecommunications companies, cyber-related companies, pension-related companies, banks and other financial institutions with an annual turnover of 100 million naira or more to pay a levy of 1 per cent of their profits before tax to the NITDA Fund. In addition, the Nigerian Maritime Administration and Safety Agency imposes a 3 per cent levy on all inbound and outbound cargo from ships or shipping companies operating in Nigeria.

The FIRS has introduced an integrated tax administration system to enhance tax administration. Thus, taxpayers are now able to file tax returns and pay their taxes electronically. This has significantly reduced the complexity, time and cost of paying taxes.
Nigeria

**Tax grouping**
Nigerian law makes no provision for the tax treatment of a group of companies as one entity. Each company within a group is therefore taxable in Nigeria on an individual basis. Consequently, losses suffered by one member of a group of companies cannot be utilised to reduce the tax liability of another company within the group, but must be carried forward and set off against the future profits of the company that incurred them.

**ii Other relevant taxes**
In addition to income taxes, Nigerian businesses are also subject to other taxes such as value added tax (VAT) under the VAT Act, CGT under the CGT Act and stamp duties under the Stamp Duties Act.

VAT is levied on the supply of all goods and services with a few exceptions. The rate of VAT is 5 per cent, and it is collected by the supplier and remitted to the FIRS, except where the supplier is a foreign company, in which case the purchaser withholds the VAT and remits it to the FIRS. A taxpayer is allowed to recover VAT incurred in acquiring stock-in-trade or inventory, but not VAT incurred on overheads and administration or on capital assets. It remains unclear whether VAT arises on the sale of choses in action (or intangible contractual rights). Lagos State has also introduced a 5 per cent consumption tax on hotels, restaurants and event centres.

CGT is charged on the gains arising on the disposal of an asset at a rate of 10 per cent. Gains that are applied towards replacing business assets are exempted from CGT, as are gains arising from the disposal of stocks and shares, and those arising from the merger of two companies provided that no cash payment is made. On the other hand, gains arising from a demerger or spin-off are not exempted even where assets have been moved to entities under the same control and ownership as the transferor.

The Stamp Duties Act provides for stamp duty to be paid on instruments. The rates are as contained in the Act, and can be as high as 6 per cent of the value of the underlying transaction.

**IV TAX RESIDENCE AND FISCAL DOMICILE**

**i Corporate residence**
The profits of a Nigerian company are deemed to accrue in Nigeria regardless of where they arise. Nigerian companies are therefore subject to CIT on worldwide profits. The profits of a non-Nigerian company are taxable in Nigeria to the following extent:

- the company has a ‘fixed base’ in Nigeria to the extent attributable to such base;
- the company habitually operates in Nigeria through a dependent agent who conducts business on its behalf, or who delivers goods or merchandise on its behalf from stock maintained in Nigeria, to the extent attributable to such activities;
- all the profit where the company executes a turnkey contract in Nigeria, that is, a single contract for surveys, deliveries, installation or construction; and
- the adjustment made by the FIRS where the foreign company does business with a connected Nigerian company, and the FIRS considers the terms to be artificial or fictitious.
ii Branch or permanent establishment

In determining the fiscal residence of a non-Nigerian company incorporated in a country that has a double taxation treaty with Nigeria, the applicable concept is that of ‘permanent establishment’, which such treaties define as a fixed place of business through which the business of an enterprise is carried on. However, a permanent establishment will not include facilities used solely for the purpose of carrying on an activity of a preparatory or auxiliary nature, or for the storage, delivery or display of goods or merchandise of a non-resident company. The FIRS directed that all non-resident companies are to file income tax returns taking effect from tax year 2015.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

The drive to encourage foreign direct investments in Nigeria has led to the enactment of various pieces of legislation, including the Industrial Development (Income Tax Relief) Act. This Act encourages investment in sectors of the economy that are necessary for the economic development of the country by granting tax relief to businesses. For a business to enjoy relief from corporate income tax under this Act, it must be engaged in one of the industries listed in the Act, or would have to apply and obtain a designation of its activity as a pioneer industry. Relief under this Act is for an initial period of three years extendable up to a maximum period of two years. Dividends are not subject to tax in the hands of the shareholders of the company enjoying the relief. Capital allowances can be carried forward and utilised at the end of the tax relief period. This incentive regime was reviewed in 2017 by the Application Guidelines for Pioneer Status Incentive. The Guidelines have replaced the erstwhile ‘service charge’ of 2 per cent of estimated tax savings with a new annual service charge of 1 per cent of actual pioneer profits.

The Venture Capital (Incentives) Act provides tax incentives to venture capital companies that invest in venture capital projects and provide at least 25 per cent of the total project cost. The incentives include a 50 per cent reduction of the withholding tax payable on dividends distributed by project companies, allowing equity investments in venture project companies to be treated as qualifying capital expenditure, and exempting capital gains on the disposal of such equity from tax.

The Nigeria Export Processing Zones Act also contains certain fiscal incentives for businesses. It provides in Section 8 that approved enterprises within a zone would be exempted from all federal, state and local government taxes, levies and rates. It also provides in Section 18 that such enterprises may repatriate capital, profits and dividends at any time. The Oil and Gas Export Free Zone Act grants similar incentives to approved enterprises operating within the zone.

Capital allowances are another form of tax incentive. Capital allowances are granted on the acquisition of qualifying capital expenditure that is used solely for the purpose of the business. Capital allowances serve to reduce the profits of a company, and ultimately reduce tax liability. Under the CITA, there are initial and annual allowances. The initial allowance can be claimed only in the year in which the asset was acquired, while the annual allowance, based on the remainder after deducting the initial allowance from the cost of the asset, is spread over the tax life (including the first year) of the asset until the cost of the asset is reduced to a book value of 10 naira.

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Under the PPT Act, a petroleum investment allowance (PIA), which allows an uplift of up to 20 per cent on qualifying capital expenditure, is available as an incentive to encourage investment in offshore exploration. In addition to the PIA and capital allowances, companies operating production-sharing contracts (PSCs) in Nigeria’s deep offshore and inland basin regions are entitled to either an investment tax credit (ITC) or an investment tax allowance (ITA), depending on when the PSC was signed, which is equal to 50 per cent of annual qualifying expenditure. The ITC operates as a full tax credit, while the ITA is deductible from profits before the calculation of tax. The ITC does not result in a deduction from qualifying capital expenditure for the purposes of calculating capital allowances. There are also special incentives available to oil companies to encourage gas utilisation or the development of gas delivery infrastructure. Most significantly, such companies can offset their gas-related capital allowance against their oil production profits. Given the difference in tax rates between gas production and oil production (30 per cent versus 85 per cent), this incentive has led to considerable investment in gas utilisation projects.

To stimulate the financial markets, the federal government, in 2012, amended relevant laws to exempt from taxation, income earned from debt instruments. Consequently, income from bonds issued by sovereign or sub-sovereign entities and those of corporate bodies are exempted from tax in the hands of the bondholder. Proceeds from the disposal of government or corporate bonds are exempt from VAT. These exemptions for corporate bonds are only for a period of 10 years and will lapse in 2022. In addition, the government has increased the tax relief available to companies that incur expenditure on infrastructure or facilities of a public nature. Such companies will now enjoy a 30 per cent uplift in basis for deductibility of the relevant expenditure.

i **Holding company regimes**
Nigeria does not have any special holding company regimes.

ii **IP regimes**
Nigeria does not have any special IP regimes.

iii **State aid**
No state aid is available.

iv **General**
See Section I.

VI **WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS**

i **Withholding on outward-bound payments (domestic law)**
By law, where any amount is payable by one company to another company or person as interest, royalty, rent or dividend, the company making the payment shall first deduct tax at a rate of 10 per cent and pay it to the tax authority. This withholding tax is treated as the final tax when the payment is due to a non-Nigerian company. Where a dividend is paid to a
Nigerian company, the amount deducted as withholding tax is treated as franked investment income and is not subject to further tax in the hands of the recipient. In all other cases, such withholding tax qualifies as a credit against CIT liability.

ii  **Domestic law exclusions or exemptions from withholding on outward-bound payments**

Withholding tax exemptions are available on outward-bound payments where:

a  the payment of a dividend is satisfied by an issue of shares of the company paying the dividend;

b  dividend is paid by a company exempted from tax under the Industrial Development (Income Tax Relief) Act;

c  dividend is paid out of profits that have been subjected to PPT;

d  dividend is paid by an enterprise operating within a free zone; or

e  interest is paid by a Nigerian company on a foreign loan with a tenor of at least seven years.

In all other cases of outbound remittance of payments, tax withheld at source by the company making the payment will be the final tax.

iii  **Double tax treaties**

Nigeria has signed a number of double taxation treaties with countries. Residents of these countries enjoy a preferential withholding tax rate of 7.5 per cent on payments of interest, rent, royalties and dividends. While Nigeria’s double taxation treaties mostly employ the credit method for the elimination of double taxation, a few treaties also employ the exemption method.

iv  **Taxation on receipt**

As a general rule, dividends, interest, rent and royalties brought into or received in Nigeria by a Nigerian company do not qualify for a credit against Nigerian CIT in respect of foreign tax or withholding already suffered. Exceptions include when the income in question is liable to Commonwealth income tax or when the income is brought in from a country with a double taxation agreement with Nigeria that allows for such a credit. In an instance where a credit is not allowed, the ordinary treatment for these types of profits is to aggregate them with business profits subject to tax at the applicable rate of CIT (i.e., 30 per cent); however, such profits will be exempt from CIT if they are brought into Nigeria through a commercial bank.

VII  **TAXATION OF FUNDING STRUCTURES**

Small and medium-sized businesses are predominantly funded by equity, as most businesses of this size do not have access to long-term debt. On the other hand, most large businesses, including foreign-owned companies, are predominantly funded by debt.
Nigeria does not have thin capitalisation rules. There are no restrictions on debt-to-equity ratios, although minimum equity capital requirements exist, mainly in the financial services sector. There are, however, anti-avoidance provisions under which the FIRS may disallow the deduction of interest and other financing costs that it deems not to be at arm’s length.

Generally, finance costs may be deducted, provided that the relevant test for deductibility of expenses is satisfied. However, as group relief or consolidation is not available, it will be difficult to push acquisition debt down to the target except by, for example, the acquisition financiers directly refinancing target company debt or a mechanism such as post-completion merger.

A Nigerian company can only pay dividends out of distributable profits, namely, trading profits, revenue reserves and capital gains. A company shall not declare or pay dividends if its directors are of the opinion that doing so will leave the company in a position where it is unable to meet its liabilities as they fall due.

A company may cancel paid-up shares that it considers to represent excess capital and return such capital to its shareholders. A resolution for the cancellation of shares for purposes of returning capital, like all other procedures that reduce share capital, must, however, first receive court sanction. At the discretion of the court considering an application for reduction of capital, creditors of the company making the application may object to the reduction. Before making an order confirming a reduction of capital, the court must be satisfied that the consent of every creditor entitled to object to the reduction has been obtained, or that the debt owed to them has been discharged, determined or secured, and that the company’s authorised share capital has not, by reason of the reduction, fallen below the statutory minimum.

A court order confirming reduction of capital must be registered with the Corporate Affairs Commission before it can take effect and repayment can be made. The return of capital using this procedure is tax-neutral, because proceeds from a disposal of shares are not subject to either CIT or CGT.

Foreign companies acquiring interests in local businesses usually avoid doing so through a local vehicle, unless the circumstances demand it. Instead, most foreign investors prefer to use an investment vehicle located offshore, usually in a low-tax or double taxation treaty country.

It is quite common for acquisitions of this type to be funded by debt or by portfolio investments. Consideration payable to local sellers is usually structured as a cash payment for shares in the local entity. This structure is tax-neutral.
ii  Reorganisation
Mergers and other corporate reorganisations that involve the exchange of shares or cash payment for shares are tax-neutral. CGT may be payable where a reorganisation involves the payment of cash for assets.

iii  Exit
A foreign investor wishing to liquidate an investment in a Nigerian company may do so by winding up the business or selling its shares in the business. Capital returned in the process of winding up and proceeds from the sale of shares will not be subject to tax in Nigeria.

IX  ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i  General anti-avoidance
Various tax laws contain general anti-avoidance provisions. These provisions allow the FIRS to make necessary adjustments to counteract the reduction in tax that would result from transactions it considers artificial. The FIRS may deem any transaction to be artificial if it finds that its terms have in fact not been effected or, where it is a transaction between related parties, if its terms do not reflect arm’s-length dealings.

ii  Controlled foreign corporations
There are no rules relating to controlled foreign corporations. There is legislation that empowers the tax authorities to tax undistributed profits of a company where the company is controlled by five persons or fewer.

iii  Transfer pricing
The Income Tax (Transfer Pricing) Regulations 2018 provide guidance in the application of the arm’s-length principle in related-party transactions. The Regulations allow related parties to adopt any of a number of listed methods as a basis for pricing of controlled transactions. The methods are:

- the comparable uncontrolled price method;
- the resale price method;
- the cost-plus method;
- the transactional profit split method; and
- the transactional net margin method.

With the approval of the FIRS, a method outside of those listed above may be used. The Regulations also allow for advance pricing agreements with the FIRS. The Regulations replace the Income Tax (Transfer Pricing) Regulations 2012 and incorporate the 2017 updates on the OECD’s Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

Companies with related-party transactions of over 300 million naira are obliged to prepare and submit contemporaneous transfer pricing documentation. A transfer pricing declaration form must also be filed with the documentation. The Regulations stipulate punitive administrative penalties for late filing and non-disclosure.
iv  Tax clearances and rulings

There are no provisions authorising the FIRS to give tax rulings. In practice, the FIRS does issue circulars and opinions regarding the tax treatment of contentious issues. However, such circulars and opinions have been held to be non-binding.

It is also not possible to obtain an advance ruling from the courts. In Nigeria, the courts will refuse to hear an action based on hypothetical or academic issues. Consequently, the only means of ascertaining the position of the law is to institute an action when a dispute arises between a company and the tax authority.

The parties to a merger, takeover or other corporate reorganisation involving the transfer of business undertakings or assets must obtain directions from the FIRS as to the value at which assets will be transferred. The parties must also obtain clearance from the FIRS in respect of any CGT resulting from the transaction.

X  YEAR IN REVIEW

To diversify the revenue base, the tiers of government have increased focus on raising revenue through taxes. In February 2017, the Nigerian Federal Executive Council (FEC) approved the National Tax Policy, which among others things, prescribed the following recommendations regarding taxation in Nigeria:

\[ a \] promoting tax culture;
\[ b \] improving tax compliance;
\[ c \] curbing tax evasion; and
\[ d \] widening the tax net as well as improving the tax to GDP ratio as core objectives.

In furtherance of the foregoing, the government at all levels has taken much more aggressive measures to curb tax evasion, widen the tax net, and curb base erosion and profit shifting from Nigeria. In August 2017 the federal government of Nigeria signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) and the Common Reporting Standard Multilateral Competent Authority Agreement (CRS MCAA). The aim of the CRS MCAA is to implement the automatic exchange of financial account information pursuant to the OECD/G20 Common Reporting Standard (CRS), which would drive delivery of the automatic exchange of information between 101 jurisdictions.

The legal framework for the domestication of the CRS MCAA has now been completed by the introduction of the Income Tax (Country-by-Country Reporting) Regulations 2018 (CbCR Regulations). The objective of the CbCR Regulations is to provide tax authorities with information about multinational enterprises’ (MNEs) global activities, profits and taxes by sharing relevant information among tax authorities, thereby improving transparency in tax activities of MNEs and preventing tax avoidance. The CbCR Regulations apply to MNEs with consolidated group revenue of 160 billion naira and above. MNE groups are required to file CbC reports in Nigeria where the ultimate parent entity or constituent entity are resident for tax purposes in Nigeria. The CbC reports summarise the global financial and tax information of all members of the group to the FIRS. The CbCR Regulations define ‘group’ as enterprises that are related through ownership or control such that it is either required to prepare consolidated financial statements for financial reporting purposes, or would be
so required if equity interests in any of the enterprises were traded on a public securities exchange. MNE groups are required to comply with the CbCR Regulations from January 2018.

Furthermore, the FIRS has in June 2018 released the new Income Tax (Transfer Pricing) Regulations 2018 (2018 TP Regulations). The 2018 TP Regulations incorporate the 2017 updates to the OECD’s Transfer Pricing Guidelines and introduced a regime of specific administrative penalties for non-compliance with the filing of transfer pricing forms and documentations. Under the 2018 TP Regulations, the obligation to maintain contemporaneous transfer pricing documentation has been relaxed for companies with a controlled transaction value of less than 300 million naira. However, the FIRS may still require such companies to prepare and submit their documentation within 90 days from the date of receipt of the notice. Also exempt from the obligation to file transfer pricing forms and submit documentations are taxpayers whose related-party transactions are covered by an advanced pricing agreement, and taxpayers who price their related-party transactions in line with the requirements of the guidelines issued by the FIRS from time to time. The 2018 TP Regulations stipulate stringent penalties for late filing of the transfer pricing form; 10 million naira or 1 per cent of the related-party transactions’ value (whichever is greater) in the first instance, and 10,000 naira for every day the default continues.

Following the release of the 2018 TP Regulations, the FIRS issued a public notice on the Regulations and Guidelines on Transfer Pricing Documentation. The Guidelines are meant to guide taxpayers on the preparation of transfer pricing documentation. The public notice also gives taxpayers a deadline of 31 December 2018 to discharge all outstanding transfer pricing obligations or bear the full penalties contained in the 2018 TP Regulations.

In June 2017 the Federal Ministry of Finance set up the Voluntary Assets and Income Declaration Scheme (the Scheme). The Scheme provided a time frame of 12 months within which persons who had defaulted in paying their taxes would regularise their tax status for the previous tax periods and pay any tax due. In exchange for declaring their assets and income for the preceding six years, the taxpayer would be granted pardon on interests and penalties, and assurances that they would not face tax investigations or criminal prosecution. The period of compliance under the Scheme ended on 30 June 2018 and the federal government has begun the process of going after tax defaulters who did not take advantage of the Scheme.

Owing to the success of the Scheme, the federal government has introduced the Voluntary Offshore Assets Regularisation Scheme (VOARS), which came into effect on 8 October 2018. The VOARS mandates Nigerian taxpayers who hold offshore assets to voluntarily declare those assets within a period of 12 months and pay either a one-time levy of 35 per cent or the applicable taxes plus penalties and interest. Compliance with the VOARS gives the taxpayer immunity from prosecution for tax offences related to the offshore assets. Failure of a defaulting taxpayer to take advantage the VOARS will result in investigation and enforcement procedures against the offshore assets. Persons who are already under investigation for financial crimes in respect of such assets are not eligible under the VOARS.

In addition to other strategies to enforce compliance with tax payment undertaken by the federal government, the FIRS has written letters of substitution to several commercial banks in Nigeria appointing them as collecting agents for the FIRS and directing them to withhold the amounts allegedly owed by taxpayers and remit same to the FIRS’ accounts. The letter also directs the banks to halt further transactions on the taxpayer’s account until the alleged tax payable is remitted to the FIRS. This was done pursuant to Section 31 of the FIRS Regulations.
Act, which empowers the FIRS to appoint a person as an agent of a taxpayer for the recovery of the tax that is payable by the taxpayer. The appointed agent will be required to pay any tax payable by the taxpayer from any money held by the agent on behalf of the taxpayer. This action of the FIRS has raised a number of concerns, the major one being what will be deemed ‘tax payable’? Taxes are only payable when a tax assessment is deemed final and conclusive, after the exhaustion of all objections and appeals in relation to the assessment. How will the banks determine that the alleged tax being demanded by the FIRS has become final and conclusive and not an arbitrary number alleged by the FIRS? It may amount to a breach of the contractual obligations of the bank to its customers to remit any alleged tax payable to the FIRS without an order of the court.

Furthermore, the Federal Executive Council (FEC) has approved two executive orders and five amendment bills touching on key provisions in the Nigerian tax legislations. The approved executive orders and amendment bills are as follows: the Value Added Tax Act (Modification) Order; the Review of Goods Liable to Excise Duties and Applicable Rates Order 2017; the Companies Income Tax Act (Amendment) Bill; the Value Added Tax Act (Amendment) Bill; the Customs, Excise, Tariff etc. (Consolidation) Act (Amendment) Bill; and the Personal Income Tax Act (Amendment) Bill. The major aim of the new executive orders and amendment bills is to improve the ease of doing business in Nigeria by simplifying tax payment. The modifications contained in the executive orders will take effect as specified in the orders while the amendment bills will be enacted by the National Assembly and receive the assent of the President to become the law.

The VAT Act imposes VAT on the supply of all goods and services other than those goods and services expressly stated to be exempt in the Act. The Act also requires the supplier to register with the FIRS before it can charge or collect VAT, which will be remitted to the FIRS. Where a non-resident supplier ‘carries on business in Nigeria’, the Act requires the supplier to register for VAT and charge VAT on its invoice, while placing the obligation of remitting the tax on its Nigerian customer. The conflicting decisions of two different panels of the Tax Appeal Tribunal (TAT) on this issue for a time created a conflict on the applicable interpretation of the law. In one case, the TAT decided that since a non-resident supplier contracting with a Nigerian company is not necessarily carrying on business in Nigeria, such company is not obliged to register for or charge VAT, and the Nigerian customer is not obliged to remit VAT to the FIRS where the supplier does not issue a VAT invoice. In another case, a different panel of the TAT took the view on the basis of the ‘destination principle’ that, since the service in question – the supply of bandwidth capacities – was consumed in Nigeria, its supply was subject to VAT in Nigeria, notwithstanding that it was supplied outside Nigeria by a foreign supplier. However, on appeal, the Federal High Court has held in two different cases that a non-resident company will be deemed to be carrying on business in Nigeria if it was providing service to a Nigerian company on an agreed consideration; it was irrelevant that the non-resident company did not have a physical company in Nigeria. The court also held that the statutory requirement for registration is relaxed for non-resident companies, and as such, even where a VAT invoice is not issued, local companies consuming the goods and services are to assess and remit the VAT to FIRS. The conflict on this matter, therefore, seem to be settled for now, until a higher court decides otherwise.

Also worth noting in relation to VAT is the Value Added Tax Act (Modification) Order approved by the Federal Executive Council in June 2018. The VAT Order includes an additional list of goods and services exempt from tax. Some of the services now VAT-exempt include transport services for use by the general public, residential leases or rentals and life
insurance premiums. The VAT Order also provides clarity on the applicability of VAT for operators in the Nigeria electricity supply industry. It provides the legal basis for a single point of VAT collection in the electricity supply chain, which is at the point of sale of electricity from distribution companies (DisCos) to final consumers. Included in the list of exempt items under the Order are supply of gas from producing companies to generating companies (GenCos), supply of electricity from GenCos to National Grid/NBET companies, and electricity transmitted by transnational companies of Nigeria to DisCos.

There is also a major drive by state governments to increase internally generated revenue through tax. This can be gleaned from the introduction of consumption tax by some state governments; however, the courts have declared the imposition of consumption tax over the same goods and services that were already subject to VAT as illegal as it amounted to double taxation. The Lagos state government also recently introduced a new Land Use Charge Law in March 2018. The annual land use rate under the law has been increased in some cases within the range of 200 and 500 per cent. The law, it is believed, will serve to increase the internally generated revenue of the state.

Some unresolved issues with regard to the implementation of existing tax legislation include the following:

- the CIT Act sets out rules for taxation of a new trade or business that can result in double taxation of a company’s profits in its first three accounting years;
- to be deductible, management fees or expenses relating thereto must be approved by the Minister of Finance, while any expenses incurred outside Nigeria are deductible only to the extent allowed by the FIRS;
- demergers or reorganisations are not tax-neutral, so there is a disincentive for companies within a group to transfer assets between each other;
- tax authorities have taken the view that losses from one line of business cannot be offset against profits from other lines of business of the same company; and
- VAT is expected to be paid even when the taxpayer has not received payment for goods or services supplied, resulting in a cash flow challenge. A solution is for the tax authorities to collect these taxes on a cash basis instead of on an accrual basis.

Where a Nigerian parent or holding company redistributes dividends that it has received from a subsidiary, or where any company distributes profits from previous years, the distribution may be subject to further CIT even though such distribution arises from profits from which CIT had already been deducted. The TAT has upheld this interpretation of the law, although it is noteworthy that the lack of evidence by the Nigerian company to reflect that the dividends were paid from retained earnings that had already been subjected to tax was responsible for the decision taken by the TAT in that case.

There are penalties and interest for failing to file a return on time or at the end of an extension. Effective July 2017, the interest rate on unpaid taxes was pegged at 5 per cent over the Central Bank of Nigeria’s monetary policy rate (MPR). The Central Bank of Nigeria’s MPR currently stands at 14 per cent. The applicable penalty rate remains 10 per cent of tax payable.

On the corporate front, the National Assembly in May 2018 passed the Companies and Allied Matters Act (Amendment) Bill (CAMA Bill) into law. This is in line with the federal government’s commitment to improve the ease of doing business in Nigeria in order to attract more foreign investment. Some of the changes introduced by the CAMA Bill include the introduction of single member companies, limited partnerships and limited

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liability partnerships; removal of unnecessary regulatory hurdles for small companies such as the requirement to appoint a company secretary and hold annual general meetings; and promoting the use of technology in the registration and operation of Nigerian businesses. The CAMA Bill seeks to usher in a corporate framework in Nigeria and, once assented to by the President, is expected to make the Nigerian business environment as competitive as its counterparts around the world.

XI OUTLOOK AND CONCLUSIONS

With a tax-to-GDP ratio of 6 per cent, one of the lowest in the world, and dwindling revenue from oil, the federal government's resolve to increase tax revenue is stronger than ever. Nigeria has entered into a variety of multi-jurisdictional agreements for the automatic exchange of information of taxpayers, such as the Automatic Exchange of Tax Information with a number of countries including the United Kingdom. These agreements will enable tax authorities in Nigeria to receive information from tax authorities in other jurisdictions especially on the overseas assets owned by Nigerians. In addition, the Nigerian government has also completed the last step in the implementation of the CRS MCAA by the introduction of the CbCR Regulations, which enables the government to receive information from over 100 jurisdictions that have committed to exchanging information under the CRS MCAA. On the back of these agreements, the Nigerian government is well equipped to implement the VOARS.

We expect to see more aggressive initiatives from the federal government geared towards widening the tax net, curbing tax evasion and profit shifting by both nationals and foreigners. Of note in this regard is the reconstitution of the tax appeal tribunal (the first step in the resolution of tax disputes) in July 2018 after a lull of two years and commencement of its sittings in November 2018.
Chapter 24

NORWAY

Thomas E Alnæs and Marius Sollund

I INTRODUCTION

Norway has a small but robust economy, and with a corporate tax rate of 23 per cent and a participation exemption that is among the most liberal within the European Economic Area (EEA), investors tend to find Norway to be an attractive country to invest in or through.

Norway does not impose withholding tax on royalties or interest in general, or on dividends paid to corporate shareholders in the EEA. Together with a wide range of double taxation treaties with low or no withholding tax, this makes Norway a suitable base for holding companies, especially when investing into the EEA.

To balance out the low rates for corporate taxation, Norway has an extensive anti-avoidance doctrine to control the use of innovative tax-planning techniques. Special tax regimes apply to income from the exploration of petroleum resources, shipping income and income from the production of hydroelectric power.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

There are two main forms of organising a business: entities with limited liability and entities with unlimited liability.

Limited liability companies, where none of the shareholders have personal liability for the obligations of the company, may be incorporated either as a private limited liability company (AS) or a public limited liability company (ASA). Other entities with limited liability include foundations, cooperative societies, stock funds and mutual insurance companies.

The common types of entities with unlimited liability are the general partnership with joint liability (ANS), the partnership with apportioned liability (DA) and limited partnerships (KS and IS).

Entities with limited liability are subject to corporate taxation, while entities with unlimited liability are transparent for tax purposes and taxed at partner level.

i Corporate

The AS and the ASA are regulated by two separate laws but with similar structure, and largely similar content. Key differences between public and private companies are that only public companies may turn to the public to raise capital and be listed on a stock exchange.

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Public companies are also subject to stricter rules regarding organisation, the minimum board member requirement and restrictions on share classes. The required minimum share capital for a private limited company is 30,000 kroner and 1 million kroner for a public company.

As a member of the EEA, Norway has adopted the EC Regulation on European Companies (SE companies). SE companies are mainly governed by the same rules that apply to public limited companies.

ii Non-corporate

Business activities may also be organised as partnerships. In a general partnership, the partners are jointly and severally liable for all the obligations of the partnership. A general partnership can also be organised with proportional liability, where each partner is only liable to the proportional share set out in the partnership agreement.

The limited partnership is distinguished by having one or more general partners with unlimited personal liability, and one or more limited partners whose liability is limited to a set amount.

III DIRECT TAXATION OF BUSINESSES

Corporate entities incorporated in Norway, and foreign companies with their effective management in Norway, are regarded as tax-resident and liable to corporate tax on their worldwide income, including capital gains (for partnerships, the tax depends on the partner’s tax status).

Non-resident companies and Norwegian branches are taxed on Norwegian source income (see Section IV.ii).

i Tax on profits

Determination of taxable profit

As a general rule, taxable profit is a net amount based on accounting profit adjusted for differences between the accounting rules and the tax accounting rules.

Income is taxed on an accruals basis. Income derived under contracts will, with the exception of fixed price production contracts, be considered accrued when the taxpayer is entitled to the consideration from the other party under the contract (when the taxpayer has delivered his or her goods or services under the contract).

Income

The taxable corporate income comprises all kinds of income, inter alia, interest, dividends, capital gains on the disposal of assets or ownership interests and foreign-sourced income taxable in Norway (i.e., ordinary business income). For resident limited liability companies or entities, the participation exemption is applicable for dividends and gains on shares and partnership interests (see Section V.i).

For partnerships (transparent for tax purposes), the net result of the partnership is calculated as if the partnership were a company and then allocated to the partners and taxed

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3 The profit element of these contracts is recognised as taxable income according to the completed contract principle.
at the partner level. Income and loss covered by the participation exemption (capital gains and dividends from shares) shall not be included. However, 3 per cent of dividends shall be recognised as taxable income.

A limited partner will not be able to deduct partnership losses against ordinary income from other sources. Such losses may be carried forward for deduction against future partnership income or gains upon the realisation of partnership interests. Dividends and gains on shares received by corporate partners will to a large extent be tax-exempt under the participation exemption (see Section V.i).

**Expenses**

When calculating net taxable income, the general principle is that all expenses incurred to acquire, maintain or safeguard the company's taxable income are deductible.

As a starting point, interest on debts is deductible, whether paid periodically or discounted. The deductibility may, however, be limited under the interest deduction limitation rule (see section VII) or the arm’s-length principle.

Expenses unrelated to normal business activities are not deductible (e.g., excessive entertainment expenses, donations and bribes or similar payments).

Dividends distributed and appropriations of profits are not deductible in taxable income for the distributing company.

**Depreciation and amortisation**

The amount of tax-allowable depreciation is determined by the tax legislation and may differ from the accounting rules. There are two alternative methods to determine the deductible amount:

\[ a \] the declining balance method (which in general applies to tangible assets and goodwill – the rates vary from 2 to 30 per cent); and

\[ b \] the linear method (which applies to intangibles that are not covered by the declining balance method).

Land and plots are not depreciable.

**Capital gains and income**

Capital gains are considered as ordinary income for tax purposes.

Gains on shares and partnership shares will, however, to a large extent be tax-exempt under the participation exemption (see Section V.i).

**Losses**

Tax-deductible losses may be carried forward indefinitely and set off against future profits. When a company is liquidated, any loss may be carried back for the two preceding years.

The tax position of a loss carried forward will survive a change in ownership unless the predominant motive is to exploit the tax position, for example through a group contribution. In these cases, the tax position of the loss may be lapsed (see Section IX.ii).

Losses on intra-group loans (between companies where the lender has more than 90 per cent ownership) are not deductible.
In general partnerships, a limited partner will not be able to deduct partnership losses against ordinary income from other sources. Such losses may be carried forward for deduction against future partnership income or gains upon the realisation of partnership interests.

**Rates**

The corporate income tax rate is 23 per cent.

**Administration**

As a general rule, the income tax year follows the calendar year. Companies must file tax returns electronically by 31 May in the year following the income tax year. Companies may apply for a deviating 12-month tax year, but a tax year may never include more than 18 months. Companies must pay advanced tax by 15 February and by 15 April in the year following the income tax year.

The Norwegian Tax Authority is responsible for the administration of all direct taxes and VAT for domestic sales. Complaints against decisions made by the tax authorities may be filed with the Norwegian Tax Appeal Board. Decisions by the Tax Appeal Board may be brought before the courts.

As of 2017, the statute of limitation period for reassessment of the tax return is five years (10 if the taxpayer intentionally or through gross negligence has given misleading or incomplete information about his or her income).

Penalty tax will be imposed where the company gives misleading or incomplete information about its income and this result in – or could have resulted in – an underassessment. The penalty tax will normally be 20 per cent, but is raised to 40 per cent if misleading or incomplete information was filed intentionally or by gross negligence.

**Tax grouping**

If a resident company (the parent company) holds more than 90 per cent of the capital and votes of other resident companies, the companies will constitute a tax group. Each company within a tax group is, as a general rule, treated as a separate entity, and assets, dividends, interest, income and deductions cannot be moved between companies. However, in a tax group, the participating companies may make tax-deductible group contributions and intra-group transfers of assets without immediate realisation of latent gains (i.e., the taxation is deferred).

A company resident in the EEA may be the parent company in a Norwegian tax group, and a permanent establishment (PE) of a company resident in either the EEA or in a state with which Norway has a tax treaty may also qualify for the tax grouping benefits.

**Other relevant taxes**

**Value added tax**

VAT of 25 per cent is imposed on the sale of goods and services (certain goods and services are subject to reduced rates). Norway applies VAT as a net consumption tax calculated according to the indirect subtraction method, which means that suppliers of goods and services are entitled to deduct from the amount of VAT due on their goods and services (output VAT) the amount of VAT incurred on their purchases (input VAT).

Taxpayers must remit the net amount of VAT (balance of output and input VAT for the tax period) to the tax authorities on a bimonthly basis (or shorter periods if applied for).
If input VAT exceeds output VAT for the tax period, taxpayers are entitled to reclaim the balance. All companies with annual turnovers that exceed a certain threshold (at present, 50,000 kroner) must register with the Norwegian VAT Register.⁴

Since taxation (including indirect taxation) is not explicitly covered by the EEA Agreement,⁵ Norway is not required to harmonise its VAT law with EU VAT law. Movements of goods are treated as traditional exports and imports with the required customs formalities and paperwork.

**Stamp tax**

The registration of transactions involving immovable property in the Land Registry is subject to a stamp duty of 2.5 per cent of the accepted value of the property at the time of the registration.

There are no other stamp duties in Norway.

**Customs duties**

Imported goods may be subject to customs duties depending on the country of origin and the type of goods concerned.

**Real estate tax**

Individuals and companies that own immovable property may be subject to municipal real estate tax regulated by an immovable property tax law.⁶

**The financial activity tax**

A financial activity tax was introduced from 2017 for the financial sector. For enterprises defined as financial institutions the corporate tax rate will remain at 25 per cent even if the ordinary corporate tax rate is 23 per cent. Financial institutions also have a 5 per cent tax imposed on their total salary costs.

**The petroleum tax system**

All petroleum-related income on the Norwegian continental shelf is governed by the Petroleum Tax Act; however, the general tax legislation will also apply.

The petroleum tax regime is characterised by a very high marginal income tax rate (78 per cent), which to some extent is offset by relatively generous tax deductions, such as the immediate expense of all exploration costs, fast tax depreciation, an uplift allowance for special tax purposes and a tax deduction for financial costs related to upstream business activity.

Income tax from 2018 comprises the ordinary 23 per cent corporate tax rate and the 55 per cent special tax rate.

There are no field operation ring-fencing arrangements on the Norwegian continental shelf, and all exploration costs may be deducted. Companies may, however, no longer deduct exploration costs abroad from the Norwegian income. Companies in a loss position may choose between a cash refund of the tax value (i.e., 78 per cent) of the exploration costs or

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⁴ See Section XI for proposed changes.
⁵ EEA Agreement, Article 1(2).
⁶ Law of 6 June 1975, No. 29.
to carry the cost forward with interest. When winding up the business on the Norwegian continental shelf, a company will receive the tax value (78 per cent of exploration cost and 23 per cent of all other cost) of any unused losses the company may have.

A norm price, set by a separate norm price board, replaces the actual sales price when calculating the taxable gross income from the sale of crude oil (regardless of the actual sales price being higher or lower).

There is no dividend withholding tax on distribution from profits subject to the 55 per cent special tax.

**Hydroelectric power production companies**

In addition to the ordinary income tax rate of 23 per cent, hydroelectric power production companies are subject to a 35.7 per cent natural resource rent tax, so that the total tax rate amounts to 58.7 per cent. An amount equal to the normal rate of return on the investment is shielded against the additional tax. Further, the hydroelectric power production companies are subject to a municipal resource extraction tax of 0.013 kroner per produced kwh.

**Tonnage tax system**

For shipping companies, the tax on corporate profits may be replaced by a tax based on the tonnage operated by a company.

Elaborate ring-fencing arrangements limit the benefit of tonnage tax on the operation of ships, and companies within the regime may not carry on any other business.

**Employers' social security contribution**

The rates range from zero to 14.1 per cent depending on the tax municipality of the employer.

An employer resident abroad is required to pay social security contributions in respect of employees working in Norway, but is subject to a possible exemption under the EEA or other social security treaties.

**IV TAX RESIDENCE AND FISCAL DOMICILE**

**i Corporate residence**

Limited liability companies whose effective management and control at board level are carried out in Norway are considered tax resident in Norway.

For foreign-incorporated companies to avoid tax residency in Norway, the board meetings and other decisions beyond the day-to-day management of the company must take place outside Norway.

**ii Branch or permanent establishment**

Norwegian tax legislation does not define a PE and, as a general rule, a foreign incorporated company conducting or participating in business in Norway will be considered as having a taxable presence in Norway. However, most Norwegian bilateral tax treaties are based on the OECD’s Model Tax Convention, and with Norway’s extensive network of tax treaties the PE definition will normally be decisive for a company’s taxable presence in Norway.

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7 Organisation for Economic Co-operation and Development.
The allocation of income between a foreign head office and the taxable presence in Norway, a Norwegian PE or branch should be calculated according to the arm’s-length principle.

Capital gains on shares realised by non-resident corporate shareholders are not subject to taxation in Norway unless the foreign shareholder has a PE in Norway, and the shares are effectively connected to the PE or presence in Norway and are not covered by the participation exemption.

Activities on the Norwegian continental shelf related to petroleum resources will constitute a taxable presence as a PE after a certain number of days of activity, often as little as 30 days within a 12-month period.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes

The participation exemption, an extensive network of tax treaties and a tax credit system that allows unused tax credits to be carried forward, ensure the avoidance of double taxation and make the Norwegian holding regime one of the most favourable in Europe.

Participation exemption

Pursuant to the participation exemption, corporate shareholders are exempt from taxation of dividends and gains on shares (except for a clawback of 3 per cent on dividends, if the receiving company owns less than 90 per cent of the shares and voting rights of the distributing company).

The participation exemption comprises dividends and capital gain on shares in companies resident in Norway, and the EEA. Dividends and capital gain on shares in companies resident outside the EEA, but not in a low-tax jurisdiction, are also tax-exempt provided that the shareholder has held at least 10 per cent of the shares and capital for a period of two years. Dividends and capital gains on shares in companies in low-tax jurisdictions outside the EEA are not tax-exempt, and losses on such shares will be deductible.

For dividends, 3 per cent of the dividends received are subject to the 23 per cent corporate tax (effective taxation on exempt dividend is 0.69 per cent). The clawback of 3 per cent does not apply to intra-group dividends within a tax group from companies resident in Norway and that have more than 90 per cent ownership in the distributing company, or within the EEA provided that the shareholder has held at least 10 per cent of the shares and capital for a period of two years.

There are no requirements for participation or holding periods for dividends and capital gains on shares of Norwegian or EEA-resident companies for the exemption method to apply. However, companies resident in a low-tax jurisdiction within the EEA must be genuinely established and conduct genuine business within their state of residency (substantial business test) in order for the participation exemption to be applicable. As a general rule, this implies that the business is organised in a similar way as other local businesses of the same kind, and a tax-avoidance motive is not proven.

Capital gains on a partnership’s shares will, for a corporate partner, be tax-exempt if at least 90 per cent of the partnership’s investments at all times during the past two years have been in tax-exempt shares. Losses on the partnership’s shares will, for a corporate partner, be deductible only if the partnership’s non-qualifying shares have exceeded 10 per cent of the
total value of shares during the previous two years (note that the tax rules regarding gains and losses on a partnership’s shares are asymmetrical, and the requirements could lead to double taxation if both the shares owned by the partnership that are not tax-exempt and the partnership shares are sold). For corporate partners resident in Norway, this applies irrespective of where the partnership is registered.

Corporate partners receiving distributions from a partnership’s shares are, as for dividends from shares, liable to 23 per cent income tax on 3 per cent of the distributions received (after a deduction for the partner’s tax on the partnership’s share).

With effect from 2016, distributions from companies for which the distributing company has been able to deduct the distribution will not be covered by the participation exemption.

ii IP regimes

There is no special IP tax regime in Norway.

A tax relief may, however, be granted according to the rules of SkatteFUNN R&D tax incentive scheme (see below).

iii State aid

Norwegian authorities offer a wide range of state aid for investments, R&D (see below), and development and exports through a regional development fund (Innovasjon Norge) supporting businesses establishing in Norway and abroad.

iv General

SkatteFUNN is an R&D tax incentive scheme that entitles all enterprises subject to Norwegian taxation to a tax deduction of expenses related to R&D (within certain limits and provided certain conditions are met), provided that the research programme has been approved by the Research Council of Norway.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)

Outbound dividends paid to a non-resident shareholder or owner are subject to a 25 per cent withholding tax unless an exemption or lower tax rate applies pursuant to a tax treaty.

There is no withholding tax on royalties, interest or other payments such as service and management fees, rents or lease payments.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

The participation exemption applies (i.e., no withholding tax on dividend distributions) to corporate shareholders within the EEA provided that the shareholder meets the substantial business test (see Section V.i).

iii Double tax treaties

Norway currently has tax treaties covering 94 jurisdictions.
The withholding tax rate on dividends is normally reduced to 15 per cent, and to 5 per cent in parent–subsidiary situations, under a tax treaty. For dividends under the participation exemption (within the EEA) there is no withholding tax. Norway does not impose withholding tax on royalties or interest in general, and some tax treaties, in particular relating to royalties, interest or other payments, provide for a withholding tax rate of zero.

iv Taxation on receipt
Dividends received by, and capital gains from the sale of shares by private and public limited companies and other companies treated equally for tax purposes, are tax-exempt pursuant to the participation exemption.

If the participation exemption is not applicable, dividends will be fully taxable. In such cases, the Norwegian parent company is entitled to a tax credit for foreign withholding tax, and (on certain conditions) may claim tax credit for underlying corporate tax paid by the foreign subsidiary.

Royalties, interest and other payments, such as service and management fees, rents and lease payments, are taxable as corporate income.

VII TAXATION OF FUNDING STRUCTURES

i Thin capitalisation
Norwegian tax legislation contains no specific statutory or regulatory prescriptions of thin capitalisation, and as a rule, all interest paid to an unrelated party is deductible. Between related parties, interest deductibility may be limited under the arm's-length principle or the interest deduction limitation rule, both set out under the Norwegian Tax Act.

Limitation of interest deduction between related parties
The interest deduction limitation rule states that net interest expenses to a related party exceeding 5 million kroner are only fully deductible if the internal and external interest expenses combined do not exceed 25 per cent of taxable earnings before interest, taxes, depreciation and amortisation (EBITDA). In this regard, parties are considered related when there is ownership or control of 50 per cent or more of one party by another.

External loans guaranteed by a related party of the borrower (tainted debt) will be treated the same way as loans to related parties.

The interest deduction limitation rule applies to limited liability companies, and similar other companies and entities. The rules also apply to partnerships, shareholders in controlled foreign corporations (CFCs) and foreign companies with PEs in Norway. Financial institutions are exempt from the interest deduction limitation rule.

ii Deduction of finance costs
Interest costs on business debt (see above), issue expenses and commissions on loans are tax-deductible. The same applies for interest charged for late payment of debt. Even under the participation exemption, companies may continue to deduct interest on debt incurred to finance acquisition of shares giving rise to tax-exempt income.

Excessive interest or business profits paid to the parent company or a related company may, depending on the circumstances, be regarded as dividend distributions and thus not deductible.
Financial acquisition costs may not be deducted from the company’s taxable income, but have to be capitalised together with the cost of the acquired shares.

iii Restrictions on payments
Dividends may be distributed several times during the year, but only if the company has sufficient net assets to cover the share capital after the distribution of dividends.

iv Return of capital
Paid-in equity may be repaid on a tax-neutral basis through a reduction and return of capital.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition
Capital gains on the transfer of shares by corporate shareholders (limited liability companies, etc.) are tax-exempt, and losses are not deductible pursuant to the participation exemption. The acquisition costs are not deductible even if the transaction is aborted, and any allocation of acquisition costs to the target company is regarded as illegal financial aid.

Asset deals are, for tax purposes, regarded as selling the company’s possessions separately, and gains are taxable and losses deductible.

ii Reorganisation
Mergers and demergers may, subject to certain conditions, be carried out without triggering taxation if all the companies involved are resident in Norway. One of the crucial conditions for carrying out a merger or demerger without triggering taxation is that it is done with tax continuity on both company level and shareholder level, and thus maintains the tax positions of the parties.

Cross-border mergers between companies within the EEA may be carried out tax-free if the transaction is carried out pursuant to principles for tax continuity applicable in the state where the assigning company is resident. However, if the transferring company is resident in Norway, the company’s assets will be considered realised for tax purposes upon exit (see below) if moved out of the Norwegian tax jurisdiction. Corresponding rules apply for a demerger of a limited liability company resident in an EEA state if the acquiring company is resident in Norway.

Cross-border mergers and demergers will not be tax-exempt if one or more of the companies taking part in a merger or demerger are resident in a low-tax country within the EEA, and if the company or companies do not fulfil the substantial business test.

iii Exit
A company can relocate only by moving the actual or effective management and control at board level from Norway (whether on purpose or not).

When the company ceases to be resident in Norway for tax purposes and relocates to a state outside the EEA, or a low-tax jurisdiction in the EEA in which the substantial business test is not met, all business assets and liabilities are regarded as realised at marked value, and are subject to tax or tax deduction. If the company relocates to other states, tax on tangible assets except for merchandise may be deferred upon certain conditions.
When assets are moved within the EEA, the tax payable on tangible assets (except for merchandise) may, subject to certain conditions, also be deferred. The exit tax for tangible assets is then annulled if the asset is not realised within five years.

For intangible assets and merchandise, the exit tax is definitive and payable on the day of exit.

**IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION**

i  **General anti-avoidance**

Norway has an expansive anti-avoidance doctrine, with both general and specific anti-avoidance rules.

The courts have developed a general anti-avoidance doctrine that ensures that the tax authorities can cut through structures and dispositions whose primary motive is to achieve tax benefits and are deemed ‘disloyal’ to the tax legislation.

The tax legislation also contains a specific anti-avoidance rule that states that if a company has tax positions that are unrelated to any asset or liability, and the ownership of such company changes by merger, demerger or other transaction with the predominant motive of exploiting that position, the tax position will be void.

ii  **Controlled foreign corporations (CFCs)**

The CFC taxation rules imply that the shareholder of a company is taxed on a yearly basis for its proportionate share of the company’s income, whether distributed or not. The rules apply to shares in companies incorporated in a low-tax jurisdiction controlled by Norwegian shareholders (Norwegian control, directly or indirectly, over at least 50 per cent of the shares or votes).

A low-tax jurisdiction is defined as a country with an effective income tax rate lower than two-thirds of the effective tax rate in Norway for the same type of business (the Ministry of Finance has published a non-exhaustive ‘white list’ and ‘black list’).

The CFC legislation does not apply to companies that are established in an EEA country and that meet the substantial business test (see Section V.i).

If the company is resident in a Norwegian tax treaty country, the CFC legislation only applies if the company’s income is predominantly of a ‘passive’ character (financial or rental income, royalty, etc.).

iii  **Transfer pricing**

Intra-group transactions are to be priced in accordance with the arm's-length principle.

If the income of a Norwegian-resident company is reduced owing to transactions with a related party, the tax authorities may adjust the income of the company in accordance with the arm's-length principle.

Reporting documentation requirements apply, and group companies must, in their tax return, give information on intra-group transactions. The taxpayer must be prepared to file transfer pricing documentation (type and volume of the transactions, functional analysis, comparable analysis and a report of the transfer pricing method used) within 45 days of a written notice from the tax authorities.
iv Tax clearances and rulings

Advance rulings may be obtained from the Directorate of Taxes and from local tax inspectors in respect of direct taxes, social security contributions and VAT. These rulings will be binding for the tax authorities, but optional for the taxpayer.

X YEAR IN REVIEW

In the Fiscal Budget for 2019, the corporate tax rate is proposed to be reduced to 22 per cent from 2019. The government’s policy is that the proceeds from the resource rent industries shall not be reduced as a consequence of a reduction of the general tax rate. Consequently, the special tax rate for petroleum companies is proposed to be increased to 56 per cent and uplift is reduced to 5.2 per cent, and the resource rent tax for hydroelectric power production companies is increased to 37 per cent (see Section III.ii).

XI OUTLOOK AND CONCLUSIONS

In 2017, the Norwegian Ministry of Finance issued a public consultation paper regarding amendments to the interest deduction limitation rule and the domestic tax residency rule. The proposals relating to these matters were followed up in the government’s proposal of the Fiscal Budget for 2019, which was presented to Parliament on 8 October 2018.

The proposed new interest deduction limitation rule mainly entails that for Norwegian companies that form part of a group, interest expenses on external debt will also be subject to limited deductions (25 per cent of EBITDA). The Norwegian part of such a group is proposed to have a combined threshold of 25 million kroner for the limitations to apply. The proposal also includes two alternative escape clauses providing that the company or group can escape the limitations completely if:

a the relevant company on a stand-alone basis has a debt-to-equity ratio similar to or stronger than the consolidated debt-to-equity ratio in the group that the company is a part of; or

b the Norwegian part of the group has a consolidated debt-to-equity ratio that is similar to or stronger than the consolidated debt-to-equity ratio in the wider group.

The amendments to the domestic tax residency rule aim for all companies incorporated in Norway to be considered resident here for tax purposes, regardless of where the management of the company takes place. The analysis of whether a foreign incorporated company shall be considered tax resident in Norway shall, according to the proposed amendments, be based on an overall assessment where several factors may be relevant and taken into consideration.

Currently, no consultation paper to introduce a withholding tax on interest and royalties or a proposal to introduce VAT into the financial sector has been set forth. However, the Ministry of Finance has announced that such consultation paper will be published in due course.
Chapter 25

PERU

César Castro Salinas and Rodrigo Flores Benavides

I INTRODUCTION

Since 1992, Peru has experienced sustained and steady economic growth, mainly fuelled by the implementation of a social market economy model that recognised the importance of promoting the creation of wealth and guaranteeing the freedom of private enterprise, commerce and industry. The participation of government and public entities in business activities has diminished progressively, to the extent that it can now be considered subsidiary and reserved for exceptional cases of overriding public interest, leaving the matter in the hands of private companies.

In the 1990s, the government established an attractive constitutional and legal framework that, complemented by its strong macroeconomic performance and stable policies, encouraged foreign business presence to increase in Peru. Although Peru has experienced an economic slowdown in the past few years, foreign investment continues to play an essential role.

Among other factors, economic growth has been possible owing to the following guarantees granted to foreign investors:

- equal treatment of national and foreign investment;
- free production of goods and services and foreign trade;
- no limitations or restrictions on the possession and disposition of foreign currency and remittance of funds abroad;
- free market, and a prohibition on monopolistic practices and abuse of dominant position; and
- the ability to execute legal and tax stability agreements with the government.

In addition, Peru has executed over 30 bilateral investment treaties establishing the terms and conditions for the protection of private investment. In several cases, such treaties have been subsumed under other commercial agreements with wider scope (such as free trade agreements), which contain specific chapters related to the promotion and protection of private investment. Peru has executed free trade agreements with Canada, Chile, China, Costa Rica, the EFTA countries (Iceland, Liechtenstein, Norway and Switzerland), the EU, Guatemala, Honduras, Korea, Japan, Mexico, Panama, Singapore, Thailand, the United States and Venezuela, and most recently with Australia.

Peru is a signatory to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States. Its membership was approved by Congress and entered
into force in 1993. Peru is also a member of the Convention for the Multilateral Investment Guarantee Agency, which grants insurance against political non-commercial risks. The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards has been enforceable in Peru since 1988.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

The most commonly used business entity in Peru is the corporation. Depending on the number of shareholders, the existence of restrictions on the transfer of shares and some other factors treated in more detail in the following paragraphs, corporations may adopt two additional sub-types: close corporations and public corporations.

Other entrepreneurial forms to set up a business presence in the country are the limited liability company and – mostly in the specific case of foreign investors – the branch.

As a general rule, all business entities established in Peru are subject to taxation on their net income (i.e., they are taxed only for the difference between the revenues derived from their economic activities and the expenses incurred for such purpose).

i Corporate

Businesses generally adopt a corporate form (corporation, limited liability company or branch). The most relevant characteristics and key differences of these types of entities are as follows.

Corporations

A corporation is created with contributions of at least two shareholders (either local or foreign individuals, or legal entities) to perform certain economic activities with the aim of obtaining profits in return. There is no maximum number of shareholders.

The liability of the shareholders with third parties is limited to the amount of their respective equity contributions (capital). The funds initially invested must be deposited in a local banking account.

The articles of incorporation and by-laws of the corporation must be converted into a public deed with a notary and then registered with the Public Registry, which gives place to the legal ‘birth’ of the corporation.

The bodies of the corporation are:

a the general shareholders’ meeting (maximum body formed by the owners of the company, which decides by majority on the relevant matters thereof);

b the board of directors (body in charge of designing the economic policies of the company, submitting for the consideration of the shareholders’ meeting annual reports and balance sheets, and profits distribution); and

c the general management, represented by a chief executive officer (in charge of executing the economic strategies and ordinary business activities of the company).

Close corporations

Unlike the regular corporation, in close corporations the maximum number of shareholders is 20, and the transfer of shares may be subject to some limits and restrictions if agreed upon by the shareholders.

Likewise, the existence of a board of directors in this type of corporation is optional.
**Public corporations**

Public corporations must be registered with SMV, the Stock Market Superintendency, and their shares must be listed on the Stock Exchange Market.

Owing to its public nature, transfer of shares is completely free in this type of corporation.

**Limited liability companies**

The setting up, steps and liability parameters of limited liability companies (LLCs) are the same as those for corporations. Likewise, with regards to the number of shares and managing bodies, LLCs resemble close corporations without a board of directors.

Unlike all other types of corporations, LLCs do not issue shares in favour of their partners, but rather ‘participation’ titles. Transfer of such titles is subject to first refusal rights of the existing partners, and must be formalised through a public deed and registered with the Public Registry (which is not required by corporations).

**Branches**

Companies, whether established in Peru or abroad, may freely organise branches in the country following similar procedures to those required for the creation of corporations. The formal document containing the agreement of the parent company for the creation of the branch describing, *inter alia*, the latter’s line of business, capital assigned and appointment of legal representatives with detail of its powers, must be converted into a public deed and subsequently registered with the Public Registry. In addition, a certificate that proves the existence of the parent company (certificate of good standing) must be provided.

From a legal standpoint, branches do not have a status independent of their parent companies, but rather constitute an ‘extension’ of them. Nevertheless, branches represent parent companies with autonomy on management matters within the scope of the activities assigned by them, and are considered as independent local taxpayers from a tax standpoint.

**ii Non-corporate**

Even though the predominant way of doing business in the country is through corporate entities, some non-corporate forms are used in particular cases, such as consortium agreements and joint ventures.

These associative agreements (partnerships) are regularly used when two or more companies or individuals not wishing to create a new legal entity are interested in participating in a specific business activity or work (usually subject to a fixed term) for the purposes of which each of the participants is prepared to contribute determined ‘specialised’ resources of their own for the benefit of the common interest (funds, services, immovable property, know-how, workforce, client portfolios, etc.).

With respect to the applicable tax provisions, partnerships must keep accounting records that are independent of those of the partners (unless otherwise authorised by the tax administration) so that they are treated as separate taxpayers. Owing to this legal fiction, partnerships are taxed on the difference between the revenues generated by the specific activities or works conducted and the expenses incurred in the development of those activities.

In those cases where the partnerships do not keep independent accounting records, they will be treated as transparent entities, meaning that revenues and expenses will be attributed to the contracting parties in proportion to their respective participation in the business.
III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Regardless of the individuals’ nationality, the companies’ place of incorporation and the location of the productive source, resident entities are subject to income tax on their worldwide income, while non-resident entities and their branches, agencies and permanent establishments (PEs) are only taxed in respect of their domestic-sourced income.

Income subject to taxation is that obtained from:

- capital, work, and from the joint application of both factors (i.e., enterprises);
- capital gains;
- other profits derived from third parties’ operations; and
- some specific imputed income.

To assess the taxable profits, taxpayers are entitled to deduct all expenses required for the generation of income or maintenance of its source, as well as those related to the generation of capital gains, provided that they are not specifically forbidden by law. In other words, tax legislation has adopted a broad criterion for the deduction of expenses. Therefore, it is acceptable to deduct, *inter alia*:

- interest derived from debts contracted to acquire goods or services related to the generation of taxable income or the maintenance of the productive source;
- insurance premiums covering risks over transactions, services and goods related to the production of taxable income;
- write-offs for bad debts and equitable provisions for the same purpose;
- awards, bonuses, compensations and, in general, payroll payments agreed for staff;
- royalties; and
- travel expenses incurred in connection with the business activities.

Likewise, depreciation of fixed assets and amortisation of finite intangible property, when related to the generation of taxable income, are also deductible. With respect to depreciation of assets, tax law has adopted the straight-line method, with maximum annual rates. For the depreciation to be accepted, it has to be recorded on the accounting books of the company, and the corresponding assets have to be related to the generation of income or maintenance of its source.

On the other hand, tax law contains a list of non-deductible expenses, such as:

- personal and living expenses of the taxpayer and his or her relatives;
- fines, surcharges and interest applied by governmental entities;
- donations not complying with legal requirements;
- expenses not supported with proper formal documentation; and
- expenses (including capital losses) incurred with entities domiciled or established in tax havens, with few exceptions.2

The starting point for determining taxable income is the profit and loss statement derived from accounting recorded in companies’ books, which are adjusted in accordance with the previously mentioned rules on deductible and non-deductible expenses. Taxable profits and deductible expenses are computed on an accrual basis (a cash flow or receipt of funds is not

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1 Such as interest for loans, insurance policies and lease of ships and aircraft.

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necessary). For the first time ever, a legal definition of ‘accrual’ – in force as of 2019 – has been included in the tax legislation. Accordingly, as a general rule income shall be considered accrued whenever the substantial facts for its generation have occurred, provided the right to obtain the income is not subject to conditions. Additional rules have been approved to determine the accrual of income arising from specific transactions, such as alienation of goods, rendering of services, temporary assignment of goods and non-performance obligations.

Capital and income
In general terms, both income and capital gains obtained by resident entities are taxed in the same manner.

Losses
Tax losses may be relieved by carrying them forward and applying them to income obtained in subsequent fiscal years. There are two possible carry-forward systems that companies may choose between: system A allows losses to be carried forward for up to four years as from the year following on from the generation of the losses; and system B allows losses to be carried forward indefinitely, but only up to 50 per cent of the taxable income each year.

Any changes in the ownership of the company (i.e., at shareholder level) do not affect the loss tax relief. Companies are not allowed to carry-back their losses.

Rates
The general income tax annual rate for resident entities is 29.5 per cent. In addition, resident entities are obliged to make advance payments on a monthly basis by applying a coefficient over the accrued taxable income of the month. Advance payments are to be offset against the annual income tax obligation.

Companies involved in certain economic sectors may be subject to special or reduced income tax rates (i.e., companies involved in agriculture, animal husbandry and similar activities are entitled to a 15 per cent rate).

Companies entering into sectoral tax stability agreements for mining or oil and gas projects are subject to an additional two percentage points.

Administration
Peruvian-resident legal entities must file tax returns and pay taxes both on a monthly and annual basis.

The most important tax authority is the National Superintendency of Tax Administration (SUNAT), which is in charge of the administration and collection of all taxes assigned as public resources of the national government (taxes on income, sales, assets and financial transactions, as well as customs duties), public pensions and health security system contributions.

3 Workers’ profit sharing is applicable on the same basis in companies with more than 20 employees. The rate varies according to the economic sector (mining, retail and wholesale trade, 8 per cent; fishing, industry and telecommunications, 10 per cent; other activities, 5 per cent). It is deductible from taxable income.

4 A minimum 1.5 per cent advance payment is applicable, subject to certain exceptions.
In addition, each of the approximately 1,800 municipalities in Peru is considered as a separate tax authority with respect to municipal taxes (mainly taxes on the ownership and transfer of immovable property, real estate and payment of municipal public services).

Tax authorities have discretionary faculties to exercise their auditing duties, which are not conducted on a routine cycle but rather on a variable basis. Larger businesses are usually audited every year, while medium-sized and small businesses may be audited on a biannual or lower frequency rate.

Should uncertainty exist as to the correct interpretation of a legal tax provision, SUNAT may issue a formal opinion providing proper guidance. Such opinions are mandatory for the employees of the tax administration.

If, however, the tax authorities try to collect taxes based on a criterion not shared by the taxpayer, the latter may file an administrative claim challenging the tax administration resolution. If said tax administration upholds its criterion, the claimant taxpayer may appeal the decision to the Tax Court, which constitutes the final administrative level for challenging tax resolutions. Further, the Tax Court’s resolutions may be contested in the judiciary.

**Tax grouping**

Peruvian tax law does not contain any provision for consolidated taxation (‘group of companies’ doctrine). Indeed, as a general rule, all assets, losses, dividends, interest, etc., may not move within a tax group, but should remain within the particular company that originated them. In the case of reorganisation processes (such as mergers and spin-offs), however, it is possible to move tax credits and rights (but not deductible losses) from one company to another, subject to some specific requirements and restrictions.

**ii Other relevant taxes**

In addition to income tax, the following taxes should be taken into account when performing business activities in Peru.

**Value added tax (VAT)**

VAT at a rate of 18 per cent is generally imposed on the following transactions: sale of movable property, rendering and use of services, construction contracts, first sale of real property (except land) made by builders and the import of goods.

As occurs with many indirect tax systems, to determine the tax payable by the company performing the above-mentioned transactions (output VAT), the VAT paid in the company’s acquisitions is accepted as a tax credit (input VAT). Exporters can recover VAT paid in acquisitions for up to 18 per cent of an export’s free on board (FOB) value.

Companies that have not commenced productive operations with a pre-production stage equal to or longer than two years may resort to a special system to obtain the advanced recovery of the VAT levied on certain acquisitions provided that they execute an investment agreement with the state.

**Payroll taxes**

Companies must pay 9 per cent upon wages and salaries for Peru’s health and social security system.

An approximate 13 per cent withholding on wages and salaries paid to employees is mandatory for AFP, the private pension fund.
A special retirement fund for mining and metallurgical workers shall be financed by 0.5 per cent of the mining companies’ annual net income before income tax, and 0.5 per cent of the workers’ gross monthly salary.

All wages, salaries, remunerations, bonuses, awards and, in general, compensations received by employees are subject to taxation with a progressive scale of 8, 14, 17, 20 and 30 per cent for resident employees, and with a flat 30 per cent rate for non-resident employees.

Temporary tax on net assets
This tax is levied at a rate of 0.4 per cent on the value of companies’ assets exceeding an approximate amount of US$300,000. Temporary tax on net assets that has been effectively paid can be offset against income tax obligations for that fiscal year or reimbursed, at the taxpayer’s option.

Tax on financial transactions
A 0.005 per cent tax on financial transactions is imposed on credits and debits in local banking accounts.

Customs duties
In addition to VAT, the import of goods is subject to the payment of customs duties, which may vary from zero up to 11 per cent, depending on the nature of the imported goods.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence
Whether owned by local or foreign investors, entities incorporated in Peru are resident for tax purposes.

Without prejudice to the comments below regarding branches and PEs, a non-locally incorporated entity may not be considered a tax resident itself unless it agrees to transfer its legal domicile to the country and be registered as a local company with the Public Registry.

ii Branch or permanent establishment
A non-locally incorporated entity can have a fiscal presence in the country through a formal branch or agency, as explained in Section III, as well as through PEs.

According to the Income Tax Law and its regulations, a PE is deemed to exist in any of the following cases:

a a fixed place of business where a foreign entity develops activities such as administrative offices, factories, workshops, places where natural resources are extracted, and any fixed or mobile facilities used for the exploration or exploitation of natural resources;

b a building site or construction, installation or assembly project, as well as related supervision activities, exceeding 183 calendar days within any 12-month period, unless an applicable tax treaty has set forth a shorter term, in which case such term will apply;

c the furnishing of services, conducted in the country for the same or a connected project or service, for a period or periods aggregating more than 183 calendar days within any 12-month period, unless an applicable tax treaty has set forth a shorter term, in which case such term will apply;
an individual acting in the country on behalf of a non-locally incorporated sole proprietorship enterprise, company or entity, provided that such individual habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the non-locally incorporated sole proprietorship enterprise, company or entity, and these contracts are:

- in the name of the said entities;
- for the transfer of the ownership of, or the granting of the right to use, property owned by them or that they have the right to use; or
- for the provision of services by them; or

e an individual acting on behalf of a foreign entity customarily keeping goods or merchandise destined to be negotiated in the country on behalf thereof.

Branches, agencies and PEs are subject to taxation in respect of their Peruvian-source income only.

Double taxation treaties entered into by Peru do not provide for special protection with respect to the generation of PEs. Nonetheless, such agreements allow income arising from certain activities to be subject to reduced tax rates or even exempted from taxation that otherwise would have been levied owing to the generation of a PE pursuant to domestic law.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

There are special tax regimes for certain activities (public infrastructure and services concessions, electricity, geothermal energy, hydrocarbons, mining, tourism, agriculture, agribusiness, water farming, education), or for certain locations (jungle, Andes highlands and duty-free zones). Given that local and foreign investors, and the companies in which they invest, enjoy equal treatment, there are no special tax regimes for entities’ operations outside their home jurisdiction or shareholders resident outside such jurisdictions.

i Holding company regimes

There are no special holding company regimes, such as participation exemptions, withholding exemptions, or exemptions for receipt of non-local dividends or income.

ii IP regimes

There are no special IP tax regimes, and no draft legislation for such a purpose is in the pipeline.

iii State aid

State aid is available in the form of the special tax regimes covering the sectors referred to above. Nevertheless, a type of state aid is being applied with the drawback of tariffs paid on the import of goods by exporters. It amounts temporarily to 3 per cent of the export FOB value as long as the production cost does not exceed 50 per cent of the FOB value.

There are a few exceptions established by the Constitution and special laws.
iv General

**Tax stability agreements**

Although the tax regime has been relatively stable for the past few years, since tax simplification enacted in 1992 reduced the number of taxes from more than 40 to seven, tax stability agreements with the state have continued to be available to investors and recipient companies, and have played a key role in attracting investment to Peru, in particular in the mining and oil and gas sectors, where operations entail large investments in exploration or huge investments for the development of a project and its long-term operation. A second type of tax stability agreement is available for the mining and oil and gas sectors, providing for a broader scope of stability and longer terms than the stability provided in the ordinary stability agreements for all sectors.

Pursuant to the Peruvian Constitution, tax stability agreements are deemed contract law and cannot be amended unilaterally, not even by a law passed by Congress.

**Juridical stability agreements (JSAs)**

JSAs with the state are available for foreign or local investors in any economic activity, and for companies receiving investment from a foreign or local investor entering into a JSA, with the following characteristics:

a. minimum investment committed for the next two years: US$5 million (mining and hydrocarbon activities US$10 million);

b. term of the stability agreement: 10 years from the date of its execution;

c. tax regime stabilised for foreign investors, dividend tax regime;

and
d. tax regime stabilised for local companies receiving investment, corporate income tax regime.

As the stability for investors is referred to a committed investment amount, such amount can be increased within the above-mentioned two-year term, hence expanding the stability scope. Likewise, successive agreements with the same investor can be executed and be effective simultaneously. In turn, as the stability for local companies receiving the investment is referred to the profits of the company, regardless of its source of investment, it may only have in place one JSA at a time.

**Mining stability agreements (MSAs)**

MSAs are available for mining projects. They comprise not only the whole tax regime for the project, but also foreign exchange and trade regulations. Companies that invest in a new mining project may enter into a contract with the state that would guarantee the stability of the tax laws in force at the time the contract is executed, and for a term of 15 years, provided that they invest at least US$500 million to either develop a mining project of not less than 15,000 tonnes per day or to expand an existing operation to reach a minimum processing

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6 In the case of investment in companies to operate a public infrastructure or service concession, the term is the concession’s life (usually 30 years).

7 This also ‘freezes’ for the investor the regime that guarantees the investor’s right to free access to foreign currency, the right to use the most favourable exchange rate available, the right to repatriate capital and to remit profits abroad, and the right to non-discrimination in legal matters.

8 This also maintains for the investor the hiring regime for workers and export incentives.
capacity of 20,000 tonnes per day. Alternatively, mining companies may conclude a 12-year stability agreement provided that they invest at least US$100 million to either develop a mining project of not less than 5,000 tonnes per day or to expand an existing operation to reach a minimum processing capacity of 5,000 tonnes per day. In addition, a 10-year stability agreement is available to companies investing at least US$20 million to develop a mining project larger than 350 tonnes per day and up to 5,000 tonnes per day.

The stability term starts in the year when the committed investment in developing the mine is completed and exploitation begins, or at the request of the mining company as from the following year.9

Through an MSA, the state guarantees that the mining project will be subject solely to the tax regime in force on the date of execution of the MSA, including income tax rates, the calculation method to determine taxable income, tax refund mechanisms, customs duties, municipal taxes, water licences and good standing fees. The mining company is subject to the tax regime in force on the date of execution of the MSA and will not be subject to any other tax created thereafter. Moreover, it will not be subject to any further changes to the regime governing the calculation and payment method of taxes.10

An additional two percentage points in the regular income tax rate are also applicable to profits from mining projects with an MSA.

Legal mining royalties and the special tax on mining are also subject to the stability agreement. An MSA grants the mining company the right to keep its accounting records (and capital) in foreign currency and the right to apply a total annual overall depreciation rate of up to 20 per cent on fixed assets.11

Oil and gas stability agreements

The licence contract to be entered into with the state for the purpose of oil and gas activities guarantees that the tax regime in force at the time the licence contract is entered into will remain unchanged during the lifetime of the licence contract, under the following terms:

a. the contractor is subject to the regular tax regime of Peru, including the ordinary income tax regime and specific regulations set out in the Organic Law for Hydrocarbons in force on the execution date;

b. no taxes established after execution of the licence contract, or any changes that may be introduced at the source that generates the tax obligation, or in the amount of the tax, or in the exemptions, benefits, incentives and exclusions, shall apply, with the exception of VAT, excise taxes and any other tax on consumption, as well as the special regime applicable to exports and exemptions regarding imports;

9 Alternatively, at the request of the mining company, the stability period may be advanced and commence prior to completion of the required investments for a term of up to eight years (15-year and 12-year contracts) or three years (10-year contract).

10 The following are other guarantees granted under an MSA: free availability of export-related foreign currency, both in the country and abroad; non-discrimination as to the exchange rate used to convert the FOB value of exports or local sales (or both) into local currency, it being understood that the most favourable exchange rate is to be granted for foreign trade operations; free sale of mineral products; stability with respect to special regimes, in the event they are granted, for tax refunds and temporary imports, among others; and the guarantees granted under the MSA cannot be unilaterally changed by one of the parties.

11 Except depreciation of constructions, the rate for which is 5 per cent.
in the case of exemptions and other tax benefits, the tax stability shall be subject to the terms and conditions established by the legal provision that grants the said benefits; and

d the tax system that the contractors enjoy shall also apply to whomever, subsequent to the execution of a contract, assumes the contractor’s condition according to law.

An additional two percentage points in the ordinary income tax rate are also applicable to profits from activities of the licence contract.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)
Dividends and other forms of profits distributed by local companies in favour of non-resident individuals or entities are subject to a 5 per cent income tax withholding. The tax is due at the time the distribution is agreed to by the general shareholders’ meeting or when the distribution is effectively performed, whichever occurs first.

Reimbursement to a shareholder following a capital reduction up to the amount of non-distributed profits, revaluation surplus, reserves or additional capital at the time of the capital reduction is deemed to be taxable dividend.

On the other hand, branches and other PEs are subject to a 5 per cent dividend tax at the time their annual income tax return is due. The tax is calculated on the outstanding profits (after corporate income tax) available for distribution in favour of the foreign entity.

Likewise, interest is subject to income tax withholding if the capital is invested or economically used within the country, or if the payer is a resident entity. The applicable tax rate is 4.99 per cent if certain conditions are met; otherwise, the withholding tax rate is 30 per cent.12

Technical assistance services economically used within the country may also be subject to a special 15 per cent withholding income tax, for the purposes of which certain formalities must be fulfilled.13

Finally, royalties are subject to a 30 per cent withholding income tax whenever the rights in respect of which they are paid are economically used within the country or if the payer is a resident entity.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments
Currently, domestic law exemptions from withholding on outward-bound payments are reduced to very specific cases, such as interest from promotion credits granted by international

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12 Conditions: (1) in the case of cash loans, the remittance of funds to Peru is duly documented; (2) the loan is subject to an annual interest rate not greater than the LIBOR rate plus seven points; (3) the lender and the local borrower are not regarded as related parties; and (4) the transaction is not considered as a related parties ‘sham transaction’ (e.g., back-to-back). If (1), (3) and (4) are not met, the withholding tax rate is 30 per cent. If (2) is not met, only the excess of such interest is subject to such 30 per cent rate.

13 If the fees amounted to more than approximately US$170,000, a certification from a local or international audit firm stating that the technical assistance was effectively rendered is required.
organisations or foreign government institutions, or royalties for technical, economic, financial and any other consulting provided from abroad by state entities or international organisations.

### iii Double tax treaties
Peru’s double taxation treaty network currently comprises Brazil, Canada, Chile, Korea, Mexico, Portugal and Switzerland. These treaties are largely based on the OECD Model Tax Convention. Likewise, Bolivia, Colombia, Ecuador and Peru, as members of the Andean Community, are subject to a common regime to prevent double taxation.

OECD-type treaties concluded by Peru establish maximum tax rates for dividends, interest and royalties in the residence state of the payer or where such items of income arise.

In turn, the Andean Community treaty establishes that royalties, interest and dividends are exclusively taxed at source, this is, in the state where the intangible property is used, the payment is attributed and recorded, and the distributing company is domiciled, respectively.

### iv Taxation on receipt
Dividends and income flows received from abroad increase the taxable income of local companies, but if such flows were taxed in their country of origin, a ‘direct’ credit is given to reduce the local tax charge applicable to them. As from 2019, an ‘indirect’ credit is also available in respect of the corporate taxes paid abroad by the company that distributed dividends to the Peruvian shareholder. These credits proceed provided that foreign taxes do not exceed the amount resulting from the application of the ‘average rate’ of the taxpayer to the income obtained abroad, or the amount of tax actually paid abroad.

### VII TAXATION OF FUNDING STRUCTURES
The most common ways for local entities to be funded is by means of capital contributions or through loans.

#### i Thin capitalisation
A maximum debt-to-equity ratio of 3:1 is in force regarding loans granted by related (or, as from 2019, unrelated) companies. Interest corresponding to the portion of the loan exceeding this ratio is not deductible. As from 2021, thin capitalisation rules are expected to be replaced by a new rule according to which interest is deductible up to an amount not exceeding 30 per cent of the previous year’s EBITDA (as specifically defined in the law).

#### ii Deduction of finance costs
Interest from debts and expenses originated by the contracting, renewal or payment thereof may be deducted provided they have been contracted to acquire goods or services related to the generation of taxed income or the maintenance of the source.

It should be noted that interest can be deducted as to the portion that exceeds the amount of exempt interest income.
Restrictions on payments

The main restriction on dividend payments arises from corporate legislation, pursuant to which they may only be paid owing to the existence of profits or freely disposable reserves provided that the net equity of the company is not lower than the paid-in capital.

Return of capital

In general terms, equity capital can be repaid to shareholders by a reduction of capital without limitations. Should the repayment be performed in favour of local individuals, or non-resident entities or individuals, a 5 per cent dividend tax would apply on the difference between the nominal value of the shares and the amounts effectively received by them.14

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

Acquisition

Non-local companies acquiring local businesses generally structure a transaction through an acquisition of shares or a capital contribution. Usually they use a non-local entity for the acquisition. If the acquirer of the shares is a local subsidiary, financial expenses related to such acquisition would, in principle, be considered non-deductible.15 Thin capitalisation rules as described above are applicable. Withholding tax on the consideration for non-resident sellers (if there is a capital gain) is applicable only at payment and proportionally to it.

The legal concept of Peruvian-source income includes capital gains from ‘indirect alienation’ of Peruvian-issued shares by non-resident companies, deeming such to be (1) the alienation of shares issued by a non-resident company; (2) a capital increase or capital reduction carried out by a non-resident, when the main value of such non-resident company is made up by the value of its shares in Peruvian companies; or (as from 2019) (3) the alienation of shares issued by a non-resident company, when the Peruvian-issued shares are worth approximately US$50 million or more.

Reorganisation

Under the Income Tax Law, corporate reorganisations, including mergers, demergers, spin-offs and simple reorganisations, enjoy a special regime when all the parties involved in the reorganisation are companies established in Peru. They can elect to reorganise themselves by transferring assets and liabilities at book value without attracting taxes owing to the application of the fair market value rules. It is a tax deferral system through an exemption of fair market value rules. Transfers of shares or capital reductions that occur within the taxable year following reorganisations by way of spin-offs or simple reorganisations have negative tax consequences.

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14 See Section VI.i: the tax treatment for reimbursement to a shareholder following a capital reduction up to the amount of non-distributed profits, revaluation surplus, reserves or additional capital at the time of the capital reduction is deemed to be taxable dividend.

15 An exception to such criteria was declared in Tax Court Rulings No. 4757-2-2005 and 539-5-2018, which took into account the synergies that benefited the acquirer.
For tax purposes, losses of a company cannot be transferred to another company within the framework of a corporate reorganisation. Certain restrictions apply to the use of own losses as well. Taxable surplus derived from a revaluation carried out prior to a reorganisation cannot be offset with carried losses.

Transfer of assets in a corporate reorganisation is VAT-free, and parties involved can agree the amount of VAT credit that can be assigned to each of them.

This same treatment is applicable to branches of foreign companies. Specifically, assets (and liabilities) of the branch transferred within the framework of a corporate reorganisation may be made, for tax purposes, at their book value and not at their fair market value.

Shares exchanged as a result of corporate reorganisation are, in principle, not taxed. It is easy to consolidate an acquired business through corporate reorganisation. There are no restrictions if merging with a non-local entity, but the special tax treatment provided to corporate reorganisations is not applicable if any involved parties are not local.

Reorganisations involving local companies and non-resident companies are not addressed in the tax legislation.

iii Exit

Although authorised in the corporate legislation, the tax effects of relocation of companies to or from Peru are not specifically considered in the tax legislation and there are no rulings to this extent. Currently, there are no exit taxes applicable in Peru, and no tax penalties incurred in relocating businesses.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

The Tax Code provides for a general anti-avoidance rule that grants to the tax administration a broadened scope for applying the substance-over-form criteria in assessing the true nature of a taxable event. A specific procedure was recently approved for SUNAT to be allowed to apply the general anti-avoidance rule. However, the effective application of this rule remains suspended until the approval of regulations that clarify its scope.

ii Controlled foreign corporations (CFCs)

Foreign-source passive income (dividends, interests, royalties) and capital gains obtained by a CFC may be attributed to the Peruvian-resident controlling taxpayer in the corresponding proportion.

iii Transfer pricing

Transfer pricing rules, with the adoption of the arm's-length principle as interpreted by the OECD, have formed part of the local tax system for approximately 15 years. Likewise, the OECD three-tiered reporting standard (local file, master file and country-by-country report) has also been included in Peruvian tax system.

16 A corporation located in a low or zero-tax jurisdiction in which a Peruvian resident owns more than 50 per cent.
The main purpose of these rules is to ensure that the prices agreed upon between related parties are similar to those that would have been agreed among non-related parties with respect to comparable transactions under similar circumstances. In other words, transfer pricing rules dictate that all transactions are carried out at fair market value.

**iv Tax clearances and rulings**

Economic, labour and professional entities, as well as national public sector entities, may make ‘institutional’ inquiries regarding the meaning and scope of the tax rules. This procedure is also available to private companies and individuals (‘private’ inquiries), although restricted to specific taxpayers.

Interpretation criteria provided by the tax administration are mandatory for the tax administration; however, if such criteria are considered incorrect by taxpayers, they may follow the procedures explained in Section III.i.

**X YEAR IN REVIEW**

Peru’s GDP growth for 2018 is around 4.0 per cent and estimated for 2019 is 4.1 per cent. Fiscal deficit is around 3.0 per cent. Tax pressure (tax collected/GDP) is around 13.9 per cent in 2018 and estimated for 2019 is 14.2 per cent.

In 2018, a number of tax measures entered into force, the most relevant ones being the following:

- changes in the rules referring to capital gains derived from indirect alienation of shares issued by Peruvian companies;
- new limitations on interest deductions (stringent thin capitalisation rules);
- a definition of the accrual principle for tax purposes has been included for the first time ever;
- new rules to acknowledge the existence of permanent establishments have been enacted; and
- a procedure to apply the general anti-avoidance rule has been enacted, but it will need some regulations to enter into force.

Two relevant court decisions regarding taxes were issued in 2018. The first is a Constitutional Court decision that removed accrued interest on tax debts in a case where the tax administration took a long time (much longer than what has been regulated) to issue a decision on a tax assessment that was contested by the taxpayer. The other one was a Tax Court decision on the grounds of the former anti-avoidance rule in a case where a sale of shares was completed after its listing on the Lima Stock Exchange in order to benefit from the special 5 per cent tax rate on capital gains when the shares are sold through the stock exchange (instead of the regular 30 per cent rate). Based on the fact that the contract was concluded before listing and on certain contractual provisions, the Tax Court ruled that the alienation was not made through the Lima Stock Exchange and therefore, the regular 30 per cent rate was applicable.

Domestic legislation has continued to be passed to meet OECD standards and recommendations on transfer pricing reporting obligations, the exchange of information

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17 The three-tiered approach to transfer pricing documentation (consisting of a local file, a master file and a country-by-country report) was regulated during 2017. The obligation to present a local file for fiscal year 2016 is in force from 2017; while the obligation to present a master file and a country-by-country report for fiscal year 2017 is in force from 2018.
for tax purposes and mutual administrative assistance in tax matters (including lifting of banking secrecy), in line with Peru’s efforts to become an OECD member. Throughout the year, Peru continued to participate in regional and international meetings on the OECD base erosion and profit shifting (BEPS) project. Most notably, in 2018 Peru signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, during a plenary meeting of the Inclusive Framework on BEPS held in Lima.

Peru concluded a free trade agreement with Australia during 2018 and continued negotiations with India.

Negotiations to conclude bilateral tax treaties with Italy, Japan, the Netherlands, Qatar, Singapore, Thailand and the United Kingdom, and renegotiations with Spain, continue.

**XI OUTLOOK AND CONCLUSIONS**

Peru will continue negotiating agreements to avoid double taxation, since it is acknowledged that said agreements help attracting new investments and technologies, and to establish collaboration mechanisms and mutual assistance. The next treaty to be negotiated will incorporate the experience gained in the already executed ones to maximise their effects on investment and tax collection, as well as recommendations of the BEPS Project on international taxation.

Peru will continue incorporating the required regulations and minimum standards to adopt the recommendations of the OECD regarding international taxation and fulfil the commitment taken on by the country as an associate to the Inclusive Framework on BEPS.
I INTRODUCTION

Since Poland joined the European Union on 1 May 2004, Polish domestic law has been harmonised with EU legislation and the case law of the Court of Justice of the European Union, and all EU tax directives have been implemented.\(^1\)

In addition, foreign and local income is protected in Poland against double taxation through an extensive network of 92 double taxation treaties (DTTs) that are based on the OECD Model Convention. Whenever such a treaty does not exempt income from taxation, or in the absence of a treaty, the tax credit system applies, including the full tax credit for underlying tax applicable to Polish companies receiving foreign (inbound) dividends from countries outside the EU. As a result, in many such cases, no corporate tax would apply in Poland, since the Polish Corporate Income Tax Law (CITL) sets tax rates of 19 or 15 per cent, which are lower than tax rates in many countries.

Income derived from economic activities conducted in the Polish territory within special economic zones (SEZs) (i.e., areas designated for the purposes of running businesses on preferential terms) is tax-exempt. Furthermore, large and small investments that are crucial to the Polish economy may also find support through a number of government and other state aid programmes aimed at fostering investment or the creation of new workplaces. Flexible thin capitalisation rules also encourage investors to finance local businesses with the use of debt, including intra-group loans.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

In Poland, business activity may be pursued by any person acting either as a sole entrepreneur or a capital (corporate) company or partnership, as envisaged in the Polish Commercial Companies Code. Foreign entrepreneurs with their registered office in the EU, EFTA or EEA may perform their business activity in Poland in compliance with the rules and principles set

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1. Jaroslaw Bieroński is a partner at Sołtysiński Kawecki & Szlęzak.
2. Including Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States, and to the transfer of the registered office of a European company (SE) or European cooperative society (SCE) between Member States; Council Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States; and Council Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.
forth for Polish entrepreneurs. In turn, foreign entrepreneurs with their registered office in other countries may perform their business activity in Poland through a limited partnership, a partnership issuing shares, a limited liability company or a joint-stock company only. Foreign entrepreneurs may also perform their business activity in Poland through a local branch.

i Corporate

Corporate companies (i.e., limited liability companies and joint-stock companies) obtain legal personality upon court registration. The limited liability company is most frequently used for doing business in Poland. In turn, a joint-stock company features more advanced corporate instruments, such as convertible bonds, authorised but not issued capital, founders’ certificates and non-voting shares. Its operations and management are subject to more stringent requirements than the operations of a limited liability company. In addition, the value of all in-kind contributions to the share capital of a joint-stock company is subject to a mandatory verification by court experts. The registered share certificates may be issued prior to the full coverage of shares by shareholders. Bearer shares may be listed on stock exchanges and traded on a public market. The form of a joint-stock company is mandatory for the conduct of certain types of activities (e.g., banking or insurance). Joint-stock companies floated on the Warsaw Stock Exchange must comply with additional informational obligations envisaged by pertinent laws and stock regulations.

Corporate companies (even prior to their court registration) and other organisational units, with or without legal personality, including limited partnerships issuing shares (with the exception of other partnerships), are taxpayers liable to corporate income tax (CIT). Corporate taxpayers that have their registered office or place of management in Poland are liable to CIT on their worldwide income. If a corporate taxpayer does not have its registered office or place of management in Poland, the tax is levied only on the income derived in Poland, unless an applicable DTT provides otherwise.

Capital companies may also establish a ‘tax group’ (tax unit) – a group of two or more capital companies treated as a single CIT payer – which must first satisfy numerous conditions.

Owing to attractive tax treatment, foreign and local investors also used Poland-based regulated close-ended investment funds and qualified foreign-regulated mutual investment funds from the EU and the EEA (they must be managed by a company operating under a permit granted by the competent financial sector supervision authority of the country of the fund’s seat), and regulated investment companies from the EU and the EEA operating upon a simple notice of initiation of investment activities. Although Polish investment funds may not conduct operational business activities, they may invest in real property, in shares issued by companies and limited partnerships issuing shares, and in other securities. Such local and foreign regulated funds and regulated investment companies were entirely exempt from Polish CIT on any local and foreign income. However, since 2017 the local general tax exemption of Poland and foreign regulated investment funds is narrowed to income derived by Poland-based open-ended investment funds and qualified foreign-regulated collective investment funds from the EU and the EEA only. In principle, they must have a permit granted by the competent financial sector supervision authority of the country of the fund’s seat, be managed by a company operating under a permit of such authority and have custody. In turn, Poland-based close-ended investment funds and qualified foreign-regulated collective investment funds from the EU and the EEA operating upon a simple notice of initiation of investment activities, rather than upon a permit of the competent financial sector supervision
authority, are also able to apply the local tax exemption, with, however, the exclusion of certain items of their income (in particular, interest, donations and profits paid by local and foreign tax-transparent partnerships, and capital gains from transfers of securities issued by such partnerships). In addition, the new tax exemption for qualified foreign-regulated collective investment funds from the EU and the EEA is limited to situations where Poland may claim an exchange of information from the tax authorities of the country of such fund pursuant to a pertinent DTT or other treaty.

The administrative court also ruled that a Luxembourg investment company operating under Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers is not exempted from CIT in Poland as it is not a collective investment fund such as UCITS, which should operate upon a permit of the competent financial supervisory authority in the meaning of the EU and Polish regulations.

On the other hand, the Court of Justice of the European Union and Polish administrative courts have issued encouraging judgments stating that narrowing the tax exemption to income of regulated investment funds only from Poland and other EU or EEA Member States violates Article 56 of the Treaty on the Functioning of the European Union (TFEU). According to Article 56, taxpayers from third countries should be treated equally to taxpayers from the EU, and therefore income of investment funds from countries outside the EU or EEA should also be exempted from CIT pursuant to Article 56 of the TFEU, which may be applied by foreign funds directly. In particular, tax authorities denying that the Polish tax exemption on cross-border income of a US investment fund violates the freedom of movement of capital provisions under the TFEU.

Since 2014, CIT has been imposed at a rate of 19 per cent on profits of limited partnerships issuing shares (general and limited partnerships remain tax-transparent for income taxation). Such partnerships fall under the standard corporate tax rules, including thin capitalisation rules, and should depreciate fixed and intangible assets by continuing to apply the rates and methods they adopted prior to 2014.

ii Non-corporate

Local and foreign investors may conduct business activities through a partnership, which in general may have one of the following forms: civil law partnership, general partnership, professional partnership, limited partnership or limited partnership issuing shares (limited-stock partnership). General and limited partnerships are most commonly used. Limited partnerships issuing shares have also been popular, as they are used by close-ended investment funds for carrying out income tax-exempt business activities. In turn, civil law partnerships are established for small businesses only. All types of partnerships other than limited partnerships issuing shares are income tax-transparent. Therefore, partners are liable to income tax on profits derived through their partnership proportionally to their interests in the partnership’s profits. Creation and liquidation of partnerships are subject to special tax rules, and income from withdrawal of a partner from a partnership or from liquidation of a partnership is tax-exempt under those rules. However, according to a recent court ruling, payments received by a partner in a partnership will not be tax-exempt if such payment represents the income that was not taxed when derived by the partnership.

In general, partnerships may be taxpayers for purposes of other Polish taxes, including value added tax (VAT), excise tax, customs duty, tax on civil law transactions or real estate tax (local taxes).
III  DIRECT TAXATION OF BUSINESSES

i  Tax on profits

*Determination of taxable profit*

CIT is payable at a rate of 19 (or 9) per cent on all income derived from whichever source of income and on all capital gains derived from certain sources of capital gains, subject to certain exemptions. The 9 per cent rate applies for small taxpayers, with the exception of new taxpayers created via the restructuring of existing businesses; this rate does not apply to capital gains. Taxable income is defined by tax rules as an excess of all items of the taxable income (excluding capital gains from certain sources of such gains) over costs of such income in a given tax year. The taxable income is not equal to an accounting profit. In addition, it may include income from gratuitous services and imputed income. For example, according to interpretative guidelines issued by the Minister of Finance, a surety or guarantee issued by a shareholder without remuneration to secure a payment of debts of its corporate company constitutes taxable income of such company. In principle, income from business activities is taxable on an accrual basis. Expenses incurred to derive taxable income are deductible unless they are listed in Article 16 of the CITL, which enumerates non-deductible costs. Non-deductible costs include expenses for the acquisition of land or perpetual usufruct of land, which may not be depreciated but may be deducted upon the sale of such assets, purchase costs of shares and securities until the day of their sale or redemption, certain expenses for promotion, compensation and contractual damages, any donations, expenses (above certain limits) for the use of cars, costs incurred for tax-exempt income or depreciation write-offs pertaining to know-how contributed in-kind to the stated capital of the company, and other costs. According to the general tax interpretative guidelines of the Minister of Finance, however, deductions of payments for the rental of passenger cars used in business activities are not subject to statutory limitations in terms of expenses incurred during the use of such cars (e.g., the cost of fuel); such rental payments are, therefore, fully deductible. Another general tax interpretative guideline of the Minister of Finance states that the cost of food, beverages, lunches and other meals offered to customers and potential customers are not subject to the statutory limitations regarding expenses for the promotion and representation of a taxpayer; therefore, such costs are fully deductible.

As from 2018, new tax rules exclude from tax-deductible costs expenses incurred directly or indirectly for the benefit of affiliated entities or entities that have their seat in countries deemed to have engaged in harmful tax competition, related to the following (intangible) services, to the extent to which the aggregated expenses of such services exceed 5 per cent of taxpayer’s EBIDTA:

a  advisory services, market research services, advertising services, management and control services, data processing services, insurance, guarantee, surety and similar services;

b  licence fees for use of copyrights and IP rights, and know-how; and

c  shifting a risk of a debtor’s insolvency as regards loans, other than extended by banks and credit and savings unions, including liabilities arising out of derivatives and similar services.

The amount of costs not deducted in a given fiscal year is deductible in the consecutive five fiscal years, within the cap applicable in particular years.
According to case law, company share capital increase is tax-exempt; therefore, costs associated with such increase are non-deductible. However, the costs should be solely narrowed to expenses that are directly connected with such an increase (e.g., notarial or court fees), and not to costs connected with the general functioning of a company or its business activity generating taxable income (e.g., advisory fees), which should be deductible.

Generally, fixed assets (buildings, constructions, machinery and equipment, and vehicles) owned by a taxpayer, acquired or constructed may be depreciated if their projected service life exceeds one year, they are completed and fit for use when they are placed in service, and if they are used for business activities by the taxpayer or a third party on the basis of a rental, lease or similar agreement with the taxpayer.

The following may also be depreciated, regardless of their projected useful life: leasehold improvements placed in service; buildings and constructions developed on land owned by a third party; and buildings, constructions and other assets constituting a separate freehold used by a taxpayer for business activities on the basis of a financial lease agreement.

Taxpayers may also depreciate certain intangible assets such as computer software, copyrights, licences and goodwill.

Interest on loans received to finance acquisitions or to develop depreciable fixed or intangible assets accrued by a borrower before the assets are placed in service is subject to depreciation rather than full deduction. Generally, rates of deductible depreciation write-offs are prescribed by local tax regulations. However, taxpayers may set depreciation rates within certain limits for fixed assets used or improved, and for intangible assets. The minimum depreciation periods for intangible assets are 24 months for licences for computer software, copyrights, films, radio and television programmes, 12 months for R&D costs, and 60 months for goodwill and other intangible assets.

Once established, the depreciation rates for intangible assets may not be changed. Goodwill may be depreciated only in cases of acquisition of an enterprise or its organised part, namely where it is purchased on the basis of a sale agreement; or where the enterprise or its organised part is subject to a financial lease arrangement and is depreciated by the lessee pursuant to applicable rules, or where the enterprise or its organised part is contributed in-kind to a local company under the Privatisation Law.

After a statutory merger or demerger, acquiring companies should continue the depreciation of fixed and intangible assets of the target company on the basis of the same depreciation value, rates and methods. This also applies in cases of the contribution in-kind of an enterprise or its organised part to a company. Depreciation of fixed and intangible assets contributed to partnerships is subject to special tax rules.

From 2018, the minimum CIT will apply on income from commercial properties leased or otherwise made available to third parties: commercial and service buildings (inter alia, commercial centres, department stores) and office buildings classified as an office building in the classification of buildings, where their initial value exceeds 10 million zlotys. The taxable basis is the initial tax value of a building for its tax depreciation decreased by 10 million zlotys. The tax rate is 0.035 per cent of the table basis per month. The amount of the tax may be deducted from CIT. The tax does not apply to office buildings used exclusively or mainly for the taxpayer’s own purposes.

Capital and income

There is no capital gains tax in Poland. However, certain capital gains from a disposal or redemption of shares in corporation and partnerships, titles in investment funds, derivative
instruments and other securities, and from interest on shareholders’ participating loans as well as costs related to such gains should not be aggregated with ordinary income subject to CIT. In principle, capital expenses may be offset only against capital gains, while expenses related to ordinary income may be offset only against ordinary income.

**Losses**

Where costs of ordinary income exceed total taxable ordinary income, in a given tax year, the difference will represent a tax loss. Such loss may be carried forward against ordinary income derived in the next five consecutive tax years. However, in any of those five years, the loss from the given year may be deducted in part not exceeding 50 per cent of that loss. It is not possible to carry losses back, offsetting them against prior year income. Tax losses are linked with the legal entity that incurred them. Therefore, in cases of mergers, acquisitions (including purchases of an enterprise) and divisions, an acquiring entity may not carry forward tax losses incurred by a target business prior to such a transaction. Conversely, the acquiring entity may carry forward its tax losses incurred prior to the transaction.

Capital losses may be carried forward under the same rules applicable to ordinary losses. However, ordinary losses may not be carried forward against capital gains, and capital losses may not be carried forward against ordinary income.

**Rates**

As previously mentioned, CIT is chargeable at a rate of 19 per cent or, with respect to small taxpayers, at a rate of 9 per cent. In addition, outbound dividends are subject to local withholding tax at a rate of 19 per cent, and outbound royalty and interest payments are subject to local withholding tax at a rate of 20 per cent, unless a pertinent DTT sets out a lower rate. There is no proposed legislation aimed at a change in the CIT rates after 2017.

**Administration**

The fiscal year is the same as the calendar year, unless a taxpayer selects another period of 12 consecutive months and notifies the tax office by 30 January of a given year.

Polish taxpayers are obligated to pay corporate tax advances on a monthly basis, without, however, an obligation to file monthly CIT returns with the tax office. They may also decide to pay monthly tax advances in a simplified form, in an amount of 1/12th of the tax due as disclosed in the annual CIT return filed during the preceding tax year. All taxpayers are only obliged to file one annual CIT return within three months from the end of each tax year, and to pay the difference between the tax due and the sum of tax advances paid from the beginning of the tax year.

The taxation system is uniform across Poland (outside small differences in local taxes only). Foreign and local companies and individuals pay the same taxes. The Polish tax system is administered by:

a heads of tax offices, who supervise the collection of taxes in their territories, audit taxpayers and issue individual administrative decisions;
b heads of customs and tax offices, who perform taxation and procedural checks on fiscal settlements and conduct fiscal penalty proceedings; they also issue individual administrative decisions to taxpayers as a result of checks of fiscal settlements that were not corrected by taxpayers;
heads of tax administration chambers, who supervise the heads of tax offices and heads of customs and tax offices: they are empowered to review administrative decisions of tax offices and customs and tax offices;

d the chief of Country Tax Administration, who generally supervises the entire taxation system on the territory of Poland; examines tax cases that require that final tax decisions be declared null and void, or that tax proceedings already closed be exceptionally resumed; and issues tax decisions in tax cases falling under the local general anti-avoidance rule;

e the head of Country Tax Information, who issues private tax rulings in taxation cases upon the request of taxpayers and withholding tax agents; and secures, processes and publishes uniform information that is relevant for taxation and customs; and

f the Minister of Finance, who is responsible for budgetary policy. He or she, ex officio or upon the request of taxpayers and other entities, issues general guidelines applicable to tax rules that in his or her opinion require uniform interpretation; and

g local self-government authorities, which are responsible for the collection of local taxes.

Taxpayers may, within 14 days, appeal against a tax decision or a private tax ruling of the local tax authority. Afterwards, a complaint against the tax decision or a private tax ruling may be submitted, within 30 days, to the district administrative court, and subsequently to the Supreme Administrative Court of Poland (NSA).

Tax advantages of a few single companies may become apparent in the case of the creation of a ‘tax group’, which may compensate losses of some of its members with profits of the remaining members. The tax group may be formed by corporations that meet the following conditions:

a they are limited liability or joint-stock companies incorporated in Poland;

b the average share capital of the member companies is not less than 500,000 zlotys, excluding the value of the share capitals covered by shareholders’ loans, interest thereon or non-depreciable intangibles;

c in principle, a parent company directly holds 75 per cent of the shares of the subsidiary companies;

d the subsidiary companies do not hold shares in other subsidiary companies being members of the tax group; and

e before joining the tax group, the companies do not have any tax arrears towards the State Treasury budget.

Once the tax group is formed, the following additional requirements must be met: members of the tax group may not be exempted from CIT; the ratio of taxable income of the tax group to its total revenue in each tax year must be at least 2 per cent; and members of the tax group need to price transactions with related entities from outside the group at arm’s length according to Polish transfer pricing rules.

Violation of any of these conditions results in the dissolution of the tax group and its members have to settle CIT on their own for a current tax year and previous two tax years. The group is also dissolved at the end of a period for which it was established.

The parent company and the subsidiaries that establish the tax group need to do so for at least three years under an agreement in the form of a notarial deed to be registered with the tax office.
Each member of the tax group should calculate its profits (capital gains) or losses separately in accordance with the ordinary rules. The taxable income of the tax group is defined as an excess of total taxable profits and capital gains of members of the group over ordinary losses and capital losses of the other members during the tax year. However, tax losses or profits from years before or after the life of the tax group may not be offset against the income or losses of the tax group. The tax group is a taxpayer liable to CIT at the regular rate of 19 per cent, which should be withheld by the parent company, but for which tax all the members of the tax group may be held liable jointly and severally. If the total losses of the members exceed their total profits, such difference represents a tax loss of the tax group. However, in practice, such a situation violates the 2 per cent profitability requirement for the tax group, and triggers the end of the tax group as of the date the group files its annual tax return for its given tax year.

Owing to the required 2 per cent profit-to-revenue ratio, the benefits of creating the tax group are generally seen as rather strict when compared with the potential ‘fruits’ of the creation of such a group.

### ii Other relevant taxes

Other taxes in Poland are:

- **a** VAT;
- **b** excise tax;
- **c** stamp duty;
- **d** tax on civil law transactions;
- **e** real estate tax and other local taxes;
- **f** tonnage tax;
- **g** gambling tax;
- **h** donation and inheritance tax (which, however, does not apply to legal persons);
- **i** tax on mines;
- **j** special hydrocarbon tax;
- **k** tax on certain financial institutions; and
- **l** tax on retail sales.

The Polish VAT is in general harmonised with the EU VAT legislation, including Council Directive 2006/112/EC of 28 November 2006 on the common system of VAT. Pursuant to Article 5, Section 1 of the Polish VAT Law, in principle, supply of goods (inter alia, intra-Community acquisitions and supplies of goods) and provision of services against consideration in the territory of Poland are subject to Polish VAT at a rate of 23 per cent. Gratuitous services and supplies of goods without remuneration may be also taxable. For some goods and services, VAT rates have been reduced to zero,3 8,4 7,5 56 and 4 per cent.7

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3 For example, export and intra-Community supplies of goods, sea and air transportation, international transportation and related services.
4 For example, some groceries, fertilisers and healthcare products; sport, recreation and culture events; some services in agriculture and forestry; and construction services related to the development of public residential buildings and apartments.
5 For example, farming activities.
6 For example, printed books and specialist journals, some groceries and ready-made meals.
7 For example, taxi or cab transportation.
Certain services, including education, medical services, insurance, granting and management of loans, dealing in securities and certain other services, are subject to a VAT exemption, and the service provider may not deduct input VAT in such cases.

Pursuant to the above-mentioned EU Directive, Poland has exercised the option that any transfer of an enterprise or organised part of an enterprise is outside the scope of Polish VAT. In addition, input VAT on purchases, importation, manufacturing and use (rent, lease) of passenger cars, and VAT on the purchase of engine fuel, maintenance and other services related to such cars, may be deducted provided such passenger car is used solely for business activities. If a passenger car is used for both business and private purposes, 50 per cent of the input VAT may be deducted. Taxpayers using passenger cars for business activities only should maintain VAT records that include details about the driver, his or her itinerary and mileage.

In principle, only suppliers (importers) of goods and services are taxpayers obliged to pay VAT on their supplies; however, a VAT payer who purchases certain goods may be jointly and severally liable with a supplier of such goods for the payment of VAT chargeable on that supply if the value of goods supplied between those parties exceeds 50,000 zlotys in a given month, and the purchaser knows or should reasonably know that the supplier is not going to pay VAT on that supply. The purchaser will not be held liable if the supplier provided the tax authorities with the required security for the payment of VAT (e.g., cash deposit, bank guarantee or insurance policy).

Over the past few years the scope of the local reverse charge has been widely extended, mostly in order to tackle the VAT carousel frauds. For example, during the past year the local reverse charge has been applied to building services rendered by subcontractors. For the same reasons, in 2018 the ‘split payment’ was introduced to the VAT Law. Under this mechanism, the purchaser is eligible to: (1) divide the amount following from the invoice received into VAT part and a net price; (2) pay the VAT part to a special ‘VAT bank account’ of the supplier; and (3) pay the net price to the current bank account or settle it in some other way (e.g., in cash or set off). Currently, the application of the split payment mechanism is optional.

The VAT Law states that services provided by Polish suppliers to foreign service recipients are not subject to Polish VAT, and are subject to VAT in the country where the recipient of services has its seat or fixed establishment, provided that the recipient is registered for VAT in that country.

Similarly as with VAT, the Excise Tax Act is harmonised with the respective EU regulations. The tax is charged on certain supplies of goods, including intra-Community acquisitions and supplies of goods in Poland.

Excise tax is imposed on certain transactions performed by the taxable entity, such as transactions involving:

- import, intra-Community acquisition and first domestic sale of passenger cars that are not registered in Poland; and
- import, intra-Community acquisition, production or transfer to a tax warehouse, domestic supplies and use of certain engine fuels and gas, heating fats, oils and gas, coal products, other energy products, electric energy, and alcohol and tobacco products

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8 In principle, steel pipes for fuel and gas pipelines, fuels (except for fuels purchased at petrol stations) and gold (including gold sand and gold self-products).
listed in Attachment 1 to the Excise Tax Law, including the use of dried tobacco plant or goods exempted from excise tax because of their intended use if they are used contrary to their intended use.

Excise tax is calculated either as a percentage of the value of taxable goods (or their customs duty value) or as a flat fee per the quantity basis (fee per unit).

The refund rules in VAT and excise tax may change in 2019. It is expected that the tax authorities may deny the refund if the taxpayer has transferred the burden of tax on to clients. Otherwise, the tax refunds in VAT and excise tax may would then lead to unjust enrichment of the taxpayer.

Stamp duty is payable in nominal amounts on certain acts and documents, including:

- official applications;
- official acts;
- certificates;
- permits; and
- certain documents (e.g., powers of attorney presented in administrative and court proceedings).

Stamp duty rates are determined in relevant schedules to the Stamp Duty Act, and paid in cash or by a bank transfer.

Tax on civil law transactions is a capital (transfer) tax levied on certain civil law transactions and certain legal acts and their amendments, in particular, on the sale and exchange of goods and property rights agreements, loan agreements, on setting up a mortgage, establishing a corporate company or partnership, and increasing the company’s share capital, additional shareholder payments or loans. The tax is due if related goods are situated or property rights are exercised in Poland, or their purchaser has its residence in Poland, and the transaction itself takes place in Poland. With few exceptions, this tax is not payable if the transaction is subject to VAT, even though VAT-exempt.

Civil law transactions tax rates are either fixed or ad valorem. The rates include:

- 2 per cent of the market value of the subject of the transaction on the sale or exchange of real estate, perpetual usufruct right or movable goods;
- 1 per cent of the market value of the subject of the transaction on the sale or exchange of other property rights, including shares in companies;
- 0.5 per cent of the par value of the share capital on the establishment of a corporation or partnership or an increase in a share capital; and
- 2 per cent (0.5 per cent from 2019) of the principal amount of loans.

A number of tax exemptions apply, including a tax exemption on loans extended by a direct shareholder to its company and by non-residents of Poland conducting business activities that encompass the extending of loans. In addition, an exchange of majority shares in one company for new shares issued by another company is tax-exempt. The tax exemption also applies to an in-kind contribution of an enterprise or its organised part to the stated capital of a local capital company as well as to mergers or transformations of such local capital companies. According to a tax ruling issued by the tax authorities, a limited partnership issuing shares should be treated as a corporation, and that transfer tax exemptions pertaining to corporate mergers and restructurings should therefore also apply if they refer to a limited partnership issuing shares.
Local taxes include:

- real estate tax;
- transportation tax (imposed only on lorries and trucks);
- marketplace tax;
- agricultural tax;
- forestry tax;
- dog owner tax; and
- sanatorium tax.

Local self-governments are entitled to establish rates for certain taxes within the limits set by law. The most important local tax is real estate tax, which is paid annually (in monthly instalments) by an owner or possessor of real property and constructions, and their parts, including devices and equipment facilities, connected with business activities. For real estate used for business, the maximum tax rates in 2019 are 23.47 zlotys per square metre for buildings connected with business and 0.93 zlotys per square metre of land. In addition to statutorily defined exemptions, local self-governments may establish further tax exemptions and their conditions with a view to attracting investors and businesses to invest in certain regions of Poland. As from 2018, the local self-governments report to the Minister of Finance on the tax rates, tax base and exemptions applied in their regions.

Tonnage tax is imposed on navigation enterprises rendering international sea ship services in transportation of goods and passengers, sea tugboat and sea tow services, sea lifeboat and rescue services, deepening of the sea bottom, as well as certain other services connected with the foregoing, such as the sale of goods and services on ships, currencies exchange, management of passenger and cargo terminals, loading, unloading and reloading of cargo, and ship chartering. Tonnage tax is chargeable to the extent that the navigation enterprise uses ships with a tonnage gross (GT) capacity exceeding 100GT, and provided that it has elected to be the taxpayer of this tax instead of CIT for 10 years. The tax is chargeable at a rate of 19 per cent on total lump-sum income calculated as an aggregated product of the total net capacity (as determined in the international measurement certificate) of each ship used for the taxable services, and rates decreasing from €0.50 to €0.10 for each 100 tonnes of net capacity of each ship per day. In addition, such ship owners pay tax at a rate of 15 per cent of the gross proceeds from the sale of ships if such proceeds are not reinvested into the purchase, reconstruction or modernisation of ships within three years. They are exempted from CIT.

Gambling tax is imposed on businesses organising gambling activities (casino roulette, card games and gambling, bingo games, various lotteries, mutual bids, slot machines, etc.) under permit, except for promotion lotteries and poker tournaments; it is also imposed on individual participants in poker tournaments. Tax rates differ with respect to each gambling activity and game, and vary from 2.5 to 50 per cent of proceeds from given activities.

The inheritance and donation tax is levied on natural persons only, and depends on the tax bracket, which in turn depends on the degree of relationship between a donor and a donated party. The first two brackets pertain to relatives, and the third to other persons. The tax rates for the first bracket are 3 to 7 per cent; for the second, 7 to 12 per cent; and for the third, 12 to 20 per cent. There also apply tax exemptions regarding certain assets and regarding inheritance or donations of all assets between certain family members.

The tax on mines is imposed on copper, silver, crude oil and natural gas mining. For copper, the tax rate amounts to 0.033 x average copper price + (0.001 x average copper
price) 2.5, and applies to each tonne of copper mined by a taxpayer or included in copper concentrate produced by the taxpayer. For silver, the tax rate amounts to $0.125 \times \text{average silver price} + (0.001 \times \text{average silver price})$ 4, and applies to each kilogramme of silver mined by a taxpayer or included in silver concentrate produced by the taxpayer. If the average prices of copper or silver drop below the statutory determined thresholds, higher tax rates will apply, with a minimum tax rate of 0.5 per cent of the average price of copper or silver. From 2016, the tax is also levied on production of natural gas and production of crude oil. The tax is levied at ad valorem rates of 1.5 to 3 per cent for natural gas and 3 to 6 per cent for crude oil. In addition, a tax incentive rule entered into force according to which the tax may be reduced by 19 per cent of tax losses that could not be deducted for income tax purposes. The tax should be declared and paid to the proper tax office for each month within 25 days of the following month.

On 1 January 2016, a special hydrocarbon tax was introduced in Poland. This tax is levied on profits of natural and legal persons, and organisational units without legal personality, including civil law partnerships, derived from hydrocarbon extraction businesses such as shale gas and oil exploration. The tax rates range from zero to 25 per cent depending on the ratio of gross income derived from hydrocarbon extraction business to qualified expenses of such business. Taxpayers have to pay monthly tax advances for each calendar month by the 25th day of the next month.

In 2016, a new tax on certain financial institutions was introduced. The tax applies mainly to Polish banks, insurance institutions and branches of foreign banks and insurance institutions. The tax is levied on the accounting value of assets exceeding a statutory threshold of 4 billion zlotys for banks and 2 billion zlotys for insurers. The value of assets constituting a tax base is calculated jointly for all affiliated insurance institutions liable to the tax. The tax is charged at a rate of 0.0366 per cent monthly.

In 2016, the new Act on Tax on Retail Sales was adopted by Parliament. The tax applies to the revenues of retailers. A monthly surplus of such revenues over 17 million zlotys is subject to tax at a rate of 0.8 per cent, and a monthly surplus of revenues over 170 million zlotys is subject to tax at a rate of 1.4 per cent. However, owing to the European Commission's objection to the tax, its collection has been suspended until 31 December 2019.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

Companies, other legal persons, limited partnerships issuing shares and organisational units without legal personality (e.g., tax units), except for other partnerships, are taxpayers liable to CIT. Taxpayers having their seat or place of management in Poland are tax residents liable to CIT on their worldwide income. Other taxpayers are non-residents liable only to tax on income derived in Poland unless an applicable DTT states differently. An entity incorporated outside Poland may become a Polish tax resident if its place of management is relocated to the territory of Poland. Conversely, a locally incorporated entity may cease to be a Polish tax resident if its place of management is relocated from Poland to another jurisdiction. To determine under Polish rules where an entity has its place of management, one must look at where the entity is actually managed (namely, where decisions regarding the entity's matters are actually taken). It is a question of facts rather than law. Any legal deeds or other formal indicators of a place where the entity is managed and where decisions are made (e.g., relevant rules in articles of association or management agreements executed with the entity) may be
considered by the tax authorities, but they are neither final nor prevailing in determining the place of management. In practice, however, there exists no tax or court ruling in which local tax authorities would claim that a given entity became or ceased to be a Polish tax resident owing to the relocation of the place of its actual management. Nevertheless, the place of actual management may be effectively moved for tax purposes. In many cases, such movement could not be challenged by the tax authorities of the exit jurisdiction, since many DTTs executed by Poland state that in cases of disputes regarding where a corporate taxpayer is tax resident, it must be considered a tax resident of the contracting state in which it has a place of management.

A company incorporated in any EU Member State, including SEs, may also become Polish tax residents, and a company incorporated in Poland may relocate to another EU Member State by way of a statutory merger between such companies. SEs and SCEs may also move their corporate seat between EU Member States. Another Polish company would have to open a liquidation procedure if it decides to move its seat to another country.

In Poland, no corporate immigration or emigration taxes were levied on entities that became or ceased to be Polish tax residents. However, as of 2019 Poland introduced exit tax, as part of Polish corporate tax. Exit tax is imposed on unrealised gains in cases where, in connection with the following events, Poland would not be able to impose CIT on income that would be realised from sale of assets in the future:

- relocation of the corporate taxpayer’s seat (place of management) from Poland to another jurisdiction;
- relocation of corporate assets from Poland to another jurisdiction;
- gratuitous transfer of assets located in Poland to any Polish or foreign entity; or
- in-kind contribution of assets to an entity other than a corporation or a cooperative.

The exit tax should apply at a rate of 19 per cent to a surplus of the fair market value of assets of the CIT payer being relocated from Poland over costs that would be deductible, were such assets sold before their relocation from Poland.

ii Branch or permanent establishment

A foreign entrepreneur has its fiscal presence in Poland and is liable to Polish income tax if it derives income locally through its PE in Poland within the meaning of local definitions or a pertinent DTT. A PE is defined as a fixed place where the business activity of the foreign entrepreneur is conducted, in part or in whole, in Poland. A PE is created, in particular, if the foreign entrepreneur has a place of management, a branch office or a workshop in Poland.

PEs frequently take the form of a local branch office. A locally registered partnership of one or more of its non-resident partners may also constitute their PE. A PE may also be created without such formal presence in Poland, in particular where a foreign entrepreneur seconds to Poland an employee authorised to conclude agreements in Poland on behalf of the foreign entrepreneur, and such individual customarily exercises such authorisation.

In practice, activities of a foreign entrepreneur will create a PE if they are conducted in Poland permanently. Therefore, such establishment does not exist if activities generating local income are performed outside Poland on a permanent basis rather than in Poland. However, neither Polish domestic regulations nor DTTs define the permanency of such local activities; thus, activities conducted for a few months (e.g., six months) may create a PE. For
example, pursuant to a court judgment, cross-border advisory and other services of a Japanese company aimed at the implementation in Poland of a licence granted to a Polish company constitute a local PE within the meaning of the Poland–Japan DTT.

Owing to the protection of DTTs executed by Poland, the PE condition may not be enough to tax local income of the foreign entrepreneur. With few exceptions, most DTTs require that tax authorities prove a nexus between the local business activities of the PE and any items of income derived by the entrepreneur in Poland. In the absence of such nexus, no item of local income may be taxed. However, a few treaties, such as the DTT between Poland and Italy, set forth the presumption that one must assume that such nexus exists between the PE and all items of income (if any) derived by that taxpayer in Poland, unless the taxpayer proves the absence of such nexus with a given item of local income.

In addition, DTTs executed by Poland provide which local permanent activities and places may not be considered to be a PE. Although such activities and places differ to some extent, Polish tax treaties are based on the OECD Model Convention; therefore, such definitions are similar in all treaties. In general, a fixed place of business in Poland does not constitute a PE if it constitutes a construction site or installation for a certain period (usually lasting not more than 12 to 18 months), or if the fixed place is designated solely for the storage or delivery of products, or the purchase of goods or gathering of information (or for the combination of some or all of these). In the absence of a DTT, most such activities would constitute a PE, and any income generated by the taxpayer from such activities would have to be taxed in Poland.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

2018 brought a big change to the Polish system of tax incentives, which until 5 September 2018 were available only with respect to investments located within the territories of SEZs. Now, under the new Act on supporting of new investments and secondary legislation issued on its basis, the entire territory of Poland has become the SEZ eligible for basically the same kind of support (i.e., income tax exemption). This means that the main barrier – the need to locate a new investment in the SEZ – is no longer present. Also, under the new regulations, the investors that have already obtained state aid within the ‘old’ SEZ scheme may still enjoy such aid and utilise the tax exemption granted to them (however, only until the end of 2026, when the SEZs will finally cease to exist).

According to Article 17, Section 1, Item 34 of the CITL, income derived from economic activities conducted in the Polish territory under a ‘decision on support’ (i.e., a decision issued under the new Act on supporting of new investments) is tax-exempt. The main purpose of this new scheme is to encourage investors to invest in new ventures, irrespective of the investment’s location. In return, an investor is permitted to deduct a specific percentage (depending on pertinent regulations, up to 50 per cent) of its qualified investment outlays and costs incurred in the SEZ (eligible expenditures) from the amount of income tax. The investor must obtain a prior decision on support from the Minister of Entrepreneurship and Technology, under which the state aid with respect to the new investment is granted. The investor may benefit from the CIT exemption on the ground of costs borne for a new (initial) investment, or on the ground of costs borne for the creation of workplaces for new employees. The CIT exemption may be cancelled as a result of cancellation of the decision on support if the investor ceases to perform the business activity defined in the decision, or

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flagrantly violates conditions specified in the decision or fails to redress infringements thereof within the deadline set by the Minister. The new regulation provides a list of activities that may not be covered by the decision on support and, consequently, by the tax exemption, including:

a. administration and supporting services (such as those related to office administration services – e.g., preparation and copying of documents, post services such as emails and answering telephones), except for call centre services, which are explicitly authorised to be performed in SEZs;
b. professional, science and technical services (e.g., legal and tax advisory, management advisory, head office, advertising and translation services);
c. financial, insurance and real estate transactions;
d. certain licence services related to books, brochures, maps, magazines, computer games, software, etc.;
e. military services;
f. film, video and television production;
g. waste management services;
h. construction services; and
i. certain other services that are also excluded from state support.

In addition, costs of investments not successfully closed can be fully deducted by a taxpayer on the date of the sale or liquidation of investments. The disposal of investments should be documented with an invoice or a bill, and the liquidation of investments should be documented with a memorandum (protocol) of liquidation.

In Poland, any foreign income items may also be income tax-exempt under a pertinent DTT. If a tax treaty is silent as to the exemption, or in absence of a treaty, foreign income tax may be credited against Polish tax on the same item of income (see Section VI.iv).

It must be also noted that unlike the SEZ rules, the new legislation introduces additional conditions of applying for state aid: quantity and quality criteria.

Quantity criteria are the minimum amount of investment expenditures that must be reached in order for an investment to qualify for support. This minimum amount of investment varies depending of the unemployment rate in the area where a project is to be located and the type of the investor (lower thresholds are available to small and medium-sized enterprises).

The quality criteria include such aspects of the investment as creation of specialised jobs, employment predominantly on the basis of employment agreements, the research and development component, cooperation with academic and research centres and with industry schools, contributing to the development of industry clusters, and location of investments in the territories that are most in need of support, have the highest unemployment rate, etc.

Only an investment that meets both the applicable quantity criterion and the quality criteria (in a sufficient number, also varying depending on location) can obtain support.

i. Holding company regimes

Inbound and outbound dividends, capital gains, and other local or foreign income derived by local holding corporations or their non-resident shareholders, are subject to income taxation at a rate of 19 per cent and, in certain cases, tax exemptions or tax credits. The basic characteristics of a local special holding company tax regime are as follows:
ii IP regimes

According to the new rules, a taxpayer is entitled to deduct part of the costs incurred in R&D activities from its taxable income. The expenditures eligible for deduction include 30 per cent of the salaries of employees engaged in R&D activities, and 20 per cent (for small and medium-sized enterprises) or 10 per cent (for other enterprises) of other R&D-related costs (e.g., materials, research data, use of scientific apparatus), including depreciation write-offs. The relief does not apply to taxpayers operating within SEZs. The tax incentive for R&D activities replaces the previous incentive system involving the deduction of costs for the purchase of new technologies available under the legislation that was in force before 2016. The previous incentive entitled taxpayers to deduct 50 per cent of costs incurred in the acquisition of new technologies (e.g., software licence, research data). Taxpayers who obtained a right to the tax deduction under the previous legislation may continue to make deductions until the existing deduction is utilised in full.

From 2019 the Innovation Box tax relief applies, in addition to the existing R&D relief referred to above. Namely, eligible incomes of CIT payers carrying out R&D activities directly connected with creation, development or improvement of the ‘qualifying IP right’ is subject to CIT at a rate of 5 per cent, instead of the standard rate.

The following income is the eligible income under the Innovation Box:

a. licence fees for the qualifying IP right;
b. income from sale of the qualifying IP right;
c. a value of the qualifying IP right included in the sale price of a product or a service (transfer pricing regulations apply accordingly); and
d. compensation for infringement of the qualifying IP right if obtained in the course of litigation, including court or arbitration proceedings.
The taxable base at the rate of 5 per cent is the sum of the eligible incomes from the qualifying IP rights, less direct costs incurred by the CIT payer for purchases of the qualifying IP rights or for R&D activities related to creation, development or improvement of the qualifying IP rights during a tax year.

Costs of the same R&D works may be deducted simultaneously within the confines of both the Innovation Box and the existing R&D relief referred to above (where the total R&D costs are also deductible from ordinary income taxed at 19 per cent) and, therefore, the tax savings may be even bigger.

The qualifying IP rights comprise the following rights: patents, utility model protection, an industrial design, rights to topography of an integrated circuit, additional rights to a patent for a medical product or a plant health product, rights to new varieties of plants and breeds of animals, and copyrights to software provided that they are subject to legal protection under laws or ratified international agreements in Poland.

A loss on the activities subject to the Innovation Box relief may be carried forward for five consecutive tax years. A loss from a qualifying IP right may reduce incomes derived only from the eligible income derived from the same qualifying IP right, the same type of product or service, or the same group of products or services in which the qualifying IP right was used.

The condition for application of the relief is also to keep accounting records that should allow a CIT payer to determine the eligible income, tax-deductible costs, income (loss), attributable to each qualifying IP right, under pain of payment of 19 per cent tax in the event the records are kept improperly.

iii State aid

On 5 July 2011, the Council of Ministers adopted the Scheme Concerning Support for Investments of Material Significance to the Polish Economy for the period from 2011 to 2020 (Scheme), which was subsequently amended on 22 July 2014, on 27 October 2014 and on 8 June 2016 (when the Scheme was extended from 2020 to 2023). The purpose of the Scheme is to increase innovation and competitiveness in the economy through cash grants awarded to Polish and foreign companies. The cash grants under the Scheme are to be awarded until 2019 for a maximum period of five years, and the Scheme will end in 2023. The Scheme’s overall budget is approximately 1.5 billion zlotys.

Under the Scheme, funds may be granted to support high-value investments or the creation of new workplaces to entrepreneurs planning investment in priority sectors such as aviation, the car industry, electronic equipment manufacturing (e.g., computers, home appliances, television, radio and telecommunication devices), biotechnology, agrifood, R&D or ‘modern’ business services, including IT processing and advanced IT processing management, knowledge management, IT consulting, engineering centres and also certain business processes, and in the ‘significant investment’ in any sector (see below).9

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9 For example, HR management, accounting and tax services, risk management, hedging, netting and certain other services.
To qualify for support for the creation of new jobs, the investor should make at least one of the following investments:

- a new manufacturing investment in priority sectors offering at least 250 new jobs with a minimum investment of 40 million zlotys;
- a significant new manufacturing investment offering at least 500 new jobs with a minimum investment of 500 million zlotys, or offering at least 200 new jobs with a minimum investment of 750 million zlotys (significant investments);
- a new investment in the 'modern' services sector offering at least 250 new jobs with a minimum investment of 1.5 million zlotys; or
- a new R&D investment creating at least 35 jobs for employees with higher education degrees with a minimum investment of 1 million zlotys.

To qualify for support for new investment, the investor should carry out at least one of the following investments:

- a new investment in priority sectors offering at least 50 new jobs for employees with a minimum investment of 160 million zlotys;
- significant investments; or
- a new R&D investment creating at least 35 jobs for employees with higher education degrees with a minimum investment of 10 million zlotys.

Cash grants for significant investments may be awarded for periods exceeding five years, but only until 2023. No cash grants may be awarded for any investments in areas where the unemployment rate is below 75 per cent of Poland’s average unemployment rate, except for investments in R&D, 'modern' services, significant investments or, in certain eastern parts of Poland, investments in 'priority sectors'. In principle, it is not possible to combine cash grants awarded under the Scheme in an amount higher than 3 million zlotys with other regional cash grants originating from the state budget, CIT exemptions available in SEZs or EU grants, except for cases of cash grants for significant investments or in the R&D sector, or where the value of an investment in other priority sectors equals or exceeds 350 million zlotys or if an investor creates 500 new jobs in the 'modern' business services sector. Any deviation from this rule requires the consent of the Polish Council of Ministers.

Investors whose investments meet the above criteria may apply on a standard form to the Polish Agency of Investments and Trade (PAIH). The application is assessed by PAIH, the Inter-ministerial Committee for Investments of Material Significance to the Polish Economy and the Ministry of Economic Development. The decision of whether to award cash grants under the Scheme is discretionary; however, the Scheme defines the criteria for assessing the investment parameters for the purposes of calculating available support.

Poland-based companies, either within or outside SEZs, may under certain conditions benefit from horizontal state aid instruments for legitimate purposes (mainly employment and training). State aid for employment is, as a rule, designed to reimburse companies for part of the costs of employment or training of selected categories of persons (namely, employees, unemployed persons delegated by local labour offices, and disabled and disadvantaged persons).

Incentives are granted in Poland in compliance with the EU state aid rules. The maximum regional aid intensity available for investors varies from 15 per cent (in Warsaw) to 50 per cent (mostly in the eastern part of Poland).
iv General

The following all make Poland a very attractive jurisdiction for business development, acquisition and operation:

a domestic tax legislation harmonised with EU tax law;
b the low 19 per cent CIT rate;
c the income tax exemption offered for activities conducted in SEZs;
d the real estate tax exemption offered by local self-government bodies in many areas of Poland;
e broad state aid programmes for new investments;
f the advantageous tax treatment of IP technologies, R&D and unsuccessful investments;
g Poland’s attractive geographical location in central and eastern Europe; and
h the government's attempts to soften the adverse impact of the economic depression of other countries on Poland’s economy to maintain economic growth.

In addition, the extensive network of DTTs and the attractive foreign tax credit system, including the foreign full tax credit for dividend withholding tax and underlying tax, allow for the effective elimination or sufficient reduction of the total international and local tax burdens on income derived from Poland-based holding companies and on foreign income derived from Polish companies.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)

Withholding tax at a rate of 19 per cent applies to outbound dividends and other income from participation in corporate profits, and withholding tax at a rate of 20 per cent applies to outbound interest and royalties. Other income from participation in corporate profits includes income from share capital reductions, company liquidations, redemptions of corporate shares (except for their voluntary redemption via a transfer of shares to a company, qualified as taxable capital gains), and other income from shares (e.g., bonus shares or shareholders’ income from companies mergers and divisions) or other equity titles in legal persons. Payments of profits by limited partnerships issuing shares (which have been taxpayers since 2014) to general partners and shareholders of such partnerships are also subject to dividend withholding tax at a rate of 19 per cent.

Domestic compliance rules for the settlement of local withholding tax on cross-border interest and dividend outbound payments from securities registered on an omnibus account maintained for foreign investors also apply.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

Poland has implemented into domestic tax law Council Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, which sets forth, inter alia, the ‘participation exemption’. Accordingly, payments of outbound dividends and certain other income from participation in corporate profits of a Polish corporation are exempt from local dividend withholding taxation provided that:
a the recipient of the payment is a company that is a tax resident of any EU Member State, Switzerland or EEA Member State, provided the recipient is not entirely tax-exempt as regards its worldwide income, and has a legal form indicated in an attachment to the above Directive or is such company’s PE also located in one of the above-mentioned states;

b the recipient of dividends holds at least 10 (in the case of Switzerland, 25) per cent of shares in the Polish corporate subsidiary for an uninterrupted period of two years, even if this minimum holding period expires after the dividends were paid; and

c prior to the payment of dividends or other corporate profits, a tax certificate is delivered by the recipient of the income to the Polish subsidiary; such certificate must be issued by the former’s pertinent foreign tax authority to confirm that the recipient is a tax resident of an EU Member State or another state referred to above.

Pursuant to a judgment of the local court, the dividend withholding tax exemption may still apply, although the minimum two-year holding period elapses after a merger of a parent company from an EU Member State with its general tax successor (being another EU company referred to in the above Directive). In another judgment, the local court stated that although a local general partnership is tax transparent and is a permanent establishment of its corporate partners from other EU States, dividends paid by a Polish company to such permanent establishment may not be subject to the Polish dividend withholding tax exemption; such exemption requires that dividends be paid to a company holding shares in the Polish company directly, while the corporate partners in the partnership do not hold directly the shares in the Polish company paying dividends.

In limited partnerships issuing shares, the above dividend withholding tax exemption applies only to profits paid to shareholders. In turn, general partners (and not shareholders) may credit the CIT of the partnership (according to their participation in the partnership’s profits) against withholding tax on profits distributed to them within the next five consecutive years.

From 2016, the dividend withholding tax exemption may not apply to dividends and other income from participation in corporate profits if they result from a transaction or series of transactions lacking business reasons and aimed solely or mainly at obtaining the tax exemption rather than at avoidance of double taxation of corporate profits.

Poland has also implemented Council Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States. In particular, payments of outbound interest and royalties are exempt from withholding taxation. The withholding tax exemption as from July 2013 applies to outbound interest and royalties as long as:

a the recipient and payer of interest or royalties are associated companies where one company holds directly at least 25 per cent of shares of the other company, or another company holds directly at least 25 per cent of shares of both the payer and the recipient of interest or royalties, or the payer or recipient (or both) is a PE of any of such associated companies;

b the above minimum 25 per cent holding of shares lasts for an uninterrupted period of two years, even if this minimum holding period ends after the payment of interest or royalties;
the recipient of interest or royalties is a tax resident of any EU or EEA Member State or Switzerland, provided the recipient is not entirely tax-exempt as regards its worldwide income, or it is such tax resident’s PE located in another EU or EEA Member State or Switzerland; and

d prior to the payment, the recipient of income delivers its tax residence certificate issued by its pertinent foreign tax authority to confirm that the recipient is a tax resident in the EU Member State or Switzerland, or is such tax resident’s PE that is also located in another EU Member State or Switzerland.

The existing withholding tax exemptions of outbound dividends, interest and royalties, paid mainly to recipients from the EU, the EEA and Switzerland referred to in Section VI.ii are limited to situations where Poland may claim the exchange of information from tax authorities of the country of the foreign recipient of income pursuant to a pertinent DTT.

As of 2019, Poland introduced new compliance rules for collection of withholding taxes on cross-border payments of dividends, interest, royalties and intangible services. The new rules provide for some restrictions that impede application of exemptions and reduced rates to payments of WHT, including:

a keeping the existing principles of collection of the tax in case of cross-border payments not exceeding 2 million zlotys for amounts due to one taxpayer in a given fiscal year;

b an obligation to collect the tax in the full amount on the aforementioned payments over 2 million zlotys, without applying any exemptions or reduced rates as provided for in DTTs and the CIT Law;

c the taxpayer or withholding tax agent will be able to apply with the tax authority, through a different procedure, for a refund of the tax withheld; such a procedure will include but not be limited to examining whether:
• the actual recipient of the payments is a CIT payer in his or her country and carries out a real business activity; and
• any prerequisites exist to apply GAAR;

d the tax refund deadline is to be six months and it can be extended; and

e exceptions to the above full withholding tax at the domestic rate will apply only if:
• upon the taxpayer’s request, the tax authority issues, within six months, an opinion on application of the WHT exemption by the taxpayer; or
• under pain of criminal responsibility, the tax withholding agent declares that they have verified the beneficial owner of the payments and have been in possession of proper documents to prove non-collection of the tax or collection of the tax in the reduced amount.

In the case of payments of dividends and other proceeds from participation in corporate profits between domestic entities, analogous rules of collection and refund of the WHT will apply.

### Double tax treaties

Local interest and royalty withholding taxation at a rate of 20 per cent, and dividend withholding taxation at a rate of 19 per cent, may be reduced to 10 or 5 per cent, or even eliminated, in compliance with a relevant DTT. Pursuant to a judgment of the local court, after assignment of a loan by a bank to a third-party acquirer of the loan a typical DDT interest withholding tax exemption for loans extended by banks may still apply to interest
paid by the acquirer of the loan provided that the acquirer of the loan is also a bank. A foreign recipient of such payments should deliver a tax certificate from its respective tax authorities to confirm that it is a tax resident of the other contracting state under the meaning of the tax treaty. According to new legislation, such certificate is valid for one year only unless it indicates another period, and the same recipient of income should deliver a new tax certificate for each tax year in which it receives a payment falling under local withholding taxation. According to administrative courts, cross-border interest may be subject to a treaty withholding tax rate provided that a beneficial owner of the interest is a tax resident in a treaty state.

In turn, most of the 92 DTTs executed by Poland provide that Polish income taxation of inbound dividends, interest and royalties may be reduced through foreign tax credits on such income (not higher, however, than the Polish tax due on the same item of income). In addition, the Poland–Luxembourg DTT, which exceptionally provided for the tax exemption of foreign inbound dividends, whereby a Luxembourg company’s dividends that are subject to Luxembourg dividend withholding taxation are Polish tax-exempt, changed as from 2013. Now, the Luxembourg dividend withholding tax may only be credited against the Polish dividend withholding tax.

iv Taxation on receipt

Dividends, interest and royalties are taxed on a cash basis. Dividends paid between local corporate companies, or by a foreign corporate company tax resident in any EU or EEA Member State or Switzerland, are exempted from Polish income taxation if the Polish recipient of dividends holds at least 10 (25, in the case of a Swiss subsidiary company) per cent of shares in a subsidiary distributing dividends for an uninterrupted period of two years, even if this minimum holding period expires after the payment of dividends. However, foreign income derived from hybrid instruments is excluded from the Polish inbound dividend tax exemption.

The dividend tax exemption may not apply to dividends and other income from participation in corporate profits if they result from a transaction or series of transactions lacking business reasons and aimed solely or mainly at obtaining the tax exemption rather than at avoidance of double taxation of corporate profits.

Any inbound dividends, interest, royalties and other items of foreign income may also be exempt from Polish income taxation if a pertinent DTT provides for such an exemption. Whenever a tax treaty provides otherwise, or in the absence of a treaty, foreign income tax may be credited against Polish tax. Such credit, however, may not exceed the Polish income tax on the same income.

Polish companies receiving foreign (inbound) dividends in Poland may credit against Polish CIT foreign dividend withholding tax, as well as foreign corporate tax paid by a foreign corporation on its profits out of which such dividends were paid out (full tax credit for underlying tax). The foreign underlying tax may also be credited against Polish tax on other foreign income, not only dividends. As a result, in many cases there would be no corporate tax in Poland, since the 19 per cent Polish tax rate is lower than tax rates in many countries. The Polish tax credit for the underlying tax, however, applies only with respect to foreign tax of a foreign subsidiary being a tax resident in countries other than the EU, EEA Member States and Switzerland, having a DTT with Poland, and provided that the Polish corporation holds at least 75 per cent of shares in the foreign company distributing dividends for an uninterrupted period of two years, even if this minimum holding period expires after the payment of dividends. The scope of the foreign tax credit referred to above, including the
tax credit for foreign dividend withholding tax and underlying tax, is also granted in the case of Polish taxation of foreign income derived through a Poland-based PE of a company from the EU or EEA Member State, pursuant to a pertinent DTT.

The existing tax credit on foreign inbound income referred to here is limited to situations where Poland may claim the exchange of information from tax authorities of the country of the source of foreign income pursuant to a pertinent DTT.

VII TAXATION OF FUNDING STRUCTURES

In practice, local companies are usually financed with a mix of equity contributions (both in cash and in kind) and typical loans from shareholders or third parties, or through bonds issued to shareholders or third parties. Sometimes, companies also obtain ‘additional shareholder cash contributions’, which in principle are required to be paid to cover accounting losses of the company, but may also be used to finance operations of the company in other situations, and may be returned to shareholders to the extent that they are not required to cover company losses.

i Thin capitalisation

The CITL provides for restrictions with respect to interest paid by the Polish subsidiary on borrowings (loans) extended by qualified related lenders. Such interest is not tax deductible to the extent that the loans from qualified lenders exceed the borrower’s (Polish subsidiary) equity. Qualified lenders are a shareholder or shareholders directly or indirectly holding at least 25 per cent of the voting stock in the share capital of the borrower; or sister companies, where the same shareholder directly or indirectly holds at least 25 per cent of the voting stock in the share capital in each of those companies.

Interest on part of such a loan or loans exceeding the 1:1 debt-to-equity ratio is not deductible, but for local withholding taxation it should still be qualified as interest rather than dividends. The debt-to-equity ratio should be calculated on the last day of the month preceding the month of interest payment. A definition of the loan covers not only typical loan agreements regulated in the Polish Civil Code, but also any agreement for payment of the amount that will subsequently have to be returned, including debt securities, irregular deposits and deposits (except for derivatives). However, according to administrative courts, commercial credits resulting from deferred payment terms of purchases of goods and services from a shareholder do not qualify as shareholder loans, and interest thereon should not be subject to thin capitalisation rules.

Recent case law confirms that interest is not deductible under thin capitalisation rules if paid to a qualified lender under a loan extended by the same or other qualified lender; however, transfer of such a loan by the qualified lender to a third party (or vice versa) before payment of interest does not restrict interest deductions. Accordingly, owing to the narrow scope of qualified lenders, the impact of the thin capitalisation rules on the financing of local companies with intercompany loans is very limited.

Taxpayers may select not to apply the above thin capitalisation rules on condition of notifying the tax office. Subsequently, for at least a three-year period, they will have to apply an alternative interest deduction regime, according to which interest paid on any loan (whether from a related or non-related party) may not be deducted to the extent a sum of interest payments exceeds the statutorily determined percentage of the value of the borrower’s assets (reduced, however, by depreciable intangible assets). The new rules set the percentage
of the assets limiting interest deductions as the reference interest rate announced by the National Bank of Poland (which is currently 1.5 per cent) increased by 1.25 per cent. A surplus of interest over such limitation may be deducted over the next five consecutive tax years with other deductible interest to the extent of the aforesaid limitation.

ii Deduction of finance costs
Interest, discounts and other financial costs are deductible when they are actually paid or capitalised – that is, added to a principal amount of debt without payment. Interest that is not at arm’s length may be challenged by the local tax authorities. Interest and other costs of financing acquisitions of shares and other securities may also be deducted, including situations of pushing debt down, where interest on the parent company’s debts used to finance a purchase of shares in a subsidiary where companies subsequently are merged is deducted, after the merger, from taxable profits generated by the merged subsidiary’s business.

Interest and other costs of financing acquisitions of depreciable fixed and intangible assets accrued until the day of placing a fixed asset into service are subject to depreciation write-offs. Such costs of financing acquisitions of depreciable fixed assets accrued after that day may be deducted according to general rules.

From 2018, CIT taxpayers, including local branches of foreign enterprises, are obligated to exclude from tax-deductible costs, a surplus of their all debt financing costs over their interest income (if any), to the extent to which such surplus exceeds 30 per cent of their EBITDA in a given fiscal year.10 The new tax rules widely define costs of debt financing as any and all explicit or hidden costs of financial transactions, including interest, capitalised interest, fees, commissions, bonuses, interest-bearing part of a leasing instalment, penalties and fees for delay in payment of liabilities, and costs of securing receivables and payables (including costs of financial derivatives), securities lending and REPO transactions, regardless of who is a beneficiary of financing costs. In turn, they narrowly define revenues as the interest income (only), which will contribute to the increase in the amount of tax non-deductible costs. The limitation of tax-deductible costs also refers to costs of financing payable to either related entities or entities not related to the taxpayer or, to both. The limitation does not apply to: banks, brokerage houses, investment funds and other regulated entities in the financial services market. The amount of costs not deducted in a given fiscal year is deductible in the consecutive five fiscal years, within the cap applicable in particular years.

iii Restrictions on payments
Tax rules do not prevent dividend payments, which are not restricted by corporate law provided that they are not paid from the company’s net assets required to fully cover the par value of the share capital. Dividends may amount to the aggregated company’s profits from the last accounting year and retained earnings from previous years. Dividend payments must, however, be decreased by losses, the equivalent of treasury shares and write-offs from the company’s profits to reserve and supplemental capitals, as required by the articles of association or law.

If dividends are formally declared by a company, but not actually paid to shareholders, such dividends, as shareholders’ funds deposited gratuitously with the company, may be a source of imputed income equal to interest on a hypothetical banking loan that otherwise would be taken by the company from a bank.

iv  Return of capital
The equity capital may be repaid to the company’s shareholders as a result of capital reduction or redemption of (almost) all or some of the shares in the company. In both cases it is tax-neutral for shareholders up to the amount of the share purchase costs; only a surplus is taxable. Whenever new shares were issued in exchange for an in-kind contribution, their purchase costs may not exceed the fair market value of the in-kind contribution. In any case, losses from the capital reduction or redemption of shares are not deductible.

VIII  ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES
i  Acquisition
Most frequently, non-local companies acquire local businesses by virtue of acquisition of existing or new shares in a local corporation operating a business. In the former case, a purchase of shares is subject to capital tax (tax on civil law transactions) at a rate of 1 per cent. In the latter case, such tax is payable at a rate of 0.5 per cent by the local corporation. In addition, acquisition of new shares issued by the company in exchange for a cash contribution to the local corporation is frequently used to eliminate tax on capital gains that arises for sellers in cases of purchases of existing shares. In particular, sellers may reduce the share capital or redeem their existing shares in the corporation for a consideration to be paid by the corporation out of cash contributed for the new shares by the investor, instead of selling the existing shares to the non-local purchaser directly. In this case, the consideration for the sellers qualifies as dividend-like income that may be tax-exempt if the seller holds 10 per cent of shares in the corporation for an uninterrupted period of two years ending even after the redemption of old shares. Since 2011, the tax legislation has limited this solution to a reduction of the share capital and certain types of redemption of corporate shares; the transfer of shares to the company for the purposes of their redemption is excluded from this solution.

Acquisitions of shares in local corporations are frequently financed with intercompany or third-party loans, and often such acquisitions are followed by a merger (also cross-border) between the acquiring and target companies. According to existing tax rulings, interest paid on a banking loan extended for financing share purchase costs should not be capitalised and may be deducted on a current basis. Consequently, after the merger, interest on such loans may be deducted from the taxable profits of the target company's business.

Owing to attractive tax treatment, foreign and local investors also used Poland-based close-ended investment funds, qualified foreign-regulated mutual investment funds, and regulated investment companies from the EU and the EEA to acquire shares in local businesses. Although such funds or regulated companies may not conduct operational business activities directly, they may invest in real property, in shares issued by local and foreign companies and limited partnerships issuing shares, and in other securities. They were entirely exempt from Polish CIT on any local and foreign income. Therefore, if they invested in shares issued by a local or foreign partnership that is tax-transparent in Poland, no CIT was levied on profits derived through the partnership in proportion to interest held by such a fund in the partnership.
In 2014, Polish limited partnerships issuing shares ceased to be tax-transparent (with certain exceptions applicable until the end of October 2015) and become CIT taxpayers pursuant to new tax rules. Therefore, investment funds transfer investments from Polish limited partnerships issuing shares to other Polish partnerships in which they hold interest through other tax-transparent entities, including foreign partnerships (e.g., Luxembourg tax-transparent special limited partnerships or Dutch limited partnerships). However, from 2017, this general tax exemption of qualified foreign-regulated mutual investment funds was narrowed significantly, and their profits paid by local and foreign tax-transparent partnerships are excluded from this tax exemption (see Section II.i). In particular, interest, donations and profits paid to such investment funds by local and foreign tax-transparent partnerships and capital gains from transfers of securities issued by such partnerships are excluded from the tax exemption. In addition, the new tax exemption for qualified foreign-regulated collective investment funds from the EU and the EEA is limited to situations where Poland may claim an exchange of information from the tax authorities of the country of such fund pursuant to a pertinent DTT or other treaty.

ii Reorganisation

Poland has implemented Council Directive 133/2009/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States, and to the transfer of the registered office of an SE or SCE between Member States as regards both cross-border and domestic mergers, demergers and other corporate reorganisations determined in the Directive. Accordingly, pursuant to the CITL, a merger of companies from Poland or other EU Member States is tax-exempt for both the merging companies and their shareholders, except for upstream mergers when the acquiring company holds less than 10 per cent of voting rights in the target company. According to a tax ruling issued by the tax authorities, a cross-border downstream merger between a Polish acquiring subsidiary and its German target parent is tax-exempt under local tax rules even if the Polish acquiring subsidiary grants its treasury shares acquired upon merging to shareholders of the target company, instead of issuing and granting its new shares. The same exemptions apply to a company demerger, provided, however, that all assets and liabilities of the demerged company are divided into two or more parts, each representing a separate organised part of the enterprise. Otherwise, a demerger will be taxed as a sale of assets by the demerged company and a sale of shares by its shareholders.

The above tax exemptions apply assuming that the merger or demerger is pursued for justified business (non-tax) reasons, and where tax avoidance is not the main or one of the main merger drivers. Pursuant to the tax authorities, only statutory mergers of capital companies are tax-exempt; therefore, in the event of the merging of a local tax-transparent partnership into a capital company, shares acquired in exchange for the business of the merging partnership by a partner in such a partnership constitute taxable income of such partner.

If a company contributes in-kind a majority of shares in a company to another company in exchange for shares of the latter company, whether as a domestic or cross-border exchange, such an exchange of shares will be exempt from CIT (19 per cent) and capital tax (0.5 per cent) if all such companies are tax resident in Poland or other EU Member States. In addition, in-kind contributions of an organised part of an enterprise are exempt from corporate and capital taxes.
From 2011, an enterprise conducted by a natural person may also be transformed into a corporation in a tax-exempt manner. According to the tax authorities, the transformation of a corporate (capital) company into a local partnership is subject to CIT at a rate of 19 per cent on the retained profits of such company. On the other hand, the transformation of a local partnership into a corporate (capital) company is not subject to CIT.

However, the general tax succession applicable to the tax rights and obligations of the acquired company in cases of statutory company mergers and demergers does not cover protection arising from a tax ruling. According to a recent court judgment, nonetheless, a general tax successor may benefit from a tax ruling issued to an acquired company if the acquired company complied with such ruling before the merger.

iii Exit

A non-local investor may exit from a Polish corporate company by selling shares in such a company. Most DTTs executed by Poland exempt capital gains from such sale from Polish income tax, except for some treaties allowing for taxation if the company holds mainly real properties. Alternatively, the investor may redeem the shares for consideration that in certain cases may be considered dividend income that is tax-exempt or taxed at a lower treaty rate according to rules referred to in Section VI.i–iii. Pursuant to a judgment of the local court, in a case of a transfer of shares to a company against remuneration in order to redeem the shares, a shareholder who transfers the shares may deduct losses resulting from share purchase costs exceeding such remuneration.

Such an investor may also exit from Poland by relocating a Polish company, including an SE, to another EU Member State by way of a statutory merger with a company in such other EU Member State. The SE may also move its corporate seat between the EU Member States. Another Polish company would have to open a liquidation procedure if it decided to move its seat to another country.

In Poland, as of 2019, exit tax is levied at a rate of 19 per cent on unrealised income of entities that cease to be Polish tax resident or that relocate their assets from Poland to another jurisdiction, transfer them gratuitously to any entity or contribute their assets in-kind to an entity other than a corporation or a cooperative (about exit tax see also Section IV.i). Income from liquidation of a partnership is tax-exempt under local rules. Therefore, investors holding interests in a local partnership may liquidate it to exit from the partnership’s business in a tax-neutral way.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

Anti-avoidance rules are very limited in Poland. Article 199a of the Polish Tax Ordinance sets forth the ‘substance-over-form’ principle. Under this regulation, the tax authorities may ignore tax effects of a given transaction if it is a cover for another transaction (legal act). In such case, the tax effects should be drawn from the hidden transaction. Whenever the intentions of transacting parties cast doubt, the tax authorities should refer to a civil court to judge the existence or non-existence of such a transaction. In principle, Article 199a may
apply when a given transaction is executed or performed in an extraordinary manner to achieve tax benefits that would not normally be available if such a transaction were performed in a typical manner.\textsuperscript{11}

From July 2016, Poland introduced a general anti-avoidance rule, according to which tax authorities may disregard tax benefits (e.g., reduction or postponement of tax obligations or an increase of tax losses) resulting from a transaction or series of transactions of a taxpayer if such transaction or transactions are completed in an ‘artificial’ manner mainly or solely for purposes of achieving those tax benefits. A transaction is completed in an ‘artificial’ manner if, for example, without reasonable business or economic reasons, it is divided into separate transactions, involves intermediaries or creates risks higher than non-tax business or economic benefits that could be expected from such transaction. This general anti-avoidance rule does not apply to VAT settlements or to transactions that are subject to other specific anti-avoidance rules (e.g., exchange of shares or cross-border payments of dividends). A taxpayer may apply for a tax clearance opinion confirming that a given transaction is not completed in the ‘artificial’ manner mainly or solely for purposes of achieving the tax benefits, and that the general anti-avoidance rule shall not apply to that transaction.

Simultaneously, Poland introduced a specific rule outside the above general anti-avoidance rule. According to this rule, the inbound and outbound dividend tax exemptions will not apply to dividends and other income from participation in corporate profits if they result from a transaction or series of transactions lacking business reasons and aimed solely or mainly at obtaining the tax exemption rather than at avoidance of double taxation of corporate profits. A similar specific rule applies to the tax exemption of exchanges of shares, where a majority of shares is contributed in-kind into the share capital of another company and all the companies are residents in the EU Member States or the EEA.

In addition, since 2018 the new legislation implemented Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

\section*{ii Controlled foreign corporations (CFCs)}

Polish CFC rules apply both to corporate and personal income taxpayers shifting profits (i.e., in the form of royalties, dividends and other passive income) to a foreign company, other entity or PE located in jurisdictions with a lower income tax rate. In particular, a Polish CIT payer must incorporate income generated by its CFC (or its foreign PE) into its corporate tax base for a given year and tax it according to the Polish corporate income (personal income) tax law. A foreign entity is deemed a CFC when it is located in a tax jurisdiction applying harmful tax practices as listed by the Polish Ministry of Finance; it is located in a tax jurisdiction with which Poland has not concluded a DTT; or if the conditions referred to below are met jointly:

\begin{enumerate}
  \item a Polish entity, alone or with a related party, holds, directly or indirectly, at least 50 per cent of shares (voting rights) or other rights to participate in profits in the foreign entity or exercises actual control;
\end{enumerate}

\textsuperscript{11} As confirmed by the verdict of the NSA of 18 November 2009 No. I FSK 1133/08.
at least 33 per cent of the foreign entity’s income constitutes dividends, capital gains, royalties, income from derivatives, or from receivables, guarantees, surety, interest and income from banking, insurance or other financial services, or other income from related-parties transactions having no value added; and

c a foreign tax actually paid by the foreign entity (less any refundable foreign tax) is below 50 per cent of the Polish CIT that would be paid in Poland if the foreign entity were a tax resident of Poland.

Since 2019 the notion of a CFC has been broadened to also include any entity with or without the legal capacity, a foreign foundation, trust, any nominee relationship or direct or indirect representative. A foreign entity is not a CFC if it is a tax resident of a Member State in the EU or the EEA, and actually performing a substantial business activity in that state. In one of its judgments, the administrative court ruled out that taxable income of a Polish shareholder derived through a CFC entity may be reduced by dividends paid by such entity to the shareholder, regardless of when the company derived profits, out of which those dividends are paid out.

### iii Transfer pricing

Transactions between related parties must be priced at arm’s length. Parties are related, *inter alia*, where one party holds, directly or indirectly, at least 25 per cent of shares in the share capital of the other party, or the same persons are in the governing bodies of those entities. If, as a result of such relations between parties they agree conditions differing from those that would have been agreed by independent entities, and as a result a taxpayer does not show any income or shows income lower than would have been expected should those linkages not exist, taxable income or related costs may be reassessed, and the tax settlement of that entity may be challenged by the tax authorities. In such a situation, the tax authorities determine income on the basis of market prices of similar goods or services, or according to one of the following methods:

- the comparable uncontrolled price method;
- the resale price method;
- the reasonable margin (cost-plus) method; and
- the transaction profit method.

Note that taxpayers conducting transactions (including the execution of partnership deeds, joint-venture or similar agreements) with related entities, or if such transactions trigger payments to entities located in jurisdictions applying harmful tax practices (directly or indirectly), are required to maintain relevant tax documentation describing, *inter alia*, the functions of the parties, anticipated costs of the transaction, the method and manner of calculating profits and pricing, a business strategy and factors defining the value of the transaction. Taxpayers must present the documentation within seven days of any request of the tax authorities. Should the company fail to provide such documentation, the tax authorities may apply a 50 per cent tax rate to income reassessed by them.

According to the administrative court, the statutorily defined value of transactions that triggers local transfer pricing documentation obligations (€50,000) refers to the aggregated value of all transactions executed by a taxpayer in any given tax year, rather than separately to the value of each transaction.
From 18 July 2013, the scope of a transfer pricing tax audit has been broadened to include restructurings by related parties of their activities, where such restructuring is defined as a transfer between such parties of substantial economic functions, assets or risks.

From January 2017, CIT taxpayers’ transfer pricing reporting obligations increase significantly, and the transfer pricing documentation must be more complex. In particular, for the biggest entities, benchmarking analysis for documented transactions and a ‘masterfile’ documenting a whole group of related taxpayers are required.

In general, the obligation to prepare transfer documentation follows the OECD’s BEPS recommendations and arises for a Polish taxpayer having a transaction or other event with a related entity, when the accounting revenues of the taxpayer for the previous tax year according to its financial balance sheet exceeded €2 million and the value of the transaction or other event in one tax year exceeds €50,000.

In such a case, the taxpayer should prepare the local file including, in particular:

- a description of the transaction or other event, including financial data, related parties to the transaction and their functions, engaged assets and incurred risks, and methodology and manner of profit calculation with detailed pertinent justification;
- a detailed benchmarking analysis – only if the accounting revenues of the taxpayer for the previous tax year according to its financial balance exceeded €10 million;
- a description of the financial data of the taxpayer;
- information about the taxpayer, including organisation and management structure, subject and scope of business activities, a business strategy, and competitive environment; and
- documents, namely corporate agreements concluded between related entities and APAs.

Furthermore, if the accounting revenues of the taxpayer for the previous tax year according to its financial balance exceeded €20 million, the transfer pricing documentation must also include the master file.

The transfer pricing documentation should be prepared on an annual basis, and the taxpayer is required to confirm in its annual tax return (to be filed by the end of the third month following the given tax year) that all TP documentation is properly prepared.

iv Tax clearances and rulings

The Minister of Finance, ex officio or upon the request of taxpayers and other entities, issues general guidelines applicable to tax rules governing selected tax issues that in the opinion of the Minister require uniform interpretation. If particular cases require interpretation of the tax rules, an entity (taxpayer, withholding tax agent and certain other entities) interested in securing the certainty of such interpretation may also apply to selected heads of tax chambers, who (representing the Minister of Finance) issue individual tax rulings within three months (tax rulings regarding local taxes are issued by local government tax authorities). If a ruling is not issued within this period, the tax interpretation presented by the entity in its application will become valid for the tax authorities (a silent ruling), which allows taxpayers to avoid unjustified delays in settlements of tax issues in business activities.

An existing tax ruling may be changed by a new one; however, a taxpayer complying with an original tax ruling that is subsequently changed may not be liable to taxation contrary to the contents of the original tax ruling, and if tax referred to in the original ruling is settled
periodically (monthly, quarterly or yearly), the taxpayer is exempt from such tax by the end of
the tax settlement period during which the new tax ruling was served to the taxpayer, except
for cases arising prior to serving the original tax ruling to this taxpayer.

Taxpayers dissatisfied with any private tax ruling may file a complaint with a district
administrative court within 30 days, and subsequently with the NSA.

It is not allowed to apply for (or to issue) individual tax rulings pertaining to powers and
duties of tax authorities, CFC rules, the general anti-avoidance rule or specific anti-avoidance
rules. A taxpayer may apply for a tax clearance opinion confirming that a given transaction is
not completed in an ‘artificial’ manner mainly or solely for purposes of achieving tax benefits,
and that the general anti-avoidance rule shall not apply to that transaction (see Section IX.i).

X YEAR IN REVIEW

During 2018, investors continued to use regulated mutual investment funds from other
EU or EEA Member States to acquire shares issued by partnerships and other companies,
or to invest in other Polish securities directly. However, since 2017 the local general tax
exemption of Poland and foreign-regulated investment funds was narrowed to income
derived by Poland-based open-ended investment funds and qualified foreign-regulated
collective investment funds from the EU and the EEA only. In turn, the CIT exemption
of Poland-based close-ended investment funds and qualified foreign-regulated collective
investment funds from the EU and the EEA operating upon a simple notice of initiation of
investment activities, rather than upon a permit of the competent financial sector supervision
authority, was narrowed with the exclusion of certain items of their income (in particular,
interest, donations and profits paid by local and foreign tax-transparent partnerships, and
capital gains from transfers of securities issued by such partnerships). Therefore, during 2018
investors conducted various restructuring of business assets, including shares in companies,
securities and interest in partnerships held by such foreign investment funds in order to
qualify for the new tax exemption.

CIT taxpayers’ transfer pricing reporting obligations increased significantly, and transfer
pricing documentation became more complex from 2018. In particular, for the largest entities,
benchmarking analysis for documented transactions and a master file documenting a whole
group of related taxpayers shall be required. Therefore, taxpayers concentrated on preparing
pertinent documentation and other practices envisaged by those obligations during the year.

In turn, the administrative courts issued the following positive judgments:

a assembling cranes from parts manufactured by subcontractors in Poland and
downloading software into cranes’ digital devices by a Finland-based company on the
territory of Poland on a permanent basis does not constitute a permanent establishment
as such activity constitutes an auxiliary activity in the meaning of the Poland–Finland
DTT;

b an upstream merger of a company that paid tax-exempt dividends to the surviving
company before the merger does not deprive the target company of the dividend
withholding tax exemption applicable under local rules implementing the EU
Parent–Subsidiary Directive even if the merger occurs before the end of the two-year
holding period set forth in these rules;

c profits of a CFC company from re-evaluation of its assets should not be taxable under
CFC rules in Poland;
services of agents intermediating sales of goods are not the intangible services that are subject to the cap of cost deductions at 5 per cent of EBIDTA and, therefore, costs of such intermediary services may be deducted without such limitation; and

simultaneous contributions in-kind by several shareholders of (aggregated) majority of shares in a limited liability company in exchange for shares in the stated capital of another corporation constitute the tax-exempt exchange of shares under local rules and the EU Merger Directive even if each particular shareholder contribution does not encompass the majority of such shares.

In 2018, the tax authorities continued their policy regarding local taxation in several important matters. In particular, the Minister of Finance aimed to increase tax collections and declared the intention to fight against avoidance of taxation according to its general warning letters regarding certain transactions that may be considered as aggressive tax optimisation falling under the general anti-avoidance rule, for example, acquisition of shares in Polish companies by an investor from non-Treaty country outside the EU and the EEA via a subsidiary company from the EU or the EEA in order to exempt dividends paid by Polish companies from Polish withholding taxation pursuant to the EU Parent–Subsidiary Directive; shifting taxable income to non-Polish companies that are actually managed in Poland and should tax their total income in Poland; transferring IP assets to an SPV, which increases assets’ depreciation basis and licenses them to related companies; shifting taxable profits by local companies via payments of interest on bonds issued to tax-exempt Polish regulated investment funds; and other warning letters. In turn, local tax authorities issued general and individual tax rulings confirming the following:

local mortgage banks are not obliged to withhold tax on cross-border interest payments to non-resident corporate holders of mortgage bonds;

compensations paid by an insurance company to a bank on the basis of an insurance policy assigned by a CIT payer to that bank, as collateral security for a loan extended by the bank to the CIT payer, constitute taxable income of that CIT payer as such payments reduce loan liabilities of the CIT payer; and

in a case of sale by a company of shares contributed in-kind to its stated capital, the company may deduct costs equal to par value of shares issued by it in exchange for shares contributed.

XI OUTLOOK AND CONCLUSIONS

From 2019, a number of amendments to the CITL will enter into force, including the following.

The new legislation implements Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market. According to the new rules, taxpayers, including local branches of foreign enterprises, will be obliged to pay exit tax levied at a rate of 19 per cent on unrealised income if they relocate their assets from Poland to another jurisdiction, transfer them gratuitously to any entity or contribute their assets in-kind to an entity other than a corporation or a cooperative or if Polish CIT payers cease to be Polish tax residents (on exit tax see Section IV.i).
The new legislation also governs other tax issues, including:

a. broadening the scope of CFC rules in relation to foreign private foundations, trusts and similar entities;

b. implementing the Innovation Box, which sets forth the 5 per cent CIT rate on certain items of income (e.g., licence fees and sale proceeds) from the qualifying IP rights comprising: patents, utility model protection, an industrial design, rights to topography of an integrated circuit, additional rights to patent for a medical product or a plant health product, rights to new varieties of plants and breeds of animals, and copyrights to software;

c. narrowing DTTs’ rates and local withholding tax exemptions to cross-border royalties, interest, dividends and payments for intangible services not exceeding 2 million zlotys and introducing a refund by the tax authorities of withholding tax collected from payments exceeding 2 million zlotys;

d. specific CIT rules on gains from sales of cryptocurrencies;

e. narrowing deductions of purchase costs of receivables to proceeds from the receivables’ principal amounts;

f. exempting from withholding tax interest from bonds admitted to transactions on regulated markets in Poland or other DTT’s countries; and

g. mandatory disclosure of certain domestic and cross-border transactions that may qualify as aiming at avoidance of taxation.
I  INTRODUCTION

The Portuguese tax system is composed of several state and municipal taxes that may have a significant impact on investment decisions and the way in which businesses should be structured in an efficient manner. State taxes include taxes on companies’ and individuals’ income (corporate income tax (CIT), personal income tax and social contributions), taxes on expenditure (VAT and excise duties) and others (including stamp tax). Municipal taxes are mainly levied on the ownership and sale of immovable property (municipal property tax and property transfer tax).

Several important reforms carried out over recent years have successfully put Portugal on the map for tax competitiveness regarding inward investment. Besides a very attractive corporate tax regime, Portugal offers a wide range of tax incentives and planning opportunities for foreign companies and individuals who wish to settle or to invest in and through the country.

Furthermore, Portugal also offers a whole tranche of other compelling factors for consideration by potential investors, such as, to mention just a few, an appealing visa regime, workforce education and skills, qualified labour availability, a modern labour law, infrastructure, cost of real estate, R&D capability and access to Portuguese-speaking countries.

II  COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i  Corporate

Under Portuguese law, there is a choice of different legal forms for establishing a business, from sole trader to various types of companies, as defined in the Companies Code.

Five types of entity are listed in the Companies Code:

a  partnerships;
b  private limited companies;c single-member private limited companies;d public limited liability companies; and

e  limited partnerships (simple or limited by shares).

Of the various entities on offer under Portuguese law, the two most commonly used are the private limited company and the public limited liability company. The choice of business
entity is dependent on several factors: the desired degree of simplicity, both in terms of structure and operation; the minimum amount of paid-in capital required; and confidentiality issues relating to the ownership of capital.

In a public limited liability company, the liability of each shareholder is limited to the value of his or her shareholding. The minimum number of shareholders for the incorporation of this type of company is five, and the capital is divided into shares. Bearer shares have not been allowed since May 2017.

Private limited companies are the most common type of company in Portugal. This is the preferred model for small and medium-sized companies, given its great flexibility.

ii  Non-corporate

For CIT purposes, partnerships are subject to the same treatment as companies, although a fiscal transparency regime applies to certain resident entities: civil law companies not incorporated in commercial form; incorporated firms of professionals; and holding companies the equity of which is controlled, directly or indirectly, for more than 183 days, by a family group or a limited number of members.

A fiscal transparency regime also applies to complementary business groupings (ACEs) and European economic interest groupings treated as resident in Portugal.

III  DIRECT TAXATION OF BUSINESSES

i  Tax on profits

Determination of taxable profit

Taxable profit is calculated on the basis of accounting income adjusted according to specific rules contained in Portuguese tax legislation.

Business expenses are generally tax-deductible provided that they are incurred in generating taxable profits or deemed essential for maintaining the structure of the company. Nonetheless, some expenses are not deductible for the purpose of computing taxable profits, even where accounted for as costs or losses in the relevant accounting period. That is the case, for example, in relation to the following items:

- CIT paid;
- compensation paid in respect of insurable events;
- daily expense allowances and payments relating to an employee’s travel using his or her own car, under certain circumstances;
- excessive depreciation and accounting provisions; and
- interest and other forms of remuneration from shareholder loans exceeding certain limits.

Intangible assets without a fixed life cycle acquired on or after 1 January 2014 may be depreciated over a 20-year period (5 per cent per year) counted from the initial recording of the asset in the company’s books. This regime applies to the following intangible assets: industrial property such as trademarks, licences, production processes, models and other similar rights acquired for consideration and without a fixed life cycle; and goodwill arising from business restructuring transactions (but excluding goodwill arising from share transactions).
**Capital and income**

The CIT Code adopts a wide definition of taxable income, and capital gains are treated as ordinary business profits and taxed accordingly.

Capital gains and capital losses on the sale of a company’s assets, other than those exempt under the participation exemption regime (see below), are computed as the difference between the proceeds of disposal, net of related expenditure, and the acquisition cost, reduced by any depreciation claimed.

Only 50 per cent of the difference between capital gains and losses is taken into account where, in the year prior to the disposal or before the end of the second following year, the disposal proceeds are reinvested in the acquisition, manufacture or construction of tangible fixed assets, non-consumable biological assets or investment properties, but with the exception of second-hand assets acquired from related parties.

**Losses**

Tax losses may be carried forward for five years, although any deduction is limited to 70 per cent of the taxable profit assessed in the relevant fiscal year.

Losses carried forward may be lost if, between the tax year in which the losses were suffered and the year in which they are used, there is a change in the object or the activity effectively performed by the company, or 50 per cent (or more) of its share capital is transferred to different shareholders.

**Rates**

The regular CIT rate in Portugal is 21 per cent. The tax rate applicable to the first €15,000 of the taxable income of taxpayers qualifying as small and medium-sized enterprises, as provided by EU Commission Recommendation 2003/361/EC, is 17 per cent. Companies located in the interior regions of Portugal, with economic, agricultural, commercial, industrial or service-providing activities, benefit from a rate of 12.5 per cent for the first €15,000 of the taxable amount, reducing the tax rate from 17 per cent to 12.5 per cent. A municipal surcharge is levied in addition to CIT in most municipalities at a rate of up to 1.5 per cent of taxable income.

Corporate taxpayers with taxable income of more than €1.5 million are also subject to a state surcharge of 3 per cent. The surcharge increases to 5 per cent for taxable income exceeding €7.5 million, and to 9 per cent for taxable profits in excess of €35 million.

**Administration**

**Filing tax returns**

CIT assessment returns must be filed by Portuguese-resident entities and permanent establishments of non-resident companies and submitted by 31 May following the end of the calendar year, or five months after the authorised year-end if the company’s tax year does not follow the calendar year. An annual return containing simplified corporate information must also be filed by 15 July or by the 15th day of the seventh month following the end of the tax year.

Following OECD recommendations under the BEPS Action Plan, ultimate parent entities or other reporting entities of multinational groups of companies that register turnover higher than €750 million are required to complete and file a country-by-country report. Entities with tax residency in Portugal integrating a multinational group of companies, subject
to the country-by-country report obligation must also communicate to the Portuguese tax authorities by electronic means which entity constitutes the reporting entity of the group, the respective tax jurisdiction, its tax identification number and address.

Taxable persons liable to CIT and their representatives must also file statements in respect of registrations, changes or cancellations on the register of taxable persons, and are required to keep a tax documentation file in respect of each accounting period for a 10-year period containing all accounting and tax information.

**Tax authorities**

Taxes in Portugal are administered by the Portuguese Tax and Customs Authority, which is organised as a vertical structure integrated into the Ministry of Finance and divided into two main services: the Directorate General for Taxation and the Directorate General for Customs and Excise Taxes.

The Tax Authority has competence to carry out tax audit procedures, make additional and late interest tax assessments, and impose penalties and fines on non-compliant taxpayers.

**Advance rulings**

To reduce ambiguities, taxpayers may request advance rulings regarding their tax affairs, including their eligibility for tax benefits. When advance rulings are issued, the tax authorities may not derogate from such rulings in relation to the taxpayers that requested it, except pursuant to court decisions.

By request of the applicant, and subject to the payment of a fee, an advance ruling may be provided urgently (within 75 days), provided that such request is accompanied by a tax framework proposal. The proposed tax framework and the facts to which the urgent request for an advance ruling relate are considered tacitly sanctioned by the tax authorities if the request is not answered within 75 days.

Non-urgent rulings are delivered within 150 days.

Apart from the advance ruling regime, a taxpayer and the Portuguese Tax Authority may negotiate advance pricing agreements on transfer pricing issues.

**Means of appeal**

Following a tax audit, the taxpayer is allowed to challenge an additional tax assessment made by the tax authorities, either by means of an administrative claim submitted to the tax authorities, or through a judicial or arbitration appeal to the tax courts or to the tax arbitration court.

Decisions of the tax courts may be appealed to the Central Administrative Court of Appeal or to the Administrative Supreme Court.

**Tax grouping**

Portuguese-resident companies that are members of an economic group may opt to be taxed under the special group taxation regime.

The parent must hold, directly or indirectly, for a minimum one-year period, at least 75 per cent of the subsidiaries’ share capital and 50 per cent of their voting rights. All companies in the group must be tax-resident in Portugal (albeit indirectly held, through an EU or EEA resident company), and must be subject to Portuguese CIT on their worldwide income at
the standard CIT rate to benefit from this regime. This regime is also applicable if the parent company has a permanent establishment in Portugal that holds the capital of the subsidiaries, and some other cumulative conditions are met.

Entities with tax losses in the preceding three years are not eligible for this regime, except where their share capital has been held by the parent for more than two years.

ii Other relevant taxes

**Value added tax (VAT)**

Portuguese VAT legislation basically follows the EU common system of VAT. It applies to the supply of goods, services, and intra-Community acquisitions and imports into the Portuguese territory.

Any person or corporate entity that independently carries out an economic activity, or that carries out a single taxable transaction either in connection with the performance of the above-mentioned activities or that is subject to personal tax or CIT, is liable to charge VAT on every supply it makes in the scope of its activities, and afterwards to deliver the due amount to the tax authorities.

There are three VAT rates: 23 per cent (standard), 13 per cent (intermediate) and 6 per cent (reduced).

In the autonomous regions of Azores and Madeira, the VAT rates are currently reduced to 18 and 22 per cent (standard), 9 and 12 per cent (intermediate), and 4 and 5 per cent (reduced), respectively.

**Property transfer tax (IMT)**

IMT is levied on the onerous transfer of immovable property.

The tax is payable by the purchaser, whether an individual or a company, resident or non-resident. The taxable amount corresponds to the higher of the contractual price or the patrimonial tax value.

The tax due is assessed as described above at the following tax rates:

- **a** rural property: 5 per cent;
- **b** urban property and other acquisitions: 6.5 per cent;
- **c** urban property for residential purposes: progressive tax rates ranging from zero to 8 per cent; and
- **d** rural or urban property where the purchaser is domiciled in a blacklisted jurisdiction: 10 per cent.

**Local property tax (IMI)**

IMI is levied annually on immovable property located within each municipality. The tax is payable on the taxable value by the owner of the property as of 31 December of each year, to be paid in up to three instalments in the following year.

The taxable value of urban property corresponds to the patrimonial tax value recorded on the tax registry.

The IMI rates are as follows:

- **a** rural property: up to 0.8 per cent;
- **b** urban property: 0.3 to 0.45 per cent; and
- **c** rural or urban property where the owner is domiciled in a blacklisted jurisdiction: up to 7.5 per cent.
Additional to the IMI (AIMI)

AIMI is annually due by individuals, companies and undivided inheritances that own residential real estate located in Portugal and the taxable basis corresponds to the summation of the tax registration value (TRV) of all the urban properties owed or held by each taxpayer (reported as at 1 January of each year).

From the sum of the TRV of all the urban properties and applicable taxable basis is deducted the amount of €600,000 for individuals and undivided inheritances and, €1.2 million for married or living in non-marital partnership taxpayers, who opt to submit a joint tax return.

The applicable rates, after deductions provided, are as follows:

a. individuals and undivided inheritances: 0.7 per cent; (1 per cent on the part of the TRV exceeding €1 million regarding property held by individuals);

b. companies: 0.4 per cent; and

c. urban properties owned by entities in blacklisted countries: 7.5 per cent.

Stamp tax

Stamp tax is generally charged on certain formal acts and documents, such as transfers of title and contracts, which are signed or take place on Portuguese territory and which are not subject to VAT, as outlined in the General Table of Stamp Tax.

Loans granted to resident entities, regardless of the nature or place of domicile of the lender, are generally subject to stamp duty ranging from 0.04 to 0.6 per cent, depending on the term of the credit or loan given. A tax exemption may be granted to the following operations provided certain requirements are met: long-term loans qualifying as suprimentos for Portuguese commercial law purposes, made by a shareholder to a company, provided that the participation exemption requirements are met concerning the level of participation and detention period; and short-term (less than one year) cash management loans made by parent companies to their subsidiaries.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

Companies are deemed to be resident in Portugal for tax purposes if their head office or place of effective management (regardless of the head office’s jurisdiction) is located on Portuguese territory. These two criteria are often met simultaneously, providing consistency under tax law. However, where this is not the case, the place of effective management is the decisive factor.

According to Portuguese case law, the place of effective management is defined as the place where the management decision-making takes place, and where adequate substance (in the form of both people and real estate) exists.

Resident companies are taxed on their worldwide income. Non-resident companies are taxed on their Portuguese-source income.

2 A legal concept for shareholder loans with a deadline for repayment of over one year.
ii Branch or permanent establishment

In general terms, domestic branch profits are taxed on the same basis as corporate income. Nevertheless, there are some differences in tax treatment (general administrative expenses incurred by the head office may be allocated to the branch, and there may be certain restrictions concerning the deductibility of certain expenses charged by the head office to the branch).

All income is included in the tax base, regardless of its geographical source, provided that such income is attributable to the permanent establishment located in the Portuguese territory. All allowable items of expenditure, deductions and credits are also taken into account, regardless of the source of the income to which such items relate, with the same requirement mentioned above.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Special tax regime for non-habitual residents

The non-habitual residents regime is available for citizens who have become Portuguese residents for tax purposes, according to the criteria defined by the PIT Code, and who have not been deemed resident in Portugal in any of the previous five years. The non-habitual residents regime is applicable for 10 consecutive years, under the condition of being considered as a resident during that period. If a taxpayer does not meet the requirements to be considered as resident in any year or years within that period (thus not using the complete period), the taxpayer may resume the use of this regime as soon as he or she meets the requirements.

As this regime only sets forth a different type of residency, the non-habitual resident’s income will be subject to tax in Portugal on a worldwide basis taking into consideration the following features:

a Portuguese income obtained from highly added value activities of a scientific, artistic or technical nature is taxed at a special rate of 20 per cent. These activities are defined in Ordinance No. 12/2010 of 7 January, and include architects, engineers and similar professionals, visual artists, actors and musicians, auditors, doctors and dentists, teachers (psychologists, liberal professionals, technicians and the like), and investors, managers and directors.

b The exemption method for the elimination of double taxation will be applicable on income derived from foreign sources in categories A (employment), B (self-employment), E (capital income), F (real estate income) and G (assets), provided that some requirements are met.

ii Participation exemption for dividends and capital gains

Profits and reserves distributed to Portuguese-domiciled companies by their subsidiaries and the capital gains and losses arising from the sale of shareholdings in such subsidiaries are not subject to CIT, provided that:

a the Portuguese company holds at least 10 per cent of the share capital or voting rights of the subsidiary;

b the shares have been held for at least 12 months prior to the distribution or transfer of the shares (or if the shares are maintained for that period, in the case of distribution of profits);
Portugal

- the company distributing the dividends or reserves is subject to and not exempt from Portuguese CIT, similar tax referred to in the Parent–Subsidiary Directive or similar tax provided that its applicable rate is not lower than 60 per cent of the Portuguese standard CIT rate, unless:
  - at least 75 per cent of the profits derive from an agricultural, industrial or commercial activity, or from the rendering of services that are not predominantly targeted to the Portuguese market; or
  - the entity distributing the profits or the reserves, or in which a shareholding is sold, does not have a residence and is not domiciled in a blacklisted jurisdiction;
- the company distributing the dividends or reserves, or whose capital is subject to sale, is not domiciled in a blacklisted jurisdiction; and
- the profits or reserves do not qualify as deductible costs in the distributing entity.

Under the same universal principle of double taxation relief, companies with a registered office or effective centre of management in Portugal may exclude from their taxable base earnings and losses attributable to permanent establishments located outside Portugal, provided that the following conditions are met: the permanent establishment is subject to and not exempt from a rate of tax not less than 60 per cent of the CIT rate in the state of its location; and the permanent establishment is not located in a blacklisted jurisdiction.

iii Patent box

Income arising from the sale or temporary use of patents and industrial designs registered on or after 1 January 2014 may benefit from a 50 per cent exemption, provided that:
- the assignee uses the industrial property rights in the pursuit of an activity of a commercial, industrial or agricultural nature;
- the transferee of the rights does not use them for the delivery of goods or services that create tax-deductible expenses in the transferor company or in a company with which the transferor is grouped, whenever a special relationship is deemed to exist;
- the assignee is not resident in a blacklisted territory; and
- the accounting records of the taxpayer are organised in such a way as to allow the identification of the costs and losses directly attributable to the industrial property right subject to the assignment or temporary use.

iv State aid

National and foreign companies that intend to invest in Portugal in certain sectors of activity may apply for financial incentives granted by EU structural funds under the National Strategic Reference Framework.

Apart from such financial incentives, eligible productive investment projects set up by 31 December 2020 may also benefit from certain contractual tax incentives under the Tax Investment Code, such as CIT credits, or real estate and stamp tax reductions or exemptions. This regime complies with the EU state aid rules.

v General

Apart from the exemptions from withholding tax on outbound payments granted under the CIT Code (see below), there are some other notable tax incentives provided in the Portuguese Tax Benefits Statute and ancillary legislation. The following are an example of such incentives.
**Madeira free zone**

Companies licensed to operate under the scope of the Madeira International Business Centre benefit from extremely attractive tax benefits, such as a reduced CIT rate of 5 per cent until 2027 (except for intra-group services, financial intermediation and insurance), and exemptions from stamp duty and from property transfer tax and municipal property tax in relation to real estate located in Madeira and registered for company business use, depending on the date of the licence. Shareholders of the companies covered by the scheme, both individuals and companies, may benefit from income tax exemption on dividends and interests paid out.

**Undertakings for collective investment (UCIs)**

Under this regime, Portuguese UCIs only, including securities investment funds (SIFs), real estate investment funds (REIFs), securities investment companies (SICs) and real estate investment companies (REICs), are tax-exempt regarding dividends, interest, rental income and capital gains included in their taxable profits.

The taxation of non-resident investors will depend on the type of UCI to which the income relates.

Income arising from SIFs and SICs, including income distributed by these entities, capital gains from the disposal of units or shares, or income arising from the redemption of units, is fully exempt from tax in Portugal.

Income arising from REIFs and REICs, including income distributed by these entities, capital gains from the disposal of units or shares, or income arising from the redemption of units, is subject to a 10 per cent flat rate tax in Portugal. Furthermore, income arising from REIFs and REICs, including capital gains from the disposal of units or shares and income arising from their redemption, shall be considered as income from immovable property (i.e., shall qualify under Article 6 of the OECD Model Tax Convention).

When more than 25 per cent of non-resident entities are directly or indirectly held by Portuguese residents, or are located in blacklisted jurisdictions, they are subject to tax on all income arising from UCIs at a rate of 25 or 35 per cent, respectively.

**Capital gains realised by non-resident entities**

Capital gains from the transfer of shares, warrants and other securities issued by Portuguese-resident entities and realised by non-resident entities are income tax-exempt. This exemption does not apply to the following:

- non-resident entities, at least 25 per cent of whose equity is directly or indirectly owned by resident entities;
- entities domiciled in a blacklisted territory; and
- capital gains realised by non-resident entities on the sale of shares in the capital of a company resident in Portugal, at least 50 per cent of whose assets are made up of real estate situated on Portuguese territory.

**Conventional remuneration of the share capital**

Under this regime, 7 per cent of cash contributions made by the shareholders, as well as of conversions of shareholder loans made upon the incorporation or at the time of a capital increase, up to a €2 million threshold, may be deductible from the company taxable income.
Programme Seed

Targeted to attract individuals’ investment in start-ups, the programme allows for a deduction to the investor payable income tax (up to a limit of 40 per cent) of 25 per cent of the cash contributions. Capital gains from the sale of the start-up company shares may be excluded from taxation if the sale price is reinvested in new eligible investments.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)

Except in certain circumstances, most income obtained by non-resident entities in the Portuguese territory is subject to withholding tax. Income is deemed to be obtained in Portugal if the debtor is a resident, or has its head office or place of effective management, in Portugal, or if its payment is attributable to a permanent establishment in Portugal.

The CIT withholding tax rate is generally 25 per cent.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

Outbound dividends paid by Portuguese-domiciled companies are exempt from withholding tax, providing that the company receiving the dividends:

a is resident in a Member State of the EU or EEA, or a country with which Portugal has concluded a double tax treaty that includes a provision for administrative cooperation in the field of taxation similar to that existing in the EU;

b is subject to and not exempt from a tax mentioned in the EU Parent–Subsidiary Directive, or a tax that is similar to CIT tax, in other cases, provided that the applicable tax rate is not less than 60 per cent (12.6 per cent) of the CIT rate; and

c has held, directly or indirectly, for a 12-month period prior to the distribution a participation of at least 10 per cent of the share capital or voting rights of the company.

If the 12-month period is not completed, dividends paid will be subject to a 25 per cent withholding tax (which can be recovered after the completion of such period) eventually reduced under an applicable tax treaty.

Under a specific domestic anti-abuse provision (resulting from the transposition of Council Directive 2015/121/EU, of 27 January, which amended the Parent–Subsidiary Directive), withholding tax exemption on dividends is denied in case of an arrangement or series of arrangements the main purpose of which is to obtain a tax advantage that defeats the object and purpose of eliminating double taxation on profits, in case such arrangement or series of arrangements is not regarded as genuine, all facts and circumstances considered. For completeness, an arrangement or series of arrangements is not regarded as genuine if it is not based on valid economic reasons and has no economic reality.

Interest paid by Portuguese-domiciled subsidiaries to a parent company that is a resident in an EU Member State may benefit from a withholding tax exemption under the EU Interest and Royalties Directive.
iii Double tax treaties
In addition to Portuguese domestic arrangements that provide relief from international
double taxation, Portugal has entered into double taxation treaties with 79 countries to
prevent double taxation, 77 of which are already in force.

Under these treaties, withholding tax rates on outbound dividend, interest and royalty
payments are reduced wherever the beneficial owner of the income derived from Portugal is
a tax resident of the other contracting state. For a detailed list of the tax treaties in force and
rates applicable to interest, royalties and dividends, see Appendix I at the end of the chapter.

Portugal is a signatory of the Multilateral Convention to Implement Tax Treaty Related
Measures to Prevent Base Erosion and Profit Shifting (MLI). Under this convention, Portugal
is expected to modify its existing bilateral tax treaties in order to include specific rules
preventing the granting of treaty benefits in deemed inappropriate circumstances, notably
in situations of creation of opportunities for non-taxation or treaty-shopping arrangements
aimed at obtaining reliefs for the indirect benefit of residents of third jurisdictions.

Although the precise terms under which each treaty will be modified to include MLI
provisions are not known, the amendments are expected to become effective as of beginning
of 2019, once the ratification procedures are completed.

iv Taxation on receipt
Residents who receive foreign-sourced income are entitled to a tax credit equal to the lower
of the foreign tax paid or the Portuguese tax payable on such income. The credit applies to
income derived from treaty and non-treaty countries; however, for treaty countries, the credit
is limited to the amount of tax payable in the source country under such treaty.

Under the domestic participation exemption regime, dividends from qualifying holdings
paid to Portuguese tax-resident parent companies may benefit from a CIT exemption (see
above).

VII TAXATION OF FUNDING STRUCTURES
i Thin capitalisation
The former thin capitalisation rules were abolished on 1 January 2013, and replaced by an
earnings stripping rule that limits tax deductibility of interest expenses.

Under this rule, net financial costs are only deductible up to the higher limits of
€1 million or 30 per cent of the earnings before interest, taxes, depreciation and amortisation.

The non-deductible excess may also be considered in the determining of the taxable
profit for the following five years after the net financing expenses, with the consideration of
the limits above.

Furthermore, in respect of shareholder loans, deductible interest cannot exceed the
12-month Euribor rate in force on the day the loan was granted, plus a 2 per cent spread or
6 per cent spread for medium-sized enterprises. This limitation does not apply where transfer
pricing rules are applicable.

ii Restrictions on payments
Under the Portuguese Commercial Companies Code, the payment of dividends or reserves
to shareholders is disallowed in the following situations: where any profit is needed to cover
accrued losses or to rebuild legal or statutory reserves; incorporation and R&D expenses are
not fully depreciated, unless the amount of the free reserves and retained earnings is at least equal to non-depreciated expenses; or where the company’s net equity is less than the sum of its share capital and reserves.

iii Return of capital
Companies may return cash to shareholders by means of a dividend distribution, capital reduction, redemption of shares or liquidation.

A payment to shareholders in connection with a reduction of capital along with redemption of shares is regarded for tax purposes as a capital gain on any value exceeding the purchase price of the shares.

Liquidation proceeds are deemed to be capital gains or capital losses that are eligible for the participation exemption regime.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition
Business acquisitions are usually structured as either asset or share deals.

The main difference between asset and share deals is the type of tax treatment. There are various taxes that can be either levied on the acquisition of assets (property transfer tax, VAT or stamp tax) depending on the nature of the assets. On the other hand, the obtaining of taxable capital gains is less likely on a sale of shares.

The acquisition of shares of a public limited liability company is not subject to VAT or property transfer tax. The acquisition of shares of a private limited company, of a general partnership or of a partnership association is subject to IMT where these entities hold property and where, following the share acquisition, one of the shareholders will hold at least 75 per cent of the share capital, or the number of shareholders will reduce to two, with these two individuals being spouses married under the regime for general community property.

ii Reorganisation
Restructuring operations such as mergers, demergers, spin-off transactions, transfers of assets and share exchanges may be performed without income tax constraints for companies and shareholders involved under the Portuguese fiscal neutrality regime.

Exemptions from property transfer tax, stamp tax and notarial and registration fees may also be granted by the Ministry of Finance upon request, provided that certain conditions are met.

iii Exit
When a company transfers its tax residence abroad, the company is deemed liquidated and is subject to CIT on the positive difference between the market value and the book value of its assets, provided that these are not allocated to a permanent establishment of the company in Portugal. The same regime applies on the cessation of activity of a permanent establishment of a non-resident entity located in Portugal and to the transfer outside Portuguese territory, by any act or legal instrument, of assets allocated to that establishment.

The tax liability resulting from the transfer of residence can be deferred where the transfer is made to an EU or EEA Member State, provided that certain conditions are met.
IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance
Portuguese general anti-avoidance rules provide for a general principle of substance over form under which the tax authorities may disregard the legal form agreed upon by the parties where a transaction is deemed exclusively or principally tax-driven, and they may recharacterise the facts for tax purposes in accordance with the underlying economic reality.

ii BEPS
Portugal has already enacted several unilateral anti-BEPS measures, notably:
  a controlled foreign corporation (CFC) rules;
  b an earnings stripping rule to limit interest deductibility based on EBITDA levels;
  c denial of the participation exemption regime where the dividends received give rise to a deduction for the subsidiary;
  d denial of the participation exemption regime on structures that lack economic substance;
  e an obligation to disclose aggressive tax planning schemes;
  f a revised patent box regime incorporating the nexus approach; and
  g adoption of the 2014 EU directive on automatic exchange of tax information and exchange of information procedures under the Common Reporting Standard.

iii CFC rules
Under the CFC rules, profits or other income derived by non-residents in the Portuguese territory and subject to a more favourable tax regime can be attributed to Portuguese-resident shareholders who hold, directly or indirectly, at least 25 per cent of the share capital (or 10 per cent if more than 50 per cent of the share capital of the non-resident company is held, directly or indirectly, by Portuguese-resident shareholders) in proportion to their shareholding.

iv Transfer pricing
Portugal has implemented detailed transfer pricing legislation that broadly follows the methodologies and principles in the OECD guidelines.
  Under Portuguese transfer pricing rules, domestic and cross-border inter-company transactions must be at arm’s length, and the Portuguese tax authorities have wide-ranging powers to adjust declared income if they consider that market conditions have not been respected.
  Special relations are deemed to exist between two entities where one such entity has the power to exercise, directly or indirectly, a significant influence on the management decisions of the other entity.
  All companies undertaking transactions with related entities, even if they are not obliged to prepare a transfer pricing file, have to fill out additional declarations as part of their annual tax reporting obligations.
  Additionally, taxpayers with annual net sales and other income equal to or greater than €3 million in the fiscal year prior to the year under consideration are required to prepare a transfer pricing file, which should contain an analysis of all of the aspects of every transaction with related parties.
v Tax clearances and rulings

Upon request, tax and social security authorities may deliver a written confirmation that a company’s tax affairs are in order. These certificates are valid for three and four months.

Binding advance rulings may be awarded in specific situations (see above).

X YEAR IN REVIEW

Upholding the stability trend seen in 2017, the year in review was not marked by any major modification in the tax framework. A negative highlight goes to the increase, from 7 per cent to 9 per cent, of the tax rate applicable to highest bracket of the corporate income tax state surcharge (income in excess of €35 million). Positive news came, in contrast, from the definitive elimination of the surcharge to personal income tax, a remainder of the austerity measures introduced during the financial crisis, and from the refit of the tax incentives regime for urban rehabilitation.

In general, 2018 maintained the growing trend of foreign investment from recent years, although still heavily tourism and real estate-driven. The year was also marked by the increase in the number of foreign citizens seeking to reside in Portugal, putting additional pressure on the real estate residential market.

The commercial real estate investment market is also expected to achieve a new record, with an increase in the number of new players and the diversification of alternative products.

XI OUTLOOK AND CONCLUSIONS

Contrary to the most pessimistic expectations, Portugal managed to achieve a political stability that has proven key in achieving the budgetary targets and maintaining the current path of growth.

For 2019 it is expected that the economy will maintain a good pace, with a GDP increase and a continued decline in the unemployment rate. The state budget will target a deficit of 0.2 per cent of GDP, which is the smallest in the country’s democratic history.

Private consumption and the number of tourists is expected to continue to ‘heat up’ the economy, although with more moderate increases than in 2018.

From a tax standpoint, the state budget proposal for 2019 does not foresee significant changes to the law in force.

As regards corporate income tax, the decrease of the nominal tax rate to 19 per cent foreseen in the 2014 tax reform seems to have been definitely discarded. A new corporate income tax benefit was announced for companies established in Portugal, in respect of expenses resulting from the creation of jobs. In contrast, however, taxation over deductible expenses related to company cars will see a significant increase.

Regarding personal income tax, 2019 is not likely to bring any relief. The only significant measure expected to occur in this regard consists of a new tax incentive aiming to attract Portuguese citizens living overseas who left the country during the economic crisis. Under the proposed regime, a 50 per cent exemption of personal income tax may be granted to the employment and professional income of persons who become tax residents in Portugal and were a resident in Portugal up to 2015, provided they have not resided in Portugal in any of the previous three years.
## Appendix I: Treaty rates for dividends, interest and royalties (per cent)

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I INTRODUCTION

An unincorporated territory of the United States since 1898, Puerto Rico’s business infrastructure is very well developed and provides the necessary legal framework to conduct business on the island. In particular, Puerto Rico provides great legal and financial certainty with regards to transactions conducted on the island.

Pursuant to Section 734 of Title 28 of the United States Code (USC), Puerto Rico has an independent tax-levying authority. To this effect, the main body of domestic statutory tax law in Puerto Rico is the Internal Revenue Code of 2011, as amended (PR Code or PRIRC). The PR Code applies to income tax, payroll taxes, gift taxes, estate taxes, sales tax and statutory excise taxes.

Puerto Rico’s tax system is greatly influenced by that of the United States. However, several differences exist that make Puerto Rico more attractive to foreign investors seeking to invest in other countries. Puerto Rico currently offers foreign investors considerable tax advantages to relocate there and to bring in their capital.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

Foreign investors can conduct business in Puerto Rico through domestic or foreign entities. If an investor decides to establish its business through a local entity, several alternatives are available. Most commonly, investors use corporations or limited liability companies (LLCs). Limited liability partnerships (LLPs) may also be established to conduct business in Puerto Rico. The type of entity chosen depends on various factors, including the type of business to be conducted, who the owner is and the tax treatment of the entity.

Regardless of the place of formation, depending on the type or characteristics of the entity chosen, the tax treatment can be at the entity’s level or at the owners’ level. If the entity is taxed at its own level, its owners may also be subject to taxation at their level for distributions made by the entity to the owners.

The majority of businesses decide to adopt a corporation form to conduct their business. However, new companies are now utilising LLCs more frequently as their choice of entity

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1 Miguel A Santiago Rivera is a capital member and Alberto J E Añeses Negrón is an associate at Casillas, Santiago & Torres, LLC. This chapter is accurate as of January 2018.
Corporation

From an inbound investment perspective, the most commonly used form of business organisation in Puerto Rico is the LLC, which is preferred owing to its less arduous corporate governance requirements. Investors also have the option to conduct their business in Puerto Rico through a corporation.

The formation of both the above types of entities is simple, quick and, in most cases, very cost-effective. Both provide limited liability to their owners to the extent of the capital they have invested in the entity, and no minimum capital requirement exists.

To form a corporation in Puerto Rico, an incorporator must file articles of incorporation with the Department of State of Puerto Rico. The articles of incorporation must include:

a. the name of the corporation, which must include a designation identifying the entity as a corporation (i.e., ‘inc’ or ‘corp’);

b. the physical and mailing address of the corporation;

c. the purpose of the corporation;

d. the name and contact information of the incorporators, and whether their involvement with the corporation ends incorporation of the corporation;

e. the name and contact information of the corporation’s resident agent; and

f. the amount and type of shares the corporation may issue, any restriction imposed on the shares and the par value of the shares, if any. 2

Other information may be included in the articles of incorporation, but is not required. 3

Once the articles of incorporation are filed and the incorporation fee is paid (US$150), the corporation is duly incorporated and has its own legal personality. 4

Once incorporated, corporations must hold a shareholders’ meeting at least once a year. 5 During such meeting, the shareholders elect a board of directors that is responsible for carrying out the day-to-day operations of the entity. 6 Directors are required to be natural persons of legal age. 7 The number of directors and their duties and responsibilities are determined in the corporation’s by-laws.

Corporations must also file an annual report that includes information about the corporation’s finances, identifies the corporate officials and includes other information that the Secretary of State may require. 8 If a corporation’s business volume is more than US$3 million, audited financial statements must be filed with its annual report. The annual

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2 See Article 1.02 of the Puerto Rico General Corporations Act.
3 For example, majority vote requirements for certain decisions and restrictions on the transfer of shares may be included in the articles of incorporation.
4 See Article 1.05 of the Puerto Rico General Corporations Act.
5 See Article 7.01 of the Puerto Rico General Corporations Act.
6 Id.
7 See Article 4.01 of the Puerto Rico General Corporations Act.
8 See Article 15.01 of the Puerto Rico General Corporations Act.
To organise an LLC in Puerto Rico, an authorised person must file articles of organisation with the Department of State. The articles must include information very similar to the information provided in the articles of incorporation of a corporation. The most notable differences are that the name of the entity must use a designation that identifies it as an LLC (i.e., ‘LLC’ or ‘CRL’), and the organisation fee is higher (US$250). Instead of shares, LLCs may issue units or participations, and the incorporators are named authorised persons.

Upon organisation, members of LLCs may execute an operating agreement, which is a contract that establishes how the entity is going to be managed and administered. The contents of the LLC agreement are extremely flexible as long as the terms contained therein are not contrary to local law.

LLCs must pay an annual fee of US$250. The payment of the annual fee requires submitting some information, but not in as detailed and rigorous a manner as the information in a corporation’s annual report.

**Taxation**

From a tax perspective, corporations and LLCs are subject to Puerto Rico corporate income taxation on their income. However, in some instances, and if certain requirements are met, these entities can be treated as fiscally transparent entities, avoiding taxation at the corporate (entity) level. If this is not the case, stockholders or members may be taxed separately on distributions received from corporations or LLCs, respectively.

**ii Non-corporate**

Another type of structure that investors may choose to conduct their business in Puerto Rico is a partnership. Three types of partnership are available in Puerto Rico: general partnerships (GPs), limited partnerships (LPs) and LLPs.

A partnership is defined as an agreement between two or more natural persons or juridical entities to carry on a business for profit pursuant to a partnership agreement. Partnerships may be organised under the Civil Code, the Commercial Code or the Limited Liability Partnership Law. The Civil Code treats a GP as a juridical entity separate from its owners. However, the Civil Code does not provide any limited liability to the partners of a GP.

The only difference between a GP and an LP is that the contract governing the latter must identify the regular partners from the limited partners. Limited partners are only required to make capital contributions and are shielded from liability. However, a limited partner must indemnify the limited partnership from any harm resulting from an abuse of the partner’s position or negligence. Regular partners, on the other hand, are in charge for the day-to-day operations of the partnership and are responsible, through their patrimony, for the obligations and debts of the LP.

An LLP may be formed by two or more natural persons pursuant to the provisions of Act No. 154 of 20 August 1996. Generally, LLPs are established for the rendering of professional services. A partner of an LLP are ordinarily not personally liable for the debts.
and obligations of the partnership or for negligent or unlawful acts of another partner or employee not supervised by that partner, provided he or she had no prior knowledge of such acts. However, a partner may be held personally liable for partnership debts and obligations that arise out of an error, omission, negligence, incompetence or illegal act committed by that partner or in which that partner was involved, directly or through any person under his or her control or supervision, or of which such partner had notice or knowledge. The name of LLPs must include one of the following at the end of their name: ‘Sociedad de Responsabilidad Limitada’ or limited liability partnership, or the initials ‘SRL’ or ‘LLP’.12

**Taxation**

Partnerships are considered transparent for Puerto Rico tax purposes. Thus, the income of a partnership is not taxed at the level of the entity (partnership), but rather attributed to its partners and subject to their applicable income tax rate, regardless of whether a distribution was made. However, partnerships existing on or prior to 1 January 2011 may elect to continue to be treated as a corporation. In that case, partnerships and their partners are subject to tax at the entity level and again at the partner level to the extent the partnership makes any distributions.

iii **Trust**

Rarely used, foreign investors may choose to conduct their business through a trust. Trusts are created by virtue of public deeds authorised by notaries public. This type of entity is regulated by the Trust Funds Act.13 Generally, trusts are taxed as individuals. The tax is to be paid by the trust itself.

### III DIRECT TAXATION OF BUSINESSES

As previously mentioned, Puerto Rico’s tax system is greatly influenced by that of the United States. Puerto Rico taxes domestic entities and their residents on their worldwide income. Like the United States, Puerto Rico allows these taxpayers to claim a credit for certain taxes paid by them to the United States or foreign countries.14

Foreign corporations engaged in trade or business in Puerto Rico are taxed like domestic corporations in relation to income generated from being engaged in trade or business in Puerto Rico.

i **Tax on profits**

**Determination of taxable profit**

**Domestic entities**

Puerto Rico residents and domestic entities are subject to taxation on their worldwide income. However, not all income is taxable. The PRIRC prescribes a formula to determine

10 Article 8 of Act No. 154 of 20 August 1996, Puerto Rico Laws Annotated (PRLA) T10 Section 1867.
11 Id.
12 Article 4 of Act No. 154 of 20 August 1996, PRLA T10 Section 1863.
14 Section 1051.01 of the PRIRC, PRLA T13 Section 30201.
what amount of income is subject to taxation. Thus, to determine taxable income, taxpayers are required to compute gross income, gross income less exemptions, adjusted gross income and net taxable income.

Gross income includes:

a. all gains, wages and compensation for services performed;
b. income from professions, trades and businesses;
c. sales and dealings in properties;
d. rent;
e. interest;
f. dividends;
g. partnership profits;
h. transactions in securities; and
i. gains, profits and income derived from any source.

Gross income excludes those items listed in PRIRC Section 1031.01(b).  

After computing gross income, taxpayers must compute gross income less exemptions. These exemptions are contained in Section 1031.02 of the PRIRC.  

Finally, net income is determined by deducting from gross income allowable business deductions, and a few possible special deductions directly from ‘gross income less exclusions and exemptions’.

Corporations are not eligible for the deductions from adjusted gross income allowed to individuals, or personal and dependency exemptions.

Foreign entities and non-residents

Foreigners, corporations, pass-through entities and non-residents that are engaged in trade or business in Puerto Rico are subject to Puerto Rico taxation on their income that is effectively connected with the conduct of such trade or business. The rules to determine if income is ‘effectively connected income’ (ECI) are found in Sections 1123 (f) and (h) of the Regulation of the PRIRC of 1994, which are still in full force and effect.

In general terms, ECI includes:

a. all income from sources within Puerto Rico, and income attributable to an office or fixed place of business in Puerto Rico;
b. the following:
   • rents or royalties derived from the use outside Puerto Rico of intangibles such as secret processes, formulae, patents, trademarks, franchises and copyrights;
   • dividends, interest, gains or losses from the sale or exchange of stocks or bonds or other evidence of indebtedness that are either derived from a banking or financing

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15 See Section 1031.01(a) of the PRIRC, PRLA T13 Section 302. Some of the exclusions are, inter alia, proceeds from life insurance policies, annuity income received, and compensation for injuries and sickness.
16 Section 1031.02(a) of the PRIRC, PRLA T13 Section 3012.
17 Section 1031.03 of the PRIRC, PRLA T13 Section 3013.
18 Section 1031.05 of the PRIRC, PRLA T13 Section 3015.
19 Section 1092.01(b) of the PRIRC, PRLA T13 Section 3041.
20 Section 1123(f)(2) of the PRIRC of 1994, PRLA T13 Section 8523(f)(2).
business or from a corporation trading in stocks or securities for its own account; and

• gains or losses derived from the sale or exchange of personal property outside Puerto Rico through the corporation’s office or fixed place of business in Puerto Rico (except gains or losses from the sale of personal property that is manufactured outside Puerto Rico and is to be used, consumed or disposed of outside Puerto Rico);\(^{21}\)

c income or gains attributable to the rendering of services or the sale of property in another year if in such other year it would have been treated as effectively connected income;\(^ {22}\) and
d gains or losses from the sale or disposition of property that are used in connection with a trade or business in Puerto Rico or that ceased to be used in connection with a trade or business in Puerto Rico within the previous 10 years.\(^ {23}\)

**Capital and income**

Taxpayers may elect to treat income derived from the sale or exchange of their capital assets at a fixed preferential income tax rate, and to have their other income taxed in the regular manner; or included as part of their gross income, and taxed at the corresponding ordinary income tax rate. Currently, the long-term capital gains fixed income rate is 15 or 20 per cent for individuals and corporations, respectively.\(^ {24}\) To qualify as a long-term capital gain, the asset sold must be a capital asset and must have been owned by the taxpayer for more than one year.\(^ {25}\) As in the United States Internal Revenue Code, capital assets are defined by establishing what does not constitute a capital asset.\(^ {26}\)

**Losses**

**Operating loss**

The PRIRC allows taxpayers to deduct net operating losses (NOLs). NOLs are equal to the excess of deductions over gross income, subject to certain exclusions.\(^ {27}\) NOLs have a carryover period of 10 years,\(^ {28}\) and the deduction is limited to 80 per cent of net income.\(^ {29}\) NOLs do not include expenses paid to a related person or home office located outside of Puerto Rico.\(^ {30}\)

If a corporation is acquired, the NOL of said corporation can only be used to reduce the net income of the acquiring corporation derived from the same commercial activity or

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21 Section 1123(f)(3) of the PRIRC of 1994, PRLA T13 Section 8523(f)(3).
22 Section 1123(f)(5) of the PRIRC of 1994, PRLA T13 Section 8523(f)(5).
23 Section 1123(f)(6) of the PRIRC of 1994, PRLA T13 Section 8523(f)(6).
24 Section 1023.02 and 1023.03 of the PRIRC, PRLA T13 Sections 30082 and 30083.
25 Section 1034.01(a) of the PRIRC, PRLA T13 Section 30141(a).
26 Id.
27 Section 1033.14(a) of the PRIRC, PRLA T13 Section 30134(a).
28 Section 1033.14(b)(1)(C) of the PRIRC, PRLA T13 Section 30134(b)(1)(C).
29 Section 1033.14(b)(1)(D) of the PRIRC, PRLA T13 Section 30134(b)(1)(D)
30 Section 1033.14(d)(6) of the PRIRC, PRLA T13 Section 30134(d)(6)
trade or business that generated the loss.\textsuperscript{31} In addition, if a corporation undergoes a change in ownership as defined by the PRIRC, the use of NOLs in subsequent years may be subject to certain limitations.\textsuperscript{32}

\textbf{Carry forward}

\textit{Capital loss}

If a corporation has net capital losses, it can carry over such losses for a period of five years after the year of such losses.\textsuperscript{33} However, when capital losses are carried into another year, they are treated as short-term capital losses. If a corporation claims the deduction, the loss is limited to 80 per cent of net income.\textsuperscript{34} All other taxpayers can claim capital losses up to the amount of gains in the same taxable year.\textsuperscript{35}

\textbf{Rates}

\textit{Corporations}

Currently, the corporate income tax comprises a 20 per cent tax rate plus a graduated surtax computed on the 'surtax net income'.\textsuperscript{36} The 'surtax net income' is basically the net taxable income subject to regular tax less a surtax deduction amounting to US$25,000. The graduated surtax rates are as follows:

<table>
<thead>
<tr>
<th>Income</th>
<th>Surtax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to US$75,000</td>
<td>5 per cent</td>
</tr>
<tr>
<td>From US$75,001 to US$125,000</td>
<td>US$3,750 plus 15 per cent of surtax net income from US$75,001 to US$125,000</td>
</tr>
<tr>
<td>From US$125,001 to US$175,000</td>
<td>US$11,250 plus 16 per cent of surtax net income from US$125,001 to US$175,000</td>
</tr>
<tr>
<td>From US$175,001 to US$225,000</td>
<td>US$19,250 plus 17 per cent of surtax net income from US$175,001 to US$225,000</td>
</tr>
<tr>
<td>From US$225,001 to US$275,000</td>
<td>US$27,750 plus 18 per cent of surtax net income from US$225,001 to US$275,000</td>
</tr>
<tr>
<td>From US$275,001 and above</td>
<td>US$36,750 plus 19 per cent of surtax net income from US$275,001 and above</td>
</tr>
</tbody>
</table>

The applicable surtax rate is determined on a consolidated basis for controlled groups and related companies, and the net taxable income of all the entities subject to tax in Puerto Rico within the groups are combined for the determination of the applicable surtax rate.

Corporations are also subject to an alternative minimum tax to the extent that this tax exceeds the regular corporate tax.

Foreign entities and individuals are taxed depending on whether they are engaged in trade or business in Puerto Rico. If they are, their income effectively connected with their Puerto Rico trade or business is taxed as it would be if they were domestic taxpayers.\textsuperscript{37} If these taxpayers are not engaged in trade or business in Puerto Rico, Puerto Rico-source passive income received or deemed received is taxed at the following rates:

\begin{itemize}
  \item \textsuperscript{31} Section 1033.14(b)(2) of the PRIRC, PRLA T13 Section 30134(b)(2).
  \item \textsuperscript{32} Section 1034.04 of the PRIRC, PRLA T13 Section 30144(u).
  \item \textsuperscript{33} Section 1034.04 of the PRIRC, PRLA T13 Section 30141(d).
  \item \textsuperscript{34} Section 1034.01(c)(1) of the PRIRC, PRLA T13 Section 3014(c)(1).
  \item \textsuperscript{35} Section 1034.01(c)(2) of the PRIRC, PRLA T13 Section 30147(c)(2).
  \item \textsuperscript{36} Section 1022.02 of the PRIRC, PRLA T13 Section 30072.
  \item \textsuperscript{37} Section 1091.01(b) and 1092.01(b) of the PRIRC, PRLA T13 Section 30431.
\end{itemize}
Interest paid to an unrelated foreign corporation not engaged in trade or business in Puerto Rico is not taxable in the hands of the foreign corporation and is not subject to withholding.\textsuperscript{38}

**Individuals**

The tax rates applicable to individuals for years commencing after 31 December 2015 are as follows:\textsuperscript{39}

<table>
<thead>
<tr>
<th>Taxable net income</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net taxable income less than US$9,000</td>
<td>Zero per cent</td>
</tr>
<tr>
<td>Over US$9,000 but less than US$25,000</td>
<td>7 per cent of the excess over US$9,000</td>
</tr>
<tr>
<td>Over US$25,000 but less than US$41,500</td>
<td>US$1,120 plus 14 per cent of the excess over US$25,000</td>
</tr>
<tr>
<td>Over US$41,500 but less than US$61,500</td>
<td>US$3,430 plus 25 per cent of excess over US$41,500</td>
</tr>
<tr>
<td>Over US$61,500</td>
<td>US$8,430 plus 33 per cent of excess over US$61,500</td>
</tr>
</tbody>
</table>

Understanding the tax rates of individuals is necessary owing to their applicability to certain business that are pass-through entities.

**Administration**

Based on the principle of self-assessment, taxpayers are required to file tax returns on the 15th day of the fourth month after the closing of their fiscal year.\textsuperscript{40} Generally, corporations adopt a calendar year. However, they may elect to have a different fiscal year. A three-month extension to file a return is available.\textsuperscript{41} The payment of tax is due on the 15th day of the fourth month after the closing of the taxpayer's fiscal year.\textsuperscript{42} Taxpayers may request a six-month extension to pay the taxes owed.\textsuperscript{43} The Secretary of the Treasury of Puerto Rico may grant said request, but is not required to do so.\textsuperscript{44}

Some taxpayers may be required to file personal property tax returns by 15 May of each year and volume of business declarations by the fifth business day after 15 April.

\textsuperscript{38} Section 1092.01(a)(A)(i) of the PRIRC, PRLA T13 Section 30441.

\textsuperscript{39} Section 1021.01(a)(3) of the PRIRC, PRLA T13 Section 30061.

\textsuperscript{40} Section 1061.16 of the PRIRC, PRLA T13 Section 30256.

\textsuperscript{41} Id.

\textsuperscript{42} Section 1061.17 of the PRIRC, PRLA T13 Section 30257.

\textsuperscript{43} Section 1061.17(c) of the PRIRC, PRLA T13 Section 30257(c).

\textsuperscript{44} Id.
From a central government perspective, the Department of the Treasury is in charge of collecting taxes in Puerto Rico. The Municipal Collection Revenue Center (CRIM) collects property taxes. Finally, the department of finance of each municipality may impose and collect, subject to the authorisation of the government, additional taxes and fees such as construction fees and the municipal licence tax.

Ordinarily, a four-year statute of limitations after the return is filed applies for the Department of the Treasury to assess income, payroll, withholding, and sales and use taxes.

If a taxpayer assumes a position with respect to certain tax issues, and the Department of the Treasury, CRIM or the department of finance of a municipality disapproves of such position, the taxpayer may challenge the position taken by the tax authority. The process to challenge the tax position taken by the taxing authority varies on the type of tax at issue. However, in general terms, the taxpayer requests an administrative proceeding and then, if he or she disagrees with the outcome of such proceeding, the taxpayer may challenge it in the court system.

Prior to assuming a tax position, taxpayers may, if certain requirements and formalities are met, request the Department of the Treasury to rule on a particular issue.45 The ruling issued by the Department will be binding for both the taxpayer and the Department.46

**Tax grouping**

No tax grouping rules exists in Puerto Rico. Therefore, consolidated returns cannot be filed by corporations.

**Other relevant taxes**

**Sales and use tax**

Puerto Rico imposes a sales and use tax of 10.5 per cent on the sale, use, storage or consumption of a taxable item.47 This tax is paid by consumers; however, it is collected and remitted to the Department of the Treasury by merchants, who act as withholding agents for Puerto Rico.

**Real property tax**

Puerto Rico real property is subject to an annual real property tax. This tax is computed based on property values that date back to the fiscal year 1957–1958 (which was the last time that a general appraisal was conducted by the government). The tax assessment is made as of 1 January of each year by CRIM by discounting the current fair market value of the property to the 1957–1958 values. The applicable tax rates range from 8.03 to 11.83 per cent depending on the municipality where the property is located. Property taxes collected by CRIM are deposited into a trust fund at the Government Development Bank for Puerto Rico.

**Personal property tax**

CRIM requires the filing of a personal property tax return every year by 15 May. The rate varies from approximately 5.8 to 9.5 per cent of the reported value depending on the municipality, and may change from year to year.

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45 Department of the Treasury Circular Letter 99-01.
46 Id.
47 Sections 4020.01 and 4020.02 of the PRIRC, PRLA T13 Sections 32021 and 32022.

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**Payroll taxes**

In Puerto Rico, payroll taxes are imposed in the form of income taxes, Federal Insurance Contributions Act taxes, federal unemployment taxes, Puerto Rico employment security taxes, disability taxes, workmen’s compensation premiums and chauffeurs’ insurance premiums.

Puerto Rico employees are subject to income tax withholding on their payroll. They must also pay US social security and Medicare taxes. The obligation to withhold these taxes and remit the payment to the appropriate government entities belongs to the employer.

Puerto Rico unemployment tax is paid by the employer. This tax is imposed on the first US$7,000 of total wages paid to each employee during the calendar year, based on an experience rating system. Moreover, the employer must also pay a 1 per cent special tax on the wages subject to unemployment tax. However, the special tax together with the experience-based tax cannot exceed 5.4 per cent.

Puerto Rico provides all employees with disability insurance. This insurance is funded by imposing a contributory tax on the first US$9,000 of the total wages paid during the year (0.6 per cent). Half of this tax is paid by the employer and the other half is paid by the employee.

Employers are also responsible for paying the premiums for workmen’s accident compensation insurance. This insurance is compulsory, and is for employees who suffer injury, become disabled or lose their lives owing to a job-related accident. The premium is based on total wages paid during the government’s fiscal year. The applicable rates vary among industry types. By paying the insurance, the employers enjoy immunity from work-related accidents.

An employer with one or more drivers is subject to the chauffeurs’ social security tax. The tax is imposed on both the employer and the employee as follows: every employer must pay US$0.30 per week or fraction thereof for each covered employee; and every employee must pay US$0.50 per week or fraction thereof.

**Municipal licence tax**

Any individual or entity engaged in trade or business in Puerto Rico is subject to municipal licence tax. This tax is paid to all municipalities in which the individual or entity conducts business. If the business is non-financial, the tax may be as high as 0.5 per cent of the gross volume of business the company received or accrued during the year.

A separate tax return must be filed on or before 15 April of each year. This return is filed with each of the departments of finance of the municipalities where the entity is engaged in business, and reflects the volume of business realised by the corporation during the accounting year prior to the filing of the return. An extension of the time period for the filing of the returns is available, but an estimated payment must accompany such request.

**Excise tax**

Some products are subject to a special excise tax, including cigarettes, fuels, crude oils, vehicles, alcoholic beverages, cement, sugar and plastic products. The applicable tax depends on each product.

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48 Section 1062.01 of the PRIRC, PRLA T13 Section 30271.
49 Section 3102, 3111 and 3301 of the US Internal Revenue Code, 26 USC Sections 3102, 3111 and 3301.
50 Volume of business is defined as gross receipts.
Act 154 of 2010 adopts new source income rules and imposes a temporary excise tax on certain purchases by non-resident individuals, corporations or partnerships of products manufactured in Puerto Rico; and services related to said products by entities affiliated with the purchaser.

**Construction excise tax**

The municipalities may impose an excise tax on construction. The construction excise tax rate varies from municipality to municipality, but is generally around 4 or 5 per cent of the cost of the project. Costs of the project incurred for work performed outside Puerto Rico should not be subject to the construction tax, and the construction of certain projects is not taxable.

### IV TAX RESIDENCE AND FISCAL DOMICILE

#### i Corporate residence

Corporate residence is based on the place of incorporation, and not on where corporations are managed or controlled. Under the PRIRC, foreign corporations are deemed those not organised under the laws of Puerto Rico.51

The PRIRC does not define the term 'engaged in trade or business'. However, the Regulations issued pursuant to the Puerto Rico Internal Revenue Code of 1994 provide that said term includes the rendering of services in Puerto Rico at any time during the taxable year, and does not include transactions in shares of stock, securities or exchange commodities through a resident broker, resident agent or resident custodian.52 It should be noted that the definition of 'engaged in trade or business' of the courts of the United States is used consistently by the Puerto Rico Department of the Treasury.

Any partner of a partnership engaged in trade or business in Puerto Rico shall be deemed engaged in a trade or business in Puerto Rico with respect to his or her distributive share of the partnership’s income, gains, losses, deductions and credits.53

#### ii Branch or permanent establishment

As previously mentioned, foreign investors may conduct business in Puerto Rico through foreign or domestic entities. If they decided to conduct their business by establishing a branch in Puerto Rico, they may be subject to a branch profit tax (BPT).

A foreign corporation that derives less than 80 per cent of its gross income from sources within Puerto Rico and from income effectively connected to its trade or business in Puerto Rico, is subject to a BPT of 10 per cent of the dividend equivalent amount for the taxable year.54 This tax is imposed on the amount of earnings and profits not reinvested in activities in Puerto Rico. Net equity is equal to the excess of the basis of Puerto Rico assets owned by the foreign branch that are treated as effectively connected to its trade or business in Puerto Rico over the liabilities of the Puerto Rico branch effectively connected to its trade or business in Puerto Rico.55

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51 Section 1010.10(a)(6), (7) of the PRIRC, PRLA T13 Section 30041.
52 Regulation 6252 of 27 December 2000, Section 1231-2(c)(3).
53 Section 1071.01 of the PRIRC, PRLA T13 Section 30331.
54 Section 1092.02(a) of the PRIRC, PRLA T13 Section 30442(a).
55 Section 1092.02(c)(1), (2) of the PRIRC, PRLA T13 Section 30442(c)(1), (2).
The dividend equivalent amount is equal to the earnings and profits of the foreign branch derived from the effectively connected income relating to the trade or business in Puerto Rico reduced, but not below zero, by the increase in Puerto Rico net equity, and increased by the reduction in Puerto Rico net equity. The increases and decreases are determined by comparing the Puerto Rico net equity at the beginning of the year with the Puerto Rico net equity at the end of the year.56

To determine earnings and profits relating to ECI, the dividends distributed by a foreign corporation operating as a branch-out of earnings derived from sources within Puerto Rico are not taken into account.58 However, said earnings and profits include the excess of the accelerated depreciation deduction over the amount of the depreciation deduction that would result from application of the straight-line method, and certain interest excluded from gross income. Earnings and profits are reduced by the Puerto Rico income tax paid with respect to that year, excluding the BPT for the year, and business-related meals and entertainment expenses that were not deducted owing to the statutory limitation.

It is more advantageous to operate a subsidiary than a branch. First, the 10 per cent dividend tax is applied only when dividends are actually paid, while the BPT (when applicable) is automatically applied. Second, in the case of a subsidiary, the assets of the parent will generally not be exposed to possible claims originating from activities in Puerto Rico.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

Puerto Rico offers foreign investors several tax incentives to engage in and operate business in Puerto Rico. These incentives are structured either as tax credits or as a reduction in the applicable tax rates.

i Act 73

Designed to stimulate employment and productivity, research and development, capital investment, reductions in the cost of energy, and increased purchases of local products, the Economic Incentive for the Development of Puerto Rico Act (EIDA) allows companies qualifying under Act 73 to benefit from a simplified income tax system. To accomplish this, it applies an income tax rate of 4 per cent and a withholding tax rate of 12 per cent. Alternatively, the income tax can be lower if the income generated is from certain sources. For example, there is 100 per cent tax exemption on income generated from interest payments on assets held in Puerto Rico financial institutions.

EIDA also provides that special rates apply to projects located in low and mid-development zones, certain local projects, certain small and medium-sized businesses, and pioneering activities. (An income tax rate of 1 per cent, but for those using intangible property created or developed in Puerto Rico the income tax rate may be zero per cent). Moreover, EIDA grants a 90 per cent exemption from property taxes, a 100 per cent exemption from municipal licence taxes during the first three semesters of operations and at

56 Section 1092.02(b) of the PRIRC, PRLA T13 Section 30442(b).
57 Id.
58 Section 1092.02(d) of the PRIRC, PRLA T13 Section 30442(d).
least 60 per cent thereafter, and a 100 per cent exemption from excise taxes, and sales and use taxes with respect to the acquisition of raw materials and certain machinery and equipment used in the exempt activities.

Pursuant to EIDA, passive income derived by exempted businesses from the investment of eligible funds in Puerto Rico financial institutions, the obligations of Puerto Rico and other designated investments is exempt from income taxation as well as municipal licence taxes. Companies can also repatriate or distribute their profits free of Puerto Rico dividend taxes. Gains from the sale or exchange of shares of an exempted business by its shareholders during the exemption period that is otherwise subject to Puerto Rico income tax would be subject to a special Puerto Rico income tax rate of 4 per cent.

To obtain these benefits, companies must apply for a tax grant issued by the Office of Industrial Tax Exemption and the Department of Economic Development and Commerce.\(^{59}\) Tax grants issued to a qualifying business are for a term of 15 years.\(^{60}\)

ii  Tourism tax incentives

The Tourism Development Act of 2010 (TDA 2010) was enacted to substantially increase the country's tourism industry and thereby create more balanced economic development. To accomplish this objective, the TDA 2010 offers economic incentives to developers, operators and investors in hotels and other tourism-related projects. Some of these incentives are tax-related.

A business devoted to tourism-related activities that is not covered under a tax incentive decree under another applicable law or, if so covered, surrenders such decree, may qualify for a grant of tax incentive under the TDA 2010. The term ‘tourism-related activities’ includes:

- a  the ownership and management of hotels, condo hotels, inns and guest houses;
- b  the ownership and management of theme parks operated by or associated with an exempt hotel and golf courses operated within a resort;
- c  the ownership and management of tourist marinas, port area facilities and other facilities that constitute an inducement to tourism;
- d  the operation of a business devoted to leasing property to a business devoted to any of the above-listed activities (excluding financial leasing contracts);
- e  the development and management of natural resources used as passive or active entertainment or amusement, such as caves, forests, natural reserves, lakes and canyons; and
- f  the ownership and management of agro-inns to provide rooms for transient visitors for the enjoyment of nature and for participating in agricultural or Puerto Rican handicraft activities.

The income derived from qualifying tourism-related activities will be partly or completely exempt from taxation subject to the following:

- a  the percentage of income tax exemption offered to qualifying tourism-related activities not established on the islands of Vieques or Culebra may reach 90 per cent;
- b  for qualifying tourism-related activities established on the islands of Vieques or Culebra, the percentage of income tax exemption may reach 100 per cent; and

\(^{59}\) PRLA T13 Section 10652(b).
\(^{60}\) Section 10(a) of Act 73.
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a 100 per cent exemption will be applicable to dividend or profit distributions, and
distributions in liquidations. The income covered by a tourism decree issued under the
TDA 2010 is also exempt from corporate alternative minimum tax, corporate surtax
on improperly accumulated income and individual alternative minimum tax.

iii Free trade zones

Puerto Rico is within the customs jurisdiction of the United States. Therefore, imports into
Puerto Rico from foreign countries are subject to applicable duties under corresponding US
customs and imports laws.

US customs laws provide for the establishment of free trade zones (FTZs). There are
four FTZs in Puerto Rico:
a FTZ No. 61 located in the metropolitan area near the San Juan port facilities;
b FTZ No. 163 located near the port facilities in Ponce;
c FTZ No. 7 located in Mayaguez; and
d sub-zones located throughout the island in certain Puerto Rico Industrial Development
Company industrial parks.

From a federal tax perspective, goods, except those specifically excluded by US customs laws,
may be introduced into an FTZ, and may be stored, sold, exhibited, broken up, repacked,
assembled, distributed, sorted, graded, cleaned, mixed with other merchandise, used in a
manufacturing process, exported or destroyed exempt from US customs duties.

The goods imported directly into an FTZ in Puerto Rico are exempt from Puerto Rico
excise tax during the time they remain in the FTZ. Goods sold to a buyer in a foreign country
and shipped directly from the Puerto Rico FTZ area are not subject to Puerto Rico excise tax.

Goods destined only for foreign markets located in a foreign trade zone are pre-empted
from state local ad valorem taxes. Furthermore, the Municipal Property Tax Act of 1991, as
amended, provides in part that ‘property exempt from the payment of taxes by the laws of the
United States’ is exempt from personal and real property taxes.

Gross income derived from the exporting activities of a business located in a FTZ is
exempt from municipal licence tax. All other income derived from other activities conducted
by a business located in an FTZ is subject to municipal licence tax.

Businesses located in an FTZ in Puerto Rico are subject to Puerto Rico income tax.
However, a business that is operating under an industrial tax exemption grant is entitled to
the Puerto Rico income tax benefits offered under the terms of such grant.

iv Act 20

Enacted in 2012, the Act to Promote the Exportation of Services provides tax incentives to
individuals or corporations with a bona fide office or establishment located in Puerto Rico
that is or may be engaged in an ‘eligible business’, defined as persons that provide ‘eligible
services’, which in turn are considered for foreign markets or promotion services.

The term ‘eligible services’ includes:
a research and development;
b advertising and public relations;
c economic, environmental, technological, scientific, management, marketing, human
resources, information and audit consulting;
d advisory services on matters relating to any trade or business;
e commercial arts and graphic services;
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production of construction drawings, architectural and engineering services, and project management;

professional services such as legal, tax and accounting;

corporate headquarters;

electronic data processing centres;

development of computer programs;

voice and data telecommunications between persons located outside of Puerto Rico;

call centres;

shared services centres (‘shared services’), including but not limited to accounting, finance, taxes, auditing, marketing, engineering, quality control, human resources, communications, electronic data processing and other centralised management services;

storage and distribution centres (‘hubs’);

educational and training services;

hospital and laboratory services;

investment banking and other financial services; and

any other service that the government later determines must be treated as an eligible service.

Act 20 provides a 4 per cent flat income tax rate on export services income, 100 per cent tax-exempt distributions from earnings and profits derived from export services income, a 90 per cent exemption from property taxes (a 100 per cent exemption during the first five years of operations in the case of certain eligible services) and a 60 per cent tax exemption on municipal licence taxes. To be able to obtain these tax benefits, a service provider must apply for and obtain a tax exemption decree. This decree, if granted, will have a term of 20 years, renewable for 10 additional years, if certain conditions are satisfied. To be eligible for these tax benefits, the service provider must receive a certificate of compliance from the Department of Economic Development and Commerce annually.

Act to Promote the Relocation of Individual Investors to Puerto Rico (Act 22)

Act 22 was enacted in 2012. This Act provides a 100 per cent tax exemption from Puerto Rico income tax on interest and dividends that qualify as Puerto Rico-source income received by a ‘resident individual investor’. A resident individual investor is an individual who has not been a resident of Puerto Rico for the past six years before his or her first year of residence in Puerto Rico. Individuals applying for an Act 22 tax grant must own residential property in Puerto Rico and have a personal business account at a Puerto Rico bank or credit union.

Act 22 provides a preferential income tax rate for capital gains derived by the resident individual investor. If such gain was deemed accrued prior to becoming a Puerto Rico resident and is recognised within 10 years after the date residence is established in Puerto Rico, it will be taxed at a 10 per cent income tax rate, and at a 5 per cent income tax rate if such gain is recognised after said 10-year period but prior to 1 January 2036. Gains related to investment appreciation considered accrued after becoming a Puerto Rico resident will be 100 per cent exempted from Puerto Rico income taxes.

Other tax incentives

Act 168 of 30 June 1968, as amended, provides tax benefits to natural or juridical persons engaged in the operation of hospital units.
A tax credit is also available to investors to induce investment in the construction of facilities for the treatment and disposal of solid waste.

Act No. 135 of 9 May 1945 offers public air carriers an exemption from commonwealth and municipal property taxes on all real and personal property owned by the carrier.

Farmers are offered various tax incentives such as an excise tax exemption for certain machinery and products used in farming operations, a property tax exemption for land used intensively in raising certain agricultural crops and a 90 per cent exemption from income tax with respect to income derived from agricultural business.

To promote the construction and rehabilitation of social interest housing and middle class housing, Puerto Rico offers an exemption of up to US$5,000 of the gain from the sale of each unit of social interest housing units; and an exemption of up to US$2,500 of the gain from the sale of each unit of middle-class housing units.

Puerto Rico also offers the film industry significant tax advantages if they film their projects on the island. To this effect, on 4 March 2011, the Economic Incentives for the Film Industry Act was passed into law (Act 27). Act 27 offers significant tax benefits to certain persons engaged in, or responsible for, managing, developing, promoting or furthering an eligible film project or an infrastructure project.

vii Holding company regimes
Puerto Rico does not have a holding company regime in place.

viii IP regimes
Currently, Puerto Rico has no IP regime in place. However, individuals who qualify under Act 22, 2012 can reduce their income derived from royalties.

ix State aid
Puerto Rico offers state aid only under certain circumstances.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)
Foreign corporations and non-residents not engaged in trade or business in Puerto Rico are subject to a 29 per cent withholding on interests received by a related person, rents, royalties, salaries, annuities, compensations, remunerations, emoluments, distributions of certain types of entities related to real estate,61 income pertaining to the distributive share of a partner’s interest in a partnership, special partnership, LLC, net capital earnings, or other fixed or determinable annual or periodical gains, profits and income (other than insurance premiums or interest). This may include income received by related persons. However, a 10 per cent withholding rate applies if the payment is a dividend.

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61 Specifically, homeowner associations and any entity created or organised under the laws of the United States, or those of any state of the United States, which, during the taxable year, qualifies as a registered real estate investment company or investment trust under the United States Internal Revenue Code of 1986.
ii Domestic law exclusions or exemptions from withholding on outward-bound payments

If income is derived from interest payments on various credit facilities then the withholding rate does not apply.62

iii Double tax treaties

Owing to its political situation, Puerto Rico may not sign any treaty by itself. However, tax treaties entered into by the United States may be applicable to Puerto Rico. Pursuant to an opinion of the Puerto Rico Supreme Court, any Puerto Rico resident that is a citizen of the United States can claim the benefits of the tax treaty between the United States and the United Kingdom, and the terms of such treaty supersede any provision of Puerto Rico Law.63

VII TAXATION OF FUNDING STRUCTURES

Corporations can be funded through equity or liabilities. Ordinarily, no income is recognised by a Puerto Rico corporation on the original issuance of its stock. The PRIRC also provides that no gain or loss will be recognised if property transferred by a shareholder is solely in exchange for stock or securities of a corporation and if, immediately after such exchange, the corporation is controlled by the shareholder.64 Transfers made to investment companies, as defined by the Secretary of the Treasury, are not covered by this non-recognition provision.

If a corporation assumes liabilities of the transferor or receives property from the transferor subject to liabilities, such assumed liability is not treated as a receipt of money or other property by the transferor in determining whether the transfer is ‘solely in exchange of stock or securities.’ For the transferor, the basis of the stock received is reduced by the amount of money received, increased by the amount of gain recognised, and decreased by the amount of loss recognised by the transferor. For this purpose, the liability assumed by the corporation is treated as money received by the transferor.65

i Thin capitalisation

Puerto Rico does not have specific thin capitalisation rules.

ii Deduction of finance costs

As a general rule, finance costs can be deducted from gross income to determine the taxable income. However, this deduction is only allowed if it is ordinary and necessary in the course of business.66 In general, interest payments are deductible for non-individual taxpayers.67 The only limitation is that the debt for which the interest deduction is claimed is not used to purchase certain bonds and obligations, which income is tax free.68

62 See Section 1092.01(a)(2) of the PRIRC, PRLA T13 Section 30441.
64 Section 1034.04(o) of the PRIRC, PRLA T13 Section 30142.
65 Section 1034.02(a)(6) of the PRIRC, PRLA T13 Section 30142.
66 Section 1033.01 of the PRIRC, PRLA T13 Section 30121.
67 Section 1033.03 of the PRIRC, PRLA T13 Section 30123.
68 Id.
iii Restrictions on payments
Dividends must be declared by the board of directors of the corporation.\textsuperscript{69} Dividends can be declared charged to the corporate surplus or, in absence of such surplus, charged to the net profits of the fiscal year in which the dividend is declared or of the preceding fiscal year, or of both years.\textsuperscript{70} If the dividend is declared and the corporation does not have a corporate surplus or net profits, the directors of the corporations may be liable.\textsuperscript{71}

iv Return of capital
The Puerto Rico General Corporate Act governs the ability of a corporation to declare and pay dividends. To this effect, Article 5.18 prescribes that dividends can only be declared and paid out of the corporate surplus or, in the absence of such surplus, charged to the net profits of the fiscal year in which the dividend is declared or of the preceding fiscal year, or of both years.\textsuperscript{72}

From a tax perspective, dividends are taxed at a preferential tax rate. If dividends are paid to foreign corporations or partnerships not engaging in trade or business in Puerto Rico, the dividend is subject to a 10 per cent tax rate.\textsuperscript{73} Dividends paid by a Puerto Rico corporation or partnership, to a non-Puerto Rico corporation that has gross income connected to a trade or business in Puerto Rico of which amounts to at least 80 per cent of the total gross income for the past three full taxable years, to trusts and estates or individuals, whether residents or non-residents of Puerto Rico, are generally subject to a flat 15 per cent tax.\textsuperscript{74} If the dividend is paid to a domestic corporation by a controlled domestic corporation, then 100 per cent of the dividend paid is excludable from net income for the corporation receiving the dividend.\textsuperscript{75}

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition
Ordinarily, from a buyer’s perspective, the acquisition of a Puerto Rican business does not give rise to a taxable event. Thus, for buyers, the acquisition of a business is non-taxable at the time of the acquisition.

Buyers may structure the acquisition as they see fit – that is, buyers are free to secure credit facilities or use equity to purchase an existing business. The use of a local entity is highly suggested; however, it is not required.

ii Reorganisation
Puerto Rico provides business great flexibility, from a tax perspective, to merge or demerge. In fact, the majority of these transactions can be completed without giving rise to a taxable

\textsuperscript{69} Article 5.18 of the Puerto Rico General Corporations Act. PRLA T14 Section 3598.
\textsuperscript{70} Id.
\textsuperscript{71} Article 5.22 of the Puerto Rico General Corporations Act PRLA T14 Section 3602.
\textsuperscript{72} Id.
\textsuperscript{73} Section 1062.11 of the PRIRC, PRLA T13, PRLA T13 Section 30281.
\textsuperscript{74} Section 1023.06 of the PRIRC, PRLA T13 Section 30086.
\textsuperscript{75} Section 1033.19(a)(1)(D) of the PRIRC, PRLA T13 Section 30139.
event. Merging with a non-local entity is allowed by the Puerto Rico General Corporations Act, subject to compliance with certain requirements and filings with the Department of State.

From a tax perspective, reorganisations follow very closely (but not identically) the United States Internal Revenue Code. As in the United States, the underlying principle is that no gain or loss should be recognised owing to the fact that the new corporate structure is simply a continuation of the previous corporate structure.

If the reorganisation involves a foreign entity, transfer of property into a foreign entity in exchange for its stock or a complete liquidation of a controlled corporation into its foreign parent corporation in which no gain or loss is recognised, a ruling must be requested from the Secretary of the Treasury within 183 days after such an exchange to the effect that the corresponding transaction does not have the purpose of avoiding the payment of income taxes to Puerto Rico.

Exit

As a general rule, there are no tax penalties for relocating.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance
Puerto Rico does not have specific anti-avoidance rules.

ii Controlled foreign corporations (CFCs)
There are no controlled foreign corporation rules applicable in Puerto Rico.

iii Transfer pricing
Currently, Puerto Rico does not have transfer pricing rules in place. However, the Department of the Treasury has published proposed regulations to this effect. In general terms, said regulations follow the general principles of transfer pricing adopted by the United States.

iv Tax clearances and rulings
Prior to engaging in a transaction, taxpayers can request the Department of the Treasury to rule on the tax treatment of the transaction. The process to request such a ruling is outlined in Circular Letter 99-01. Tax clearance is not required for the acquisition of a Puerto Rican business.

76 See Section 1034.04 of the PRIRC, PRLA T13 Section 30144.
77 See Article 10.02 of the Puerto Rico General Corporate Act of 2011.
78 Section 1034.04(i) of the PRIRC, PRLA T13 Section 30144.
X YEAR IN REVIEW

President Trump signed the Tax Cuts and Jobs Act (the Act) into law. The Act introduces important changes to the federal tax regime affecting individuals, corporations, partnerships and businesses in general. The legislation will also have an impact on business operations in Puerto Rico. The extent of the impact to Puerto Rico business operations is being analysed.

XI OUTLOOK AND CONCLUSIONS

Overall, Puerto Rico provides great tax advantages for investors to conduct their business. More so, Puerto Rico also offers something that no other country in the world can offer: the certainty of the United States legal system and currency.
I INTRODUCTION

In the past few years, the Russian government has taken various measures to reduce adverse consequences of sanctions introduced by the United States, EU and certain other countries and to encourage foreigners to invest in Russia. The measures included major reform of corporate law, simplification of the regulatory framework, subsidies and guarantees, as well as various tax incentives, for example, in relation to industrial R&D, tourism and operation of ports. As of the end of the first six-month period in 2018 direct inward investment into Russia was US$438 million, slightly exceeding investment in the first six months of 2017. This is relatively small amount standing at par with inbound investments in Belgium. The OECD forecasts the growth of the Russian economy to continue at a moderate pace.

Tax incentives have been neutralised by a gradual overall increase in the tax burden, including an increase in the value added tax (VAT) rate (as of 1 January 2019) and introduction of various quasi-taxes.

Although the role of the state in the Russian economy has been growing constantly, certain mega projects have been completed by private investors. For instance, Yamal LNG, a company majority owned by Novatek (Russia), with Total (France), CNPC and Silk Road Fund (China) as private investors, completed the LNG project well ahead of the plan. Major tax and customs concessions were secured through amendments to Russian law and an intergovernmental agreement was concluded by Russia and China.

Valuation of Russian companies remains low, making them an attractive target for investors willing to take on the risk in the current economic and political environment.

At the same time, Russia has been exercising control over investments in certain sensitive industries, such as defence, aviation and nuclear. Russian law also imposes foreign ownership limitations in certain sectors (e.g., transport infrastructure, aviation and space industry, cryptology, mass media). In some cases acquisition of real estate by, and issuance of subsoil licences to, foreigners may be subject to restrictions.
II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

Russian law provides for a wide range of both corporate as well as non-corporate forms of doing business, however only a few are used in practice. Generally, tax rules do not materially differ depending on the types of corporate entities.

i Corporate

In most cases businesses prefer to invest through corporate vehicles. The two most commonly used forms of entities are the limited liability company (LLC) (shareholders in LLCs are called ‘participants’ and participants’ stakes are called ‘participatory interests’) and the joint-stock company (JSC), which may be public or non-public.

Both vehicles, as a general rule, stand for limited liability of their members provided that the corporate veil may be pierced in certain cases, including bankruptcy. The major difference between these forms is that LLC capital is divided into participatory interests, which are proprietary rights and not securities, while a JSC issues shares. The title to shares and participatory interest is recorded differently, and the rules of the registration of their transfer differ as well.

An LLC is generally perceived as an entity where personal connections between participants matter more that in a non-public JSC. That triggers some other differences: unlike non-public JSCs, an LLC’s charter may prohibit the disposal of participatory interests to third parties; an LLC’s charter may subject the transfer of participatory interest to consent of participants without any time limitation while in non-public JSCs the lock-up period is limited to five years; in contrast to LLCs, where the right of first refusal is granted by default under statute, there is no such right in non-public JSCs unless the charter provides otherwise.

Taxation of LLCs and non-public JSCs is widely similar save for specific distinctions (e.g., application of the capital gains rules).

Generally, the following taxes would normally apply to legal entities: profits tax, VAT, social security charges, property tax, land tax and stamp duties. There is no separate capital gains tax, securities tax or capital tax in Russia. Depending on the type of business they perform, companies may also be subject to mineral extraction tax and various resources-related taxes, export or import duty, excise taxes, transportation tax and state duty. Employers are normally obliged to withhold personal income tax from wages they pay. Finally, corporates may apply a range of special tax regimes available for small enterprises and the like.

ii Non-corporate

While many unincorporated forms of doing business are recognised by Russian law, they are rarely used, except for real estate investments. Examples of non-corporate organisations include the simple partnership agreement, investment partnership agreement and private equity fund.

All three structures are transparent for profits or income tax and property tax purposes. Property tax and profits or income tax (depending on whether a participant is a legal entity or an individual) are payable only by the participant but not by the partnership. Some other taxes may be paid by the managing partner on behalf of the partnership.

The mutual investment fund enjoys profits tax deferral as its main advantage compared to partnership agreements. Thanks to that, private equity funds are commonly used for real estate investment.
Apart from the mutual investment fund, non-corporate entities are not widely used in practice owing to lack of corporate protection of the participants in combination with somewhat ambiguous tax regulation.

III DIRECT TAXATION OF BUSINESSES

Key Russian taxes and their general rates for businesses are the following:

- **profits tax (20 per cent);**
- **VAT (currently 18 per cent, but will increase to 20 per cent as of 1 January 2019);**
- **social security charges (to the Pension Fund, 22 per cent for remuneration not exceeding 1.021 million roubles and 10 per cent for remuneration in excess of it; to the Medical Insurance Fund, 5.1 per cent; to the Social Security Fund, 2.9 per cent for remuneration not exceeding 815,000 roubles and zero per cent for remuneration in excess of it; and to the Social Security Fund for insurance for work-related injuries and diseases at rates ranging from 0.2 per cent to 8.5 per cent);**
- **property tax (2.2 per cent);**
- **land tax (may not exceed 0.3 per cent of the cadastral value of agricultural and residential land and 1.5 per cent for other types of land);**
- **mineral extraction tax;**
- **excises;**
- **transportation tax; and**
- **stamp duty (relatively low in Russia).**

**Tax on profits**

**Determination of taxable profit**

Corporates that are Russian tax residents are liable for profits tax on their worldwide profit (calculated as gross income minus deductible expenses).

Non-resident foreign companies with a permanent establishment in Russia pay profits tax on the taxable profits attributable to that permanent establishment. Given that Russian attribution rules are not sufficiently clear, disputes with the Russian tax authorities as regards attribution are not uncommon. Certain other income deemed to derive from Russian source and not attributable to a permanent establishment may be subject to withholding tax.

Profit is calculated as gross income less deductible expenses. Most business expenses are deductible, provided that they are economically justified (i.e., aimed at receiving profit) and properly documented. Restrictions apply to the deductibility of certain expenses, such as certain advertising expenses and interest.

Generally, profits tax is calculated on an accrual basis subject to certain exceptions. Special accounting rules apply for profits tax purposes.

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5 Although VAT is an indirect tax, we have included it in this chapter due to its structure.
6 Special rates may apply, for example 13 per cent applies to dividends received by Russian shareholders.
7 Zero per cent applies to export (exemption with credit), 10 per cent applies to certain food, medical goods, goods for children, etc.
8 Thresholds subject to annual change.
9 Decreased rates apply for particular types of taxpayers.
10 Other statutory value used in certain cases.
Capital and income

There is no separate capital gains tax in Russia. Capital gains are subject to the regular profits tax. A separate base may be required in respect of listed and unlisted securities.

An exemption is available for capital gains on the sale of participatory interests and specified in the law shares of Russian companies. In order to qualify for exemption, a taxpayer should have acquired shares or a participatory interest after January 2011 and have held them for more than five years.

Losses

Until recently loss carry-forward was limited to 10 years yet unlimited by amount. Now, loss may be carried forward indefinitely; however, such loss cannot reduce taxable profit in any year by more than 50 per cent. Loss included in the general tax profits base may be set off against received capital gain from non-negotiable instruments, but not vice versa.

Rates

Generally the profits tax rate is 20 per cent (that is shared between the federal (3 per cent) and regional (17 per cent) budgets). A zero rate applies to medical and educational institutions. In addition, the Tax Code lists certain categories of taxpayers eligible for profits tax incentives (for instance, residents of special economic zones). Until the end of 2018 regional authorities have the right to reduce, at their discretion, the regional portion of the rate from 17 per cent to 12.5 per cent. Starting from 2019, regions will only be able to reduce the rate in cases directly provided by the Tax Code, and the existing incentives will gradually fall apart.

Reduced rates also apply to certain types of income. For instance, dividends received by Russian companies from Russian and foreign subsidiaries are subject to a 13 per cent dividend tax. Furthermore, a participation exemption applies if the recipient has held at least a 50 per cent stake in the subsidiary continuously for at least one year. If the subsidiary is a non-Russian legal entity, it must also not be incorporated in a country that appears on the ‘black list’ of offshore jurisdictions published by the Russian government.

Dividends paid to non-Russian residents having no permanent establishment in Russia are subject to a 15 per cent rate unless a lower tax rate is available under an applicable tax treaty. Interest paid to non-Russian residents is subject to a 20 per cent withholding tax. However, this tax may be reduced (and even eliminated) under an applicable tax treaty. Royalties paid to non-Russian residents are subject to a 20 per cent withholding tax. Again, a reduction or full exemption may be available on the basis of a double tax treaty.

Administration

Advance profits tax returns are filed quarterly (or monthly, in some cases); the final return is filed annually.

All taxes, including profits tax, are administered by the Federal Tax Service, including its regional and local departments. Special tax inspectorates exist (e.g., for major taxpayers, for foreign taxpayers, for IT).

Tax rulings are available only in limited instances in Russia. However, it is possible to obtain individual guidance from the Ministry of Finance. Action in accordance with such

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11 A draft law is pending review that would expand the exemption regardless of when the shares were acquired.
guidance may exempt the taxpayer from fines and late payment interest, but not tax arrears. A taxpayer or tax agent can also request such guidance from the local Tax Service, however it is unclear if it grants the same benefit. Letters of the Federal Tax Service and letters of the Ministry of Finance addressed to an indefinite number of persons are formally not mandatory, but reflect the general policy of the tax authorities.

Tax assessments may be challenged with the superior tax authority or in court; most decisions are to be challenged with the superior tax authority prior to filing a lawsuit.

**Tax grouping**

Tax grouping is only available to few major corporations in Russia.

- Members of the group can count income and deduct expenses jointly, thus decreasing the tax and administrative burden. Transfer pricing rules are not applicable inside the group.
- Currently companies are prohibited from joining the existing consolidated groups. It is expected that the existing consolidated groups will be terminated by 2023.

### ii Other relevant taxes

**VAT**

VAT is charged on (1) goods, works and services 'supplied' in Russia, and also on property rights; and (2) imported goods.

- Goods are deemed to be supplied in Russia if they are located in Russia and not transported or if they are located in Russia at the time of dispatch.
- In respect of services the general rule is that they are deemed to be supplied in Russia if the seller of services carries out its activities in Russia. However, specific rules apply to certain types of services. For instance, consulting, legal, accounting, marketing, engineering and information processing services are deemed to be supplied in Russia if the purchaser or recipient of those services carries out its activities in Russia.

The standard VAT rate is 18 per cent. With effect from 1 January 2019, the standard VAT rate will be 20 per cent. A 10 per cent rate applies to certain food products, goods for children, certain mass media items (e.g., newspapers) and medical goods. The export of goods is zero-rated (exempt with credit). Certain VAT exemptions are available, for example the sale of land or residential properties and the import of certain technological equipment that has no Russian equivalent.

A company’s VAT liability is generally calculated as its output VAT invoiced to customers minus input VAT invoiced to the company by suppliers or paid to customs upon the import of goods. Where the amount of input VAT exceeds the amount of output VAT, the difference is usually recoverable.

**Personal income tax**

Russian tax residents (generally individuals who, regardless of their citizenship or domicile, are physically present in Russia for at least 183 days in any consecutive 12-month period) are subject to tax on their worldwide income. Non-residents are only subject to tax on income from Russian sources.

- In general employers are required to withhold personal income tax from wages. Personal income tax is withheld at a rate of 13 per cent from most types of income of Russian residents (special rates may apply) and at a rate of 30 per cent from Russian-sourced income.
of non-residents (although see below in relation to dividends). Employment-related income of non-resident individuals who are treated as highly qualified specialists is subject to 13 per cent personal income tax regardless of their residency status.

**Social security charges**

An employer is subject to social security charges payable on its employees’ and individual contractors’ remuneration. Employees are not subject to social security charges.

Employers are required to make contributions to different social security funds in the following amounts (assessed by reference to thresholds which are reconsidered annually):

- **a** to the Pension Fund, 22 per cent for annual remuneration not exceeding 1.021 million roubles and 10 per cent for remuneration in excess of it;
- **b** to the Medical Insurance Fund, 5.1 per cent; and
- **c** to the Social Security Fund, 2.9 per cent for annual remuneration not exceeding 815,000 roubles and zero per cent for remuneration in excess of it.

Additionally, employers are required to make contributions to the Social Security Fund for insurance for work-related injuries and diseases at rates ranging from 0.2 to 8.5 per cent, depending on the types of activities carried out by the employer.

**Property tax**

As a general rule, Russian companies are liable to pay property tax on the average annual net book value (cadastre value for trade and business centres and non-residential premises) of the fixed assets on their balance sheet. However, movable fixed assets acquired after 1 January 2013 (other than those acquired from related parties or in the course of liquidation or reorganisation) are exempt from property tax. This narrows the application of this tax to immovable fixed assets and movable fixed assets acquired before 1 January 2013. As of 1 January 2019, the property tax on movable fixed assets is abolished.

The standard property tax rate is 2.2 per cent. However, regional authorities may reduce that rate or even provide a full exemption for all or certain categories of taxpayers.

Owned land is exempt from property tax and is subject to a separate land tax.

**Land tax**

Land tax applies to landowners at the rate determined by the municipal authorities. Land tax is assessed on the cadastral (other statutory values apply in some cases) value of the land, which is usually equal or close to its actual market value. Land tax rates may not exceed 0.3 per cent of the cadastral value of agricultural and residential land. With respect to other land plots, the maximum rate is 1.5 per cent of the cadastral value.

Municipal authorities may establish tax incentives.

Businesses leasing land are not subject to land tax. Instead, they are liable for the land lease payments established by federal, regional or local authorities or other landowners.

**Mineral extraction tax (MET)**

Companies and individual entrepreneurs that extract commercial minerals must pay MET. In particular, this tax is levied on the extraction of coal, peat, crude oil, gas, ferrous and precious metals and precious stones.
**Excise taxes**

Certain activities with respect to alcoholic drinks, tobacco, transportation vehicles and oil products are subject to excise taxes payable by companies and individual entrepreneurs.

**Transportation tax**

Transportation tax is payable by persons in whose name a taxable transport vehicle is registered and is payable at the rate established for that type of transport vehicle. Regional governments are permitted to establish tax incentives for certain categories of taxpayers. Generally, transportation tax is not a great burden on businesses.

**Stamp duty**

Relatively small transactional fees apply to, among other things, the notarisation, registration and filing of legal documents and the issue of securities.

**Other taxes**

Other taxes include water tax and levies for the use of fauna and for the use of aquatic biological resources.

   Certain specific tax regimes are available to small businesses.

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**IV  TAX RESIDENCE AND FISCAL DOMICILE**

**i  Corporate residence**

All companies incorporated in Russia are deemed Russian tax residents. Companies registered outside of Russia may be deemed Russian tax residents if they have a place of effective management in Russia.

**ii  Branch or permanent establishment**

A foreign entity can establish its presence in Russia via a subsidiary, branch or representative office. Setting up a branch or representative office through which business activity is conducted regularly leads to permanent establishment in Russia unless the functions of such office are restricted to ‘preparatory and auxiliary’ activity.

   In line with an OECD tax treaty, a ‘dependent agent’ may also lead to a permanent establishment.

   As the test for permanent establishment in Russia is not formal but substantial, the only way to avoid its setting up in Russia is not to carry out regular business activity in Russia.

   The profits received due to activity of a permanent establishment are attributed to this permanent establishment. If there are several permanent establishments, the taxable base for each permanent establishment is normally calculated separately, unless a specific rule allows the taxable base to be calculated on a consolidated basis (e.g., if several permanent establishments are involved in a single technological process).

   Most of the double taxation treaties Russia is a party to are OECD-based, and so are the permanent establishment provisions.
V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

There are no special tax regimes for resident operations outside the home jurisdiction. Worldwide income of residents is subject to taxation in Russia unless a double tax treaty applies.

However, various tax incentives are available for doing business in Russia. Some of them are granted for investing in specific territories (special economic zones, territories of advanced social and economic development) or participation in certain investment projects (regional investment projects, special investment contracts). Russian tax law also encourages investment in high tech. Reduced social security charges are imposed on certain IP companies. Profits tax benefits apply in relation to depreciation of assets used in technological activities. Exemption from capital gains tax applies to listed shares of high-tech companies though, as a general rule, such exemption does not apply to listed shares. Favourable tax regimes are available for small businesses.

i Holding company regimes

Dividends are not subject to profits tax if the participation exemption conditions are met. In order to qualify for this exemption, a Russian company must have held at least a 50 per cent stake in the relevant subsidiary continuously for at least one year. If the subsidiary is a non-Russian legal entity, it must not be incorporated in a country that appears on the ‘black list’ of offshore jurisdictions published by the Russian government.

Exemption from capital gains is also available (see above).

ii IP regimes

There is no special IP regime in Russia, although there are some incentives for R&D and high-tech companies.

iii State aid

No state aid provisions apply in Russia.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)

Russian residents are required to withhold tax on dividends, interest, royalties and certain other payments to non-residents.

No withholding tax applies on profit distributions by a permanent establishment to the headquarters.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

As a general rule, such exemptions do not apply.

iii Double tax treaties (DTTs)

Russia has a very extensive network of DTTs (at the time of writing, there are 83).
DDTs may reduce local withholding on outward-bound dividends, and reduce or eliminate withholding on interest and royalties.

By way of example:

<table>
<thead>
<tr>
<th>Party to DDT with Russia</th>
<th>Dividends</th>
<th>Interest</th>
<th>Royalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cyprus</td>
<td>5 or 10 per cent</td>
<td>Exempt</td>
<td>Exempt</td>
</tr>
<tr>
<td>Netherlands</td>
<td>5 or 15 per cent</td>
<td>Exempt</td>
<td>Exempt</td>
</tr>
<tr>
<td>Luxemburg</td>
<td>5 or 15 per cent</td>
<td>Exempt</td>
<td>Exempt</td>
</tr>
<tr>
<td>Ireland</td>
<td>10 per cent</td>
<td>Exempt</td>
<td>Exempt</td>
</tr>
</tbody>
</table>

Most of the DTTs Russia is a party to are based on the OECD model. Russia is actively renegotiating its DTTs to accommodate recent trends such as source taxation of real estate shares and limitation on benefits.

iv  **Taxation on receipt**

DDTs may provide for set off of tax withheld on outbound dividends in the source country. The same applies to other types of income. The set-off amount should not exceed the amount of tax due in Russia.

**VII  TAXATION OF FUNDING STRUCTURES**

The most common way to fund business structures are loans, capital contributions and contributions to assets (financing by a shareholder with no capital increase).

i  **Thin capitalisation**

Rules on thin capitalisation apply if a Russian company (A) obtains a loan:

a from a foreign company that is ‘interrelated’ with the borrower on the basis of a 25 per cent direct or indirect ownership interest in the charter capital of the borrower; or

b from an affiliate of a foreign company that is ‘interrelated’ with the borrower on the basis of a 25 per cent direct or indirect ownership interest in the charter capital of the borrower; or

c that is guaranteed in any form by the above foreign company or its affiliate.

In these three cases, the thin capitalisation rules only apply if A’s debt-to-equity ratio exceeds 3:1 (12.5:1 for banks and leasing companies).

Interest attributable to the portion of the loan that exceeds the ratio is not deductible for A and is treated for tax purposes as a dividend that is normally subject to higher withholding tax under a tax treaty. The portion of the interest not taxed as a dividend is deductible up to the threshold set out in the Tax Code.

Thin capitalisation rules currently do not apply to permanent establishments of foreign companies.

ii  **Deduction of finance costs**

Generally finance costs can be deducted. However, interest may only be deductible subject to thin capitalisation rules and interest transfer pricing rules.
In relation to interest transfer pricing rules, if the loan is provided by a related party, interest may only be deductible if it is within the range set by the Tax Code. If the interest is higher than the threshold, only the interest up to the threshold can be deductible. This rule works for the assessment of profits tax to the lender as well: if the interest under the loan is lower than the threshold, the lender is subject to tax based on the lowest interest rate of the range provided by law.

iii Restrictions on payments

The right to receive a portion of distributed net profits (in the case of LLCs) or dividends (in the case of JSCs) arises only when the company makes a decision regarding net profit distribution or dividend payment. Profit and dividend distributions are subject to statutory solvency and certain other capital adequacy tests. In a number of situations profit or dividend distribution is prohibited, such as where the charter capital has not been fully paid up or where the company is close to being insolvent or may become insolvent as a result of the distribution.

iv Return of capital

Reduction of charter capital is allowed both in JSCs and LLCs. In some cases, such reduction may be obligatory (e.g., in case of insufficient net assets). Capital can be reduced twofold: by a decrease in the nominal value of the shares (participatory interest) or by a decrease in the number of shares (participatory interest). Share capital reduction may be either accompanied by return of capital or not.

When the reduction of share capital is not obligatory and is not followed by a capital return to shareholders then the company receives a taxable gain. Otherwise there are no tax consequences for the company.

As for the shareholders (participants), generally, irrespective of whether they are legal entities or individuals only the share premium is subject to profits tax.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Historically, a typical structure for acquisition involved an offshore company (often located in Cyprus, Luxembourg or the Netherlands) holding interests in Russian operating companies, with a shareholders’ agreement governed by English law. The popularity of offshore vehicles was owing to the greater flexibility in structuring the relationship between investors and the benefit of tax treaties and bilateral investment treaties offered by other jurisdictions.

Reforms to Russian civil law in recent years have increased the availability of Western-style structuring instruments for onshore business structuring.

Typically, relations between co-investors in such entities are governed by a Russian law shareholders’ agreement supported by an English law agreement containing anti-dilution and shareholder information provisions, and an English law deed of indemnity.

Traditional bank financing is the most common source of debt finance for Russian companies. However, sanctions limiting the debt- and capital-raising abilities of many state and state-backed companies have affected their ability to finance transactions. Further, international nervousness around sanctions has made many foreign banks generally cautious about lending money in Russia.
Equity financing via contributions to assets or increases of the charter capital of the company are common, although EU sanctions may limit the ability of EU investors to participate in these. Shareholder loans are also commonly used and tend to be unsecured.

ii  Reorganisation
Businesses can merge or demerge freely except for merging with or demerging from a foreign entity. Reorganisation itself is not taxed. All the tax duties are succeeded by the companies that resulted from reorganisation.

However, reorganisation requires completing administrative proceedings which take time. In addition, reorganisation can trigger special rights of creditors aimed at their protection (e.g., the right to demand early performance if the obligation is not duly secured) and an extraordinary tax audit.

iii  Exit
Legal entities can freely relocate within Russia. In order to do so tax authorities should be notified and the charter amended. No tax penalties for relocation exist. Relocation to a foreign jurisdiction is generally not permitted under Russian law.

Recent amendments allowed redomiciliation to Russia from foreign jurisdictions. However it is only possible to relocate to two areas – the Russian Island (Vladivostok) and the Oktyabrska Island (Kaliningrad). Special requirements are to be met in order for the redomiciliation to become possible. If the redomiciled companies meet the ‘international holding company’ criteria, they may enjoy various tax benefits, such as the lower ownership threshold for participation exemption purposes (15 per cent as opposed to 50 per cent generally) and for the capital gains exemption; in addition 5 per cent withholding tax applies on outbound dividends to foreign shareholders until 2029 irrespective of application of a tax treaty, as opposed to 15 per cent generally. International holding companies are exempt from CFC regulation, including taxation of CFC profit, until 2029.

IX  ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION
i  General anti-avoidance
GAAR have been developed in Russia by courts and applied for many years. In 2017 they were incorporated in the Tax Code, which provides that the following cases are considered tax avoidance:

- a reduction of the tax burden by misrepresentation of tax accounting and financial statements;
- the main purpose of the transaction is reduction of the tax burden or receipt of a deduction from the budget; and
- an obligation under the transaction or other operation is not fulfilled by the taxpayer’s counterparty or the person to whom this obligation was delegated.

The rule also describes circumstances that do not per se evidence tax avoidance (e.g., the possibility of the taxpayer reaching the same economic results with different means).

A taxpayer is presumed to act in good faith and the burden of proof rests with the tax authorities.

Notwithstanding the codification of GAAR, courts continue to apply the ‘unjustified tax benefit’ notion previously developed by the Supreme Arbitrazh Court.
ii Controlled foreign corporations

CFC rules came into force on 1 January 2015. Under the CFC rules, a CFC is a non-Russian entity (including funds, trusts, partnerships and foundations) which is controlled by a Russian tax resident (a company or an individual). Limited exemptions exist. The rules set out how ‘control’ is assessed and there are certain circumstances in which ‘control’ will be deemed to exist, for example where a certain minimum level of participation exists. A controlling Russian resident is now required to:

a notify the tax authorities of the CFC; and

b calculate the CFC’s profits and remit taxes to the state at the rate of 20 per cent (for Russian legal entities) and 13 per cent (for Russian individuals).

This is a relatively new area of tax law in Russia and there are still a number of questions about how it will apply in practice.

iii Transfer pricing

Generally, transfer pricing control applies to certain transactions between related persons and certain transactions that, for the purposes of transfer pricing control, are treated as being equivalent to transactions between related persons. In particular, all transactions between related persons where one of the parties is a non-Russian person are subject to such control.

Taxpayers are obliged to report to the tax authorities on all transactions that are subject to transfer pricing control. In addition, the tax authorities may conduct transfer pricing control audits.

If the price of a controlled transaction deviates from the market price and this deviation results in a reduction of taxes owed to the state, the tax authorities are able to assess the respective taxpayers for additional tax liabilities. That said, only profits tax, MET and VAT may be assessed as a result of the above control.

iv Tax clearances and rulings

See above.

X YEAR IN REVIEW

Unfortunately for businesses, the Russian government has taken certain measures resulting in the increase of the tax burden. The VAT rate will be increased by 2 per cent to 20 per cent effective 1 January 2019. Regions will lose the right to reduce the rate of profits tax payable to the regional budgets.

A new tax on additional income received from hydrocarbon production is being introduced. Taxpayers are legal persons that have licences specified by the law and satisfy certain requirements. The tax will also be applied to companies engaged in certain other activities in respect of hydrocarbon production. The tax rate amounts to 50 per cent from net profit received from hydrocarbon production reduced by expenses and the MET. The new tax will take effect from 1 January 2019.

Tightening of anti-abuse rules has been accompanied by the extension of the amnesty of capital rules. In 2018 the second stage of capital amnesty was proclaimed, which will continue until 28 February 2019. During this period, individuals who voluntarily declare foreign assets and accounts (deposits) will not be exposed to tax, criminal or administrative liability for certain categories of offences. Liquidation of their CFCs is exempt from tax. In
addition, persons who have declared certain property in this course of this campaign can reduce the income tax base on disposal of such property in future by the documented value of property received by the ultimate beneficial owner from the nominal owner.

XI OUTLOOK AND CONCLUSIONS

The main focus of the Russian tax authorities has been on challenging aggressive tax planning arrangements, including in the cross-border context. We expect that this trend will continue in the new year. In particular, the tax authorities have become very aggressive in applying the beneficial ownership concept when taxpayers claim treaty benefits.

Russia has been a strong supporter of the BEPS (base erosion and profit shifting) initiative and expects to further strengthen enforcement as a result of the introduction of automatic exchange of information.

The possible reform of taxation of the oil and gas industry remains on the agenda of the Russian government.
I  INTRODUCTION

With more than 90 double taxation agreements and one of the best tax regimes for holding companies in the world, Spain has evolved from a purely inward investment country to a tax-attractive platform jurisdiction.

Indeed, the holding regime together with the extensive participation exemption make Spain the best gateway for two main regions: (1) Latin America, since owing to its cultural links Spain is surely the best platform for investing in that region and many multinational groups are using Spain; and (2) Europe, since given the favourable tax regime for holding companies, many groups could get access to the European single market without almost any tax burden.

Spain is a business-friendly jurisdiction with highly skilled and sophisticated tax authorities that are in favour of giving certainty by means of advance tax rulings and pricing agreements.

Aligned with base erosion and profit shifting (BEPS) OECD and EU principles, Spain is involved in, and leading some of, the international initiatives aimed to promote transparency and implementation of anti-avoidance provisions such as those provided by the Anti-Tax Avoidance Directive and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting.

II  COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i  Corporate

Business can be developed by way of corporate entities, most commonly in the form of joint-stock companies (sociedad anónima or SA) requiring a minimum share capital of €60,000, or limited liability companies (sociedad limitada or SL) requiring a minimum share capital of €3,000. The responsibility of the shareholders is limited in both cases.

From the tax viewpoint, corporations, generally speaking, including not only SA and SL, but also other types of commercial companies, are subject to corporate income tax (CIT) regulations, which are levied on all legal entities resident in Spain.

Certain entities, mainly public entities and certain income of non-profit organisations, can be exempt from CIT.

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Non-corporate

There are non-corporate entities that could operate in businesses, such as the civil partnership or private equity funds.

CIT rules are also applicable to non-corporations, such as partnerships or lying heritages, provided they have a business purpose. Otherwise, in the event they do not have a business purpose, their income will be allocated (transparent) to their partners or co-proprietors. This is also the case regarding economic interest groupings, where profits or losses are taxed at the level of their co-proprietors.

Increasingly, individuals carrying out business activities – although taxed under personal income tax (PIT) – will apply, under certain cases, CIT rules when determining their business taxable income.

III DIRECT TAXATION OF BUSINESSES

i CIT

Determination of taxable profit

The taxable profit is the company's gross income for the tax period, less certain deductions. Its determination comes from the annual financial statements prepared under Spanish generally accepted accounting principles (SGAAP), as adjusted under certain statutory tax provisions.

The tax authorities are legally authorised to modify accounting results in order to determine tax results if they consider that the accounting results have not been calculated according to the SGAAP.

All necessary expenses and costs connected to producing income may be deducted from gross income to arrive at a taxable income determination. Additionally, the Spanish CIT Law provides for certain items that are never deductible (permanent differences) or are deductible in a different year (timing differences).

The standard tax rate is 25 per cent, although different rates may apply depending on activity and legal form (e.g., 30 per cent for banks).

Regarding costs, although all expenses incurred by the company will depress accounting profit, not all such expenses will be allowed for tax purposes. To be deductible, an expense must be correlated with the company's income. However, some expenses are considered non-deductible by the CIT Law: penalties, gifts, gambling losses, losses from intra-group sales, financial expenses with the group for intra-group acquisitions.

Capital gains and income

Capital gains are normally considered as ordinary income taxable at the standard CIT rate (generally 25 per cent) in the tax period they arise.

As explained below, participation exemption applies to capital gains arising on the transfer of shares when at least 5 per cent participation (or a participation value of over €20 million) is held for an interrupted period of at least one year, the transferred entity is an operating entity and certain other requirements are met.
**Losses**

Tax losses may be carried forward indefinitely, although any deduction is limited to 70 per cent of the positive taxable income before the application of the tax benefit for the capitalisation reserve and other specific items. Tax losses of at least €1 million can always be offset without limitation.

There are additional limitations for large companies and tax groups. When their turnover in the previous 12 months to the taxable period commencement reaches:

- €20 million: tax losses offsetting cannot exceed 50 per cent of the yearly taxable income before capitalisation reserve and tax losses are offset; and
- €60 million: tax losses offsetting cannot exceed 25 per cent of the yearly taxable income before capitalisation reserve and tax losses are offset.

The CIT Law provides anti-avoidance rules to prevent tax losses being utilised when there is a change in the control.

**Rates**

The standard CIT tax rate is 25 per cent and it applies to most companies, although there are other specific rates:

- special tax rates apply to certain activities such as banking, mining, oil and gas that are subject to a 30 per cent tax rate;
- non-profit entities are subject to a 10 per cent tax rate; and
- investment funds and UCITs are taxed at 1 per cent.

Apart from that, there is a special 15 per cent rate for newly created companies, applicable to the first tax period in which profit is obtained and the following period.

**Administration**

The tax year for CIT purposes matches with the accounting financial period, which may be other than a calendar year, but cannot exceed 12 months.

Corporate taxpayers must file tax returns within 25 days after six months following the end of the tax year.

Companies must make three advance payments on account of CIT during the first 20 days of April, October and December, calculated as follows depending on the turnover of the previous 12 months to the start of the taxable period and on the applicable tax rate (all below rates only apply to those companies subject to the 25 per cent CIT rate):

- companies with a turnover under €6 million must pay 18 per cent of the gross tax due liability of preceding tax year generally;
- companies with a turnover over €6 million and under €10 million must pay 17 per cent of the taxable income for the year to date; and
- companies with a turnover over €10 million will make an advance payment resulting from the higher of the following amounts:
  - 24 per cent of the taxable income for the year to date, reduced by withholding and current-year payments in advance; or
  - 23 per cent of the positive accounting profit for the same period reduced by current-year payments made in advance.
The statute of limitations for an assessment is four years as from the end of the voluntary filing period.

**Tax grouping**

The Spanish CIT Law allows Spanish tax resident companies and Spanish permanent establishments (PEs) belonging to a Spanish or multinational group to be taxed as a single group and, therefore, apply a special tax consolidation regime for CIT purposes.

To apply this regime, the main requirements are as follows:

- the Spanish companies should be owned (directly or indirectly) by the same parent company (either resident or non-resident);
- the parent company (either resident or non-resident) of the tax group must hold a direct or indirect minimum holding of 75 per cent (70 per cent for quoted companies) and the majority of voting rights in the Spanish companies belonging to the group;
- the above participation should be maintained during the whole taxable period; and
- the parent company cannot be tax resident in a tax heaven.

The main characteristics of the tax consolidation regime are described below:

- the taxable income results from the sum of all the taxable incomes of each Spanish tax resident company of the tax group, corrected as established in the following points;
- tax losses of any of the companies of the tax group can be offset against any company tax profits;
- tax profits generated from intra-group transactions are deferred and only included in the consolidated taxable income when:
  - they are carried out with third parties;
  - one of the intra-group companies that is part of the transaction ceases to form part of the group; and
  - the consolidation regime is no longer applied;
- specific limitations apply concerning the offsetting of tax losses or the application of tax credits generated by the group companies before they formed part of the tax group; and
- no withholding applies on payments made at intra-group level.

**Advance price agreement (APA)**

Taxpayers and the Spanish tax authorities may negotiate APAs on transfer pricing issues. The Tax Agency is quite favourable to the use of APAs since they can provide certainty for both parties, out of the context of a tax audit.

Although legally the length of an APA is not supposed to be longer than six months, its negotiation always takes longer. The APA cannot cover longer than four years, although it can have retroactive effect to years within the statute of limitation.

The documentation provided to the Tax Agency in the course of an APA cannot be used in a tax audit.

**Alternative dispute resolution**

Spanish taxpayers also have access to ‘the competent authority procedure’ provided in the tax treaties signed by Spain following the OECD Model Tax Treaty and the Arbitration Convention (90/436/ECC Convention of 23 July 1990) concerning the elimination of double taxation that may arise in intra-group transactions within companies residing in EU countries.
Finally, Spain is yet to implement Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union, which should be in force by 30 June 2019.

**Means of appeal**

After a tax audit, taxpayers are entitled to appeal the claim if they do not agree with it. Additionally, taxpayers might obtain suspension of the tax due under the claim, which in most cases would require a guarantee from the taxpayer.

With regard to appeals, a taxpayers have two alternatives: (1) appealing before the same body issuing the tax claim; or (2) appealing to an economic-administrative tax court.

Decisions issued by the Economic Court could be appealed to the Courts of Justice: to the Regional Courts of Justice or the High Court, depending on the amount of the claim.

Afterwards, there might be even another tier of appeal to the Supreme Court, but only when the case may create precedents, so the likelihood of accessing the Supreme Court is very limited.

Lastly, the appeal could reach the Court of Justice of the European Union (CJEU), although the taxpayer cannot directly request its involvement, but only through the Spanish tax court, if the court decides so.

**ii Other relevant taxes**

**Value added tax (VAT)**

Spanish VAT regulation implements the EU directives on VAT.

VAT is levied on the supply of goods and services provided by entrepreneurs and professionals, intra-Community acquisitions and imports of goods into Spain.

The concept of entrepreneurs and professionals includes a large number of assumptions, but basically refers to those persons (physical or legal) who carry out business or professional activities, meaning those that involve the commissioning of material and human factors of production, or one of them, for their own account in order to intervene in the production or distribution of goods or services.

The territory of application of the tax is the peninsula and the Balearic Islands. In the Canary Islands, Ceuta and Melilla other indirect taxes are applied (IGIC and IPSI, respectively). The operation of IGIC is similar to that of VAT with some differences with regard to exemptions. On the other hand, the IPSI is a basic sales tax.

There are three different rates of VAT: 21 per cent (general rate applied to regular deliveries of goods and services); 10 per cent (reduced rate applied to basic needs); and 4 per cent (super-reduced rate applied to basic needs other than those classified in the reduced rate). The ordinary rate of the IGIC is 7 per cent, and the other rates are zero per cent, 3 per cent, 9.5 per cent, 13.5 per cent and 20 per cent.

**VAT group**

When a Spanish parent company owns at least 50 per cent of one or more Spanish subsidiaries (dependent), all of them taxable in Spain, they could opt for the VAT group regime.

Within this special regime there are two forms of taxation: (1) basic level: the result of VAT tax returns of all members is aggregated and, if so, compensated; or (2) advanced level: the group is taxed like a single entity and internal operations do not generate VAT.
Regarding capital goods, their cost must be fully imputed within the period of regularisation of the quotas corresponding to the aforesaid goods.

**Property transfer tax (TPO)**

TPO applies to transfer of goods and rights when the transferor is a private individual. It also applies to real estate transfers and real estate leases when the seller is an entrepreneur but the operation is exempt from VAT.

Transfer of shares is exempt from both VAT and TPO, but when the transfer is aimed at dissimulating the transfer of real estate owned by the company, the actual taxation of transfer of real estate is applied.

TPO tax rates are 6 per cent for the transfer of real estate, as well as for the constitution and transfer of rights *in rem* over them; 4 per cent in the case of the transfer of movable property and livestock; and 1 per cent in the case of constitution of rights *in rem* of guarantee, pensions, bonds or loans.

The above rates may change from one region to another, since regional authorities have competence to increase those tax rates.

**Tax on financial transactions**

In October 2018 the government announced a draft of law that would establish a new tax on financial transactions; this tax would apply to acquisition of shares in traded Spanish companies when they have a market capitalisation above €1 billion. The tax amounts to 0.2 per cent of the consideration paid exclusively for the shares and the taxable person is the intermediary acting in the operation.

The above-mentioned draft of law requires parliamentary approval.

**Tax on certain digital services**

Also in October 2018, the government announced another draft of law whereby the ‘Google Tax’ is enacted. The tax requires parliamentary approval.

This tax applies to companies with worldwide turnover of over €750 million or Spanish income subject to this tax of over €3 million. The tax rate amounts to 3 per cent of income resulting from rendering digital services as defined in the draft of law.

**Local property tax (IBI)**

This tax is a direct municipal tax, periodic, real and mandatory in all councils, which taxes the value of real estate. The rate of taxation will vary depending on the city council, ranging from 0.3 per cent to 1.1 per cent of the cadastral value.

**Stamp tax (AJD)**

Stamp tax (document duties and registration fees) is levied on notarial instruments and records documenting transactions that need to be registered in public registries. The tax rates range from 0.5 per cent to 1.5 per cent of the operation value.

**Net wealth tax (NWT)**

NWT is levied on all assets and rights of economic content held by an individual.
IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

In general terms, an entity is deemed to be resident in Spain for tax purposes if at least one of the following requirements is met:

- it has been constituted under Spanish law;
- the registered office is located in the Spanish territory; and
- the effective management (direction and control of the activity) is located in the Spanish territory.

Under certain conditions, Spanish tax authorities can assume that an entity, located in a tax haven or a country with no taxation, is a tax resident in Spain. In order for this assumption to be applicable, the main assets and rights of the entity must be, directly or indirectly, located in Spain.

ii Branch or PE

Branches or PEs of foreign entities that are located in Spain are subject to CIT on their worldwide income.

However, a limitation in the deductibility of some of their expenses is imposed on PEs, such as payments (in the form of royalties, interests or commissions) made to its parent entity or any of its other branches as remuneration for technical assistance services or the transfer of goods and rights.

Nevertheless, administrative and management expenses derived from the parent entity might be deductible under certain conditions.

As regards the allocation of profits of PEs, reference is usually made to OECD guidelines and principles.

In practice, operating in Spain through a PE leads to uncertainty situations in terms of income allocation, as it is more difficult to be supported and sustained before the tax authorities than operating through a clearer frame (basically, resident subsidiary).

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding companies regime

The holding companies regime can be applied by entities, with material and personal means, whose corporate purpose includes the administration and management of participation in foreign entities.

Under this regime the distributions made by holding companies, of profits derived from exempt foreign-source dividends and capital gains, to foreign shareholders are not subject to withholding tax in Spain.

Additionally, the capital gains derived from the transfers of shares of holding companies that correspond to exempt dividends and capital gains are not taxed in Spain.

This regime will not be applicable if the shareholder of the entity applying the holding companies regime is located in a tax haven or a no-taxation country.
Participation exemption for dividends and capital gains, and capital losses

Dividends obtained by Spanish entities either from resident or foreign entities may be exempt from taxation under the participation exemption regime. Both domestic and foreign entities’ dividends will be generally exempt when the following conditions are met:

a. the recipient either owns at least 5 per cent of the distributing entity or has an acquisition cost higher than €20 million; and
b. such stake has at least one year’s seniority (the one-year seniority could be fulfilled afterwards).

In the case of a foreign subsidiary an additional condition is required. In order for the exemption to apply, the foreign subsidiary should be effectively subject to (and not exempt from) a tax similar to CIT at a nominal rate of at least 10 per cent; this requirement is understood to be met when a tax treaty is applicable and it includes an exchange of information clause.

It must be noted that specific requirements are demanded in case of indirect participation through a holding entity.

Furthermore, capital gains resulting from the sale of shares in both Spanish and foreign entities would be generally exempt from taxation when requirements for participation exemptions are fulfilled. In case of sale of foreign subsidiaries, the minimum taxation requirement must be met during all the years in which the participation has been held.

Capital losses from shares that could benefit from the participation exemption are not tax allowed, unless they come from liquidation with certain requirements.

Patent box

A partial exemption can be applied to the income obtained by entities from the transfer of the right to use or exploit certain assets (patents, utility models, registered advanced software, complementary certificates for the protection of medicines, phytosanitary products and legally protected designs), that have been generated by research, development and technological innovation activities. This partial exemption can amount to a maximum of 60 per cent of the income.

This partial exemption can also be applied to capital gains generated from the transfer of the above-mentioned assets to third parties. If the transaction is carried out between related parties, the partial exemption will not apply.

Capitalisation reserve

Entities that are taxed under the general and increased tax rates (25 per cent and 30 per cent, respectively) can apply a special reduction to their positive taxable base in an amount equal to 10 per cent of the increase in its net equity. The following conditions must be met in order to apply this reduction:

a. there must be an increase in the entity’s net equity that must be maintained during a five-year period; and
b. a reserve for the amount of the reduction must be booked separately in the account balance. This reserve should be recorded as restricted reserves for, at least, a period of five years.
However, this reduction cannot exceed 10 per cent of the entity’s positive taxable base prior to certain adjustments. The excess over the aforementioned limit can be carried forward for application in the following two years.

### State aid

Spanish internal regulations establish certain tax incentives to promote investment by foreign companies in Spain, which reduce the tax burden in the field of taxation on company profits. However, state aid is forbidden by the EU.

### Start-up companies

In Spain, a series of incentives for start-ups were introduced in 2013 with the aim of boosting business creation and encouraging job creation. They consist in some measures on CIT and PIT that are applicable during the first years of an activity.

## VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

### Withholding on outward-bound payments (domestic law)

Provided that a double tax treaty (DTT) is applicable, the terms of such DTT should be observed. If there is no applicable DTT or a limit of taxation is not envisaged in the relevant DTT, payments made by a Spanish taxpayer to a non-resident entity will subject to withholding tax in Spain at the following general rates:

- **a** the general rate is 24 per cent, except for 19 per cent for tax residents in the EU and EEA;
- **b** 19 per cent on dividends and interest;
- **c** 19 per cent on royalties paid to residents in the EU, Iceland and Norway, and 24 per cent in all other cases; and
- **d** 19 per cent on capital gains.

For the application of a reduced rate or one of the exemptions described below, the taxpayer must be in possession of a tax residence certificate issued by the tax authorities of the country of the recipient.

### Domestic law exclusions or exemptions from withholding on outward-bound payments

#### Dividends

According to the domestic law, dividends paid by a subsidiary to its EU parent company are exempt from withholdings when:

- **a** the parent company holds at least a minimum holding of 5 per cent in the Spanish subsidiary (or alternatively, the acquisition cost exceeds €20 million) and the interest in the Spanish subsidiary has been held for at least one year before the dividends distribution (or will be held up to completing the one-year period);
- **b** both the entity paying the dividends and the beneficial owner are subject to and not exempt from one of the corporate taxes mentioned in Article 2(c) of the Council Directive 2011/96/EU of 30 June 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States;
the payment is not a consequence of the liquidation of the subsidiary; and

both the entity paying the dividends and the beneficial owner have one of the legal forms listed in the Annexes to the Council Directive 2011/96/EU of 30 June 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

This exemption will not be applicable if the majority of voting rights of the receiving entity is directly or indirectly owned by non-residents in the EU, unless it is proven that the incorporation of the receiving entity is due to valid economic reasons and sound business reasons.

**Interest**

Interest paid to a resident in the EU will be exempt of withholding. This exemption does not apply when the recipient is tax resident in a tax haven.

**Capital gains**

Capital gains from alienation of movable goods (including shares) by tax residents in the EU are exempt from withholding, except in the following cases:

- the transferred shares are issued by a Spanish company whose main asset or assets are (directly or indirectly) assets located in the Spanish territory;
- the non-resident selling the company is a private individual that has held (directly or indirectly) at least a 25 per cent holding in the Spanish company at any time during the 12 months prior to the transfer; and
- when the transferor is a non-resident entity, the exemption will only apply if the domestic participation exemption requirements (described above) are fulfilled. This requirement aims to equalise the treatment of both residents and non-residents.

**Royalties**

Royalties paid to an EU Member State would be exempt from withholding when the following requirements are met:

- both the entity paying royalties and the beneficial owner have one of the legal forms listed in the Annexes to the Council Directive 2003/49/EC of 3 June 2003;
- both the entity paying royalties and the beneficial owner are subject to and not exempt from one of the corporate taxes mentioned in Article 3(a)(iii) to the Council Directive 2003/49/EC of 3 June 2003;
- both entities are resident in the EU and none of them is resident in a third country in accordance with a DTT;
- both entities are associated companies (i.e., (1) one has a direct minimum holding of 25 per cent in the capital of the other, or (2) a third company has a direct minimum holding of 25 per cent in the capital of both entities). This holding should be held for a minimum holding period of one year that may be completed after the payment; and
- the entity that receives those royalties should receive them for its own benefit and not as an intermediary, such as an agent, trustee or authorised signatory, for some other person and, when the recipient is a PE, the received royalties should effectively be connected with that PE’s activity and it should be a taxable income for the PE.
This exemption over royalties will not apply when the majority of voting rights of the receiving entity is directly or indirectly owned by a non-resident in the EU unless it is proven that the incorporation of the receiving entity is due to valid economic reasons and sound business reasons.

### iii DTTs

Currently, Spain has entered into DTTs with more than 90 countries, the main aim of which is to eliminate double taxation and provide for reduced rates of withholding taxes of dividends, interests and royalties. DTTs concluded by Spain are generally compliant with the provisions set forth by the OECD.

A certificate stating that the taxpayer is a resident in another contracting state is required for a non-resident to benefit from the provisions of a treaty. Certificates of residence are valid for one year.

#### Taxation on foreign-sourced income

Dividends from foreign subsidiaries might benefit from the participation exemption as described above.

Profit from foreign PE of Spanish companies could benefit from income exemption, as could dividends.

Other income from abroad might benefit from double taxation relief (credit method), which in certain cases could be more beneficial than the exemption method.

### VII TAXATION OF FUNDING STRUCTURES

#### i Thin capitalisation

Thin capitalisation rules were replaced by rules preventing earnings stripping rules.

#### ii Deduction of finance costs

As a general anti-avoidance rule, interest paid to a group entity incurred in order to acquire shares or increase equity interests in other group members is wholly non-deductible (tainted financial expenses), unless the operation might pass a test business purpose.

Remaining net finance cost (this is the net amount of financial income and cost, excluding the above-mentioned tainted financial expenses) is deductible up to an amount equal to 30 per cent of the operating profit defined as the accounting operating profit eliminating the effect of (usually increasing):

- the amortisation of fixed assets;
- the subsidies for non-financial fixed assets and others; and
- the depreciation for impairment of fixed assets as well as the gains or losses derived from the transfer of fixed assets.

The resulting amount should be increased with dividends derived from entities when the stake represents at least 5 per cent of their share capital, or, alternatively, has an acquisition cost exceeding €20 million. This rule will not apply to dividends from subsidiaries that have been acquired from other companies of the group with group debts generating tainted non-deductible financial expenses referred to above.
Net financial cost above 30 per cent of operating profit could be carried forward and deducted in the following tax years (with no term limitation) within the same limit of 30 per cent of the annual operating profit.

Conversely, if net financial cost is below 30 per cent of operating profit (e.g., capacity excess) that excess of capacity may be carried forward to deduct more financial cost in the following five years.

The above limitations do not apply when:

a. net financial cost does not exceed €1 million;

b. the entities are incorporated under the legal form of insurance or financial entities; or

c. in case of entities belonging to a tax unit or tax consolidation group, all the above calculations (net financial cost, operating profit, etc.) would be referred to the whole group.

**LBO operations**

There is a special rule for interest allowance in case of leveraged buyout operations (LBOs) whereby the above-mentioned 30 per cent operating income limit should exclude acquired entities operating income provided that the latter has been merged into the acquiring entity (or acquiring entity’s tax unity) within four years following the target company acquisition.

Two considerations should be made in relation to this LBO additional limitation:

a. this limitation does not prevent the general interest barrier rule from being applied, therefore, the rule that determined the lower amount of interest will be the applicable one; and

b. the LBO specific limitation rule will not apply if the interest bearing debt does not exceed 70 per cent of the purchase price of the shares and is proportionally reduced during eight years following the acquisition, until the debt reaches 30 per cent of the purchase price.

### iii Restrictions on payments

**Dividends**

Spanish corporate law provides that dividends or distributions of the earnings for the financial year are decided by shareholders at general meetings on the basis of an approved balance sheet.

Dividends may only be drawn on the year’s profits or freely available reserves if:

a. the requirements laid down by law and in the by-laws are met; and

b. the value of the corporate equity is not, or as a result of such distribution would not be, less than the company’s capital.

Regardless of the above, dividends distributions are subject to the following additional limitations:

a. the dividend distribution should not entail a direct or indirect distribution of any profit directly allocated to equity;

b. in the event of losses in preceding years that reduce corporate equity to less than the company’s capital, profits shall be used to offset such losses; and

c. profit distribution shall likewise be prohibited if the amount of the distributable reserves comes to less than the sum of the research and development expenses shown as assets on the balance sheet.
When there is an adverse tax treatment for dividend distribution, an alternative to be considered could be the purchasing (back) of shares by the company, which could be done with certain limits. Share buy-backs are not deemed a distribution of dividends, but a sale of shares that accordingly generates capital gains or losses to the shareholder.

**Board of directors’ retributions**

Despite being quite a controversial issue, any retribution paid to a director (including salaries when together with their position in the board the director also acts as senior management of the company) should be expressly provided in the company by-laws, since otherwise retributions are not tax deductible.

**Financial assistance**

Spanish companies must also be aware of an issue called financial assistance, which is designed to stop a target assisting by any means in its own transfer.

**iv  Return of capital**

Shareholder contributions can take three main forms: share capital, share premium and equity contributions. As a general principle, it is advisable to contribute as little capital as possible and as much share premium as possible since share premium is equity (solvency) but it gives the shareholder more flexibility when it comes to capital reduction, losses or dividend distributions.

Repayment of capital should be approved by the general meeting and it is subject to approval by a qualified majority of the shareholders, the reduction of the capital should be executed in a public deed and sometimes it is also required to be published.

From the tax perspective, when the capital repayment is executed by means of a shares cancellation, 1 per cent stamp duty applies to the equity refunded to shareholder; where shares are bought back usually no transfer tax applies.

**Anti-hybrid provision**

As of 2015 there are two limitations in connection with the hybrid structure. First, there is a limitation on interest payable with respect to a profit participating loan (PPL) that will not be deductible where the lender and the borrower belong to the same group. PPLs are a type of loan which are regarded as equity in situations where the borrower is in an unbalance situation. Second, participation exemption will not apply to the income that is regarded as dividends in the recipient entity but that generates a deductible cost in the paying entity.

Finally, Spain is about to implement the anti-hybrid rules included in the Anti-Tax Avoidance Directive (ATAD).

**Secondary adjustment and substance over form principle**

As of 2008, SGAAP mostly follow IFRS; hence, the principle ‘substance over form’ has become of great importance. According to that principle, when there is an operation without an arm’s-length value between a shareholder and a company, it should be understood that there is an equity contribution or an equity distribution depending on the party taking advantage of the lack of retribution. If the shareholder is not the single owner of the company, it is
understood that there is an equity contribution or distribution on the ownership percentage but a taxable income or a non-deductible gift for the remaining share capital owned by another shareholder.

The same rules applies when there is a tax transfer pricing adjustment and the Spanish tax authorities consider that the conditions applied are not market conditions.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

In Spain the acquisition of a business activity could be done by means of an asset deal or a shares deal. While an asset deal is generally advisable from the acquirer point of view, the sale of shares is more beneficial from the seller point of view.

Asset deal

From the seller point of view, generally, an asset deal triggers a capital gain or deductible taxable loss; the capital gain may be offset with carry-forward losses, within the legal limitations.

Conversely, the buyer might recover the price paid by taking advantage of the step up resulting from the sale. Besides, an asset deal may determine a limitation of the tax liability shifted to the buyer. Special attention should be paid when the asset deal involves real estate, since the indirect taxation could be worse than in a share deal, as VAT does not apply to a transfer of a branch of activity and, then, real estate will trigger TPO, which would result in a higher acquisition cost (non-recoverable) for the buyer.

Shares deal

Provided the sold entity is a business operating entity, the share deal will not likely result in a tax burden for the seller.

The buyer, however, will not take advantage of the assets step up (and accordingly does not uplift the basis for depreciation or amortisation and future capital gains) and the entity will be fully liable for past contingencies.

When a foreign investor acquires a Spanish entity through a special purpose vehicle (SPV) a fiscal unit (tax group) should be considered between the acquiring entity and the Spanish target company, subject to certain requirements. Accordingly, interest expense on the acquisition debt at the level of the SPV could be offset against the profits of the target entity (when the debt does not exceed 70 per cent of the price and it is proportionally reduced during eight years following the acquisition, until the debt reaches 30 per cent of the purchase price, as described above).

Reorganisation

The Spanish CIT Law offers many ways for reorganisation, such as merger, divisions, spin-off, portfolio demerger and special assets contribution. Following Council Directive 90/434/EEC of 23 July 1990, and Council Directive 2009/133/EC of 19 October 2009, on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, those operations could be done without tax costs under the neutrality regime, avoiding most direct and indirect tax costs.
However, in order to apply the neutrality regime, companies participating in the operation should be able to demonstrate that the operation is not tax-driven and it is done mainly for valid business reasons.

The neutrality regime is based on deferral and the assets acquiring entity would subrogate (for tax purposes) in acquisition value and date of the transferred assets.

Cross-border reorganisation might be tax-neutral if assets of the Spanish resident participating company are allocated to a Spanish PE.

iii Exit

The transfer abroad of either the tax residence of a Spanish entity or its legal seat is allowed by Spanish law.

When it comes to the transfer of legal seat some obstacles might appear depending on the country of destination.

For tax purposes, the transfer of tax residence will trigger a capital gain or loss for the difference between the company’s assets (and liabilities) market value and their historical tax value, triggering the exit tax.

The exit tax could be either avoided or deferred:

a it would be avoided if the assets are allocated to a PE of the foreign entity (formerly tax resident in Spain) in Spain; or

b alternatively, it could be deferred if (1) the tax residence of the company or the PE is transferred to an EU Member State or to an EEA country with effective exchange of information with Spain; and (2) the taxpayer asked for that deferral, constituting the relevant guarantee until the assets are transferred to third parties, when the tax will eventually become payable. Late payment interest will accrue along that period.

In October, the government announced a draft of law where ATAD is implemented, amending the current exit tax regime, introducing some situations where the exit tax also applies (i.e., when a PE ceases its activities) and providing that the exit tax cannot be deferred sine die, but it has to be paid in five instalments. This draft of law needs parliamentary approval.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

The Spanish General Tax Law provides several General Anti-Avoidance Rules (GAAR) that would allow Spanish tax authorities to tackle situations where the taxpayer artificially avoids the payment of taxes:

a the substance over form or requalification rule;

b a rule for conflicts in the application of the law; and
c rules for simulated schemes.

According to ATAD, EU Member States have to implement GAAR. However, since Spain already had such rules and there would not be a need to introduce new rules, no modification would be required.
Additionally, Spanish legislation has numerous Specific Anti-Avoidance Rules (SAAR), the most frequently applied being the following:

- the transfer pricing anti-avoidance rule;
- limitation of financial interest paid to group entities deductibility;
- the anti-abuse rule for mergers, spin-offs and exchange of shares; and
- a rule preventing the transfer of companies with carry-forward tax losses.

ii Controlled foreign corporations (CFCs)

CFC legislation applies to all resident taxable entities holding a participation in foreign entities located in low-tax jurisdictions other than EU and EEA Member States and whose income is passive income or, despite the nature of its income, the subsidiary does not have any substance, as defined in the law.

For CFC rules to be applicable, the following requirements should be met:

- the Spanish entity, together with other related parties, should have at least 50 per cent participation in the foreign company;
- the foreign participating entity does not have any substance or the subsidiary income is passive as defined in the law; and
- the income tax paid by the entity is lower than 75 per cent of the tax payable in Spain.

When CFC rules apply, the Spanish taxpayer owning the foreign subsidiary should allocate (transparent) the latter’s income in the proportion the taxpayer participates in the subsidiary.

CFC rules do not apply when: (1) the foreign subsidiary is tax resident in an EU Member State; and (2) it is demonstrated that the foreign entity was incorporated for sound business reasons.

In October 2018, the government announced a draft of law that will modify the CFC rules in order to implement CFC rules provided by ATAD.

iii Transfer pricing

Spanish companies and PEs must value their operations with related parties in accordance with the arm’s-length principle. This principle applies both for accounting and tax purposes. In both cases, the burden of proof is on the taxpayer’s side. It is important to keep in mind that, according to the Spanish income tax, the number of people and entities that are regarded as related parties (the ‘related parties perimeter’) is larger than in most countries.

Apart from the related parties’ perimeter, Spanish transfer pricing rules are totally aligned with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and EU transfer pricing regulations.

Transfer pricing documentation

As of 2008, transfer pricing documentation should be prepared. Documentation obligations are based not only on the EU Joint Transfer Pricing Forum Code of Conduct, but also on the OECD Transfer Pricing Guidelines.

Documentation obligations stipulated by the transfer pricing regulation can be divided into:

- group documentation to which the taxpayer belongs (master file); and
- specific documentation for the taxpayer (local file).
These new documentation requirements are applicable for tax periods beginning from 1 January 2016.

**Tax penalty regime since 2015**

The Spanish CIT Law establishes a specific tax penalty regime as follows:

<table>
<thead>
<tr>
<th>Fulfilment of documentation obligations</th>
<th>Fulfilment of the obligation to apply market value</th>
<th>Penalties</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>€1,000 for each data or €10,000 for each set of data</td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
<td>No (Only for those cases in which the valuation applied can be deduced from the documentation)</td>
<td></td>
</tr>
<tr>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>15 per cent of the adjustment</td>
</tr>
</tbody>
</table>

It is important to point out that the penalty regime is aimed at the taxpayer fulfilling formal documentation obligations rather than fulfilling the obligation to apply market value.

**iv Tax clearances and rulings**

Taxpayers may obtain certainty in advance mainly by two means:

- asking for an advance tax ruling: this type of ruling is requested from the General Directorate of Taxes (DGT) and, when obtained, is binding for tax agencies in connection to the taxpayer asking for it (other taxpayers might also benefit from the ruling’s criteria, in terms of avoiding penalties); and
- APAs, as described in Section III.

**X YEAR IN REVIEW**

2018 has been a peculiar year owing to an unsteady political situation, including a change of government, which is expected to trigger significant changes in the Spanish tax picture, but not before the end of 2018. This has meant, somehow, a quieter year in terms of tax changes than usual.

In terms of changes foreseen in 2019, in October 2018, the government announced a draft of law planning relevant changes to the Spanish taxation scenario, among which, the following could be stressed:

- a new tax on financial transactions;
- a new tax on certain digital services; and
- implementation of the ATAD.

In any case, the above measures are still in the preliminary stages and will need parliamentary consensus to be approved.
XI OUTLOOK AND CONCLUSION

Lack of a clear parliamentary majority and even a close government election would likely lead to few changes on the tax side; only those changes coming from the EU and those where a clear consensus exists are likely to be eventually enacted.

Among the possible changes to be approved is the limitation of participation exemption in order to implement a minimum tax over dividends and capital gains from stakes. However, again, consensus will tell us if this could be approved.
Chapter 31

SWEDEN

Carl-Magnus Uggla

I INTRODUCTION

The tax and legal environment in Sweden is a traditional civil law system, based on statutes rather than case law. However, since joining the European Union on 1 January 1995, case law has become an increasingly important part of the legal environment. Sweden has, as of 1 January 2019, a flat rate of 21.4 per cent corporate tax, a generous participation exemption regime and one of the most extensive tax treaty networks in the world.

Foreign investment in Sweden is promoted by the government through, inter alia, the Invest in Sweden Agency and the Swedish Trade Council, which seek to assist foreign enterprises interested in investing or conducting business in Sweden.

Sweden has no foreign exchange controls and no currency restrictions. As a general rule, there are no requirements to obtain an operating licence to conduct business in Sweden (exceptions in specific sectors do apply). Enterprises must, however, register for tax, etc.

This chapter contains an overview of certain Swedish tax rules regarding companies, and to a limited extent the taxation of foreign legal entities in Sweden. The descriptions are not exhaustive.

This chapter does not cover the taxation of natural persons.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate

The vast majority of organisations for commercial activities in Sweden are organised as limited companies. Limited companies may be public or private. Only public companies may turn to the general public to raise capital. To a limited extent, cooperative economic organisations are also used for commercial activities.

The share capital of private companies must total at least 50,000 kronor, while share capital of public companies must be at least 500,000 kronor.

Limited liability companies and cooperative economic organisations constitute tax subjects, and are subject to national income taxation scheduled as business income (lowered from 22 per cent to 21.4 per cent as of 1 January 2019).

1 Carl-Magnus Uggla is an international tax partner at Bird & Bird Advokat KB.
2 www.isa.se.
Non-corporate

Organisations for commercial activities may also be organised as partnerships, limited partnerships or unregistered partnerships. Unregistered partnerships are seldom used for sizeable commercial activities.

Partnerships and limited partnerships are, unlike unregistered partnerships, legal entities that can acquire assets and assume rights and liabilities.

The partners in a partnership have unlimited liability for the debts of the partnership, while in a limited partnership, only the general partner retains unlimited liability for the partnership’s debts. The limited partners’ liability is limited to their financial contribution to the company.

Partnerships are, from an income tax perspective, transparent, but may be liable to VAT, real estate tax, payroll taxes and taxes on pension costs for employees. In addition, partnerships may be responsible for handling social contributions and for withholding preliminary income tax for employees.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

The profit or loss of a limited company is (somewhat simplified) as a general rule calculated in accordance with Swedish generally accepted accounting principles. To determine the taxable result, certain tax adjustments are made; these include transfers to and from certain untaxed reserves, group contributions with fiscal effect, and non-taxable and non-deductible income and costs, as specified in the Income Tax Act. Examples of non-taxable income include dividend distributions and capital gains covered by the relevant participation exemption rules and write-ups on financial assets. Examples of non-deductible costs include general taxes, write-downs on financial assets, certain interest expenses, association fees and, in principle, all business entertainment.

Furthermore, depreciation of machinery and equipment and real property is subject to special tax rules. A deduction for depreciation of machinery and equipment is allowed at an annual rate of 20 per cent of the original acquisition cost or 30 per cent of the remaining non-depreciated value. An alternative 25 per cent declining balance method without correspondence to the books also exists. These rules also apply to the depreciation of, *inter alia*, concessions, patents, licences, trademarks, leases, acquired non-share-related goodwill and similar rights acquired from another party.

In respect of real estate, deductions for depreciation of buildings are allowed at various rates between 2 and 5 per cent annually, depending on the type of building. For new rental buildings, an additional 2 per cent per annum may, as of 1 January 2019, be deducted over the first six years. Land is a non-depreciable asset.

Capital and income

Income earned by a limited company is subject to a national corporate income tax rate of 21.4 per cent. The tax rate is applicable to all taxable income, including capital gains (tax-exempt gains exist: see Section V). Income earned by a partnership, including capital gains, is taxed at the level of its owners, and the tax rate is dependent on their tax status.
Losses

Tax losses are as a main rule carried forward indefinitely (no carry-back exists) and may be offset against any taxable income. However, losses on real estate and shares not tax-exempt under the participation exemption regime may only be offset against gains on the same type of assets.

Losses carried forward may be restricted following a direct or indirect change of control of a company. Where there are such changes, an amount limitation rule implies that all tax losses carried forward exceeding 200 per cent of the purchase price are permanently forfeited. For the purpose of this calculation, the purchase price must be reduced by capital contributions made to the loss company during the current and two financial years preceding the change of control.

Under an offset restriction rule, tax losses carried forward that are not forfeited by the application of the amount limitation rule cannot be offset against profits in any company belonging to the buyer’s group during the year in question and for five years following the year of acquisition. The offset restriction applies not only to an acquisition of a company with losses carried forward, but also when a group containing such a company acquires another company.

When the change of control concerns companies that prior to the change of control were in the same group, the offset restriction rule is normally not applicable. Furthermore, the amount limitation rule is normally not applicable when a controlling company, prior to the change of control, was in the same group as the loss carrying company.

The above described amount limitation rule may also be applicable in mergers unless the absorbing company has the decisive influence over the dissolved company. According to a ruling by the Tax Board for Advance Rulings, dated 18 May 2017, this exception is also applicable when a parent company is merged into its subsidiary. Furthermore, unless the companies are entitled to exchange group contributions with fiscal effect the year prior to the merger, the losses carried forward that are not forfeited as a result of the application of the amount limitation rule cannot be utilised against the absorbing company’s own profits or against group contributions during the year in which the merger is completed and for five subsequent years (merger restriction).

Rates

As noted above, income earned by a limited company is subject to a national corporate income tax rate of 21.4 per cent. Income earned by partnerships is taxed at the level of its owners.

Administration

Limited liability companies normally pay income tax on a monthly basis based upon a preliminary declaration of income. After the close of the book year, the company submits a tax return to the Swedish Tax Agency that establishes the company’s final income tax for the year. The filing date is dependent on when the book year ends.

<table>
<thead>
<tr>
<th>Book year ending</th>
<th>Filing date</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 January, 28 February, 31 March or 30 April</td>
<td>1 November, if filed on paper; 1 December, if filed electronically</td>
</tr>
<tr>
<td>31 May or 30 June</td>
<td>15 December, if filed on paper; 15 January, if filed electronically</td>
</tr>
<tr>
<td>31 July or 31 August</td>
<td>1 March, if filed on paper; 3 April if filed electronically</td>
</tr>
<tr>
<td>30 September, 31 October, 30 November or 31 December</td>
<td>1 July, if filed on paper; 1 August if filed electronically</td>
</tr>
</tbody>
</table>
The Tax Agency’s decision regarding income tax may be appealed to an administrative court. Such an appeal should be sent to the Tax Agency, not the court, at which point the Agency will make an obligatory reassessment of its decision. If the Agency does not find a reason to overturn its decision, the appeal will be forwarded to the court.

The administrative court’s decision may be appealed to the administrative court of appeal. The administrative court of appeal’s decision may then be appealed to the Supreme Administrative Court. For the Supreme Administrative Court to hear the case, a review dispensation is required, since the Supreme Administrative Court establishes precedent and generally only hears cases in which the appeal is important as guidance for the application of the law.

Tax subjects may ask the Tax Agency for a written response to tax questions. Such written responses are not formally binding. However, according to the Tax Agency, it is intended that it will treat them as binding provided that the tax subjects involved have provided all relevant information and are not using the answer for tax planning purposes, and unless the Supreme Administrative Court delivers case law demonstrating that the Tax Agency’s interpretation was wrong.

The Swedish tax system also provides for the possibility to obtain a formally binding advance ruling regarding a specific tax question. Such a ruling is delivered by the Council for Advance Tax Rulings, an independent public authority. Both the Tax Agency and the taxpayer may appeal the advance ruling to the Supreme Administrative Court without review dispensation.

The statute of limitation for the Tax Agency to review taxpayers’ tax returns is normally six years, but can in most situations be shortened to two years by filing open disclosures.

**Tax grouping**

Consolidated balance sheets are not recognised for tax purposes in Sweden. Instead, a tax consolidation system is used (i.e., a method of group contributions with fiscal effect between companies within the same corporate group where the ownership chain exceeds 90 per cent of the share capital). When these rules are applied, transfers of taxable income within an affiliated group are enabled. The group contributions are taxable in the receiving company and tax deductible in the paying company, which means that taxable profits can be shifted to a loss company in the same group to be offset against the tax losses.

The group contributions require that there are enough distributable reserves in the providing company, as group contributions are considered dividends for company law purposes. In profitable companies with no negative equity, this should not present a problem as long as no more than the yearly profit is contributed.

**Other relevant taxes**

The Swedish VAT system is harmonised with the EU rules. A general VAT rate of 25 per cent is chargeable on most goods and services. Reduced rates apply to a few goods and services, such as foodstuffs, restaurant meals, and non-alcoholic or low-alcohol drinks (12 per cent), as well as to the transport of passengers, books, newspapers and most cultural events (6 per cent). Most financial and insurance service providers are exempt from VAT, and this normally also the case for healthcare, dental care, social care and schools. VAT returns are filed, and tax is paid monthly, quarterly or yearly depending on turnover.

As a member of the EU, Sweden is also part of the customs union enforcing the Community Customs Code. Most EU customs duties are calculated as a percentage of the...
value of the goods being imported. All imported goods must be classified according to the EU customs tariff, and the duty rates applied depend on the ‘economic sensitivity’ of the goods. The actual duty rate to be applied also depends on, inter alia, the country of origin of the product and free trade agreements.

Sweden levies a real estate transfer tax (stamp duty) on most transfers of real estate. Most legal persons pay 4.25 per cent; natural persons and tenant owner associations pay 1.5 per cent tax on a base that consists of the higher of the consideration paid or the tax assessment value of the real estate. Real estate transfer tax on an intra-group transfer of real estate may usually be deferred provided the real estate, the buyer and seller remain in the same group. Real estate transferred through a merger, a demerger or real estate reallocations are currently not subject to real estate transfer tax.

Real estate tax on commercial properties totals approximately 0.2 to 2.8 per cent of the tax assessment value (normally 1 per cent) depending on the type of property. The tax assessment value is supposed to equal 75 per cent of a conservative estimate of the fair market value.

Social security charges payable on remuneration to employees (or by the self-employed) are normally levied at 31.42 per cent. Social security charges are deductible for corporate tax purposes.

Pension benefits beyond the mandatory system are customary in most Swedish employers. A special salary tax is normally levied at a rate of 24.26 per cent on these additional pension premiums and commitments. These taxes are deductible for corporate tax purposes.

Sweden does not impose taxes on gifts, and net wealth and inheritance tax do not exist.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

Swedish limited companies have unlimited tax liability in Sweden unless otherwise stated in special rules.

ii Branch or permanent establishment

A foreign enterprise is liable to pay income tax in Sweden if it is determined that it has a permanent establishment in Sweden. If the enterprise has a permanent establishment in Sweden, it will be taxed for business income (21.4 per cent). An ‘enterprise’ can be a sole trader or a legal person.

A general definition of permanent establishment is found in the Swedish Income Tax Act, which also contains rules regarding when a permanent establishment can be created by a person acting on behalf of an enterprise (e.g., an agent).

A permanent establishment is defined in accordance with the general definition as a fixed place of business through which the business of an enterprise is wholly or partly carried on. Three conditions must be met for the creation of a permanent establishment: a distinct ‘place of business’, which must be ‘fixed’, as in having a certain degree of permanence, and the business of the enterprise must be carried out through that fixed place of business.

The general definition also contains a list of examples of what a permanent establishment may be constituted by: a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry or any other place of extraction of natural resources, a building site or construction or installation project, or real property that is a current asset in a business operation.
The definition mainly conforms to the permanent establishment definition found in the OECD Model Tax Convention on Income and Capital.

If Sweden has an agreement for the avoidance of double taxation (a tax treaty) with the jurisdiction from which an enterprise originates, a permanent establishment must be present both in accordance with the Income Tax Act and the tax treaty for the enterprise to be liable to pay income tax. In accordance with the Income Tax Act, foreign enterprises have a permanent establishment in Sweden if they carry on business wholly or partly from a fixed place of business in Sweden. A business operation is usually considered to be ‘fixed’ through having a certain degree of permanence when it is carried on for a six-month time period. In most tax treaties that Sweden has entered into with other states, building sites, construction or installation projects are considered to be fixed (have such a degree of permanence) when they are carried on for more than 12 months.

A foreign enterprise may have a permanent establishment in Sweden even when there is no fixed place in Sweden that the business operations are carried on from. This may be the case when the business operations in Sweden are carried on through a dependent agent.

A foreign enterprise is required to submit a tax application to the Tax Agency if it has a permanent establishment in Sweden, is an employer in Sweden or conducts business for which it is liable for Swedish VAT. The Tax Agency may then approve the enterprise as a tax subject conducting business, and decide whether the enterprise must pay, *inter alia*, preliminary income tax, special salary tax on pension costs, pension yield tax or real estate tax.

A foreign enterprise’s business operations in Sweden may be carried on through a branch. The enterprise must register the branch with the Swedish Companies Registration Office.

### V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

#### i Holding company regimes

There are no rules that apply specifically to holding companies as such, but the participation exemption rules in practice constitute a very favourable holding regime.

There is a capital gains tax exemption for Swedish corporate entities on gains related to the disposal of shares ‘held for business purposes’. Shares in Swedish corporations and participations in partnerships, as well as in foreign companies, can qualify as shares held for business purposes, and thus be divested tax-exempt.

Unlisted shares will in principle always be considered as held for business purposes. Listed shares are considered held for business purposes if the company has a holding corresponding to at least 10 per cent of the voting rights or, in certain situations, if the shares are held in the course of the business. An additional condition regarding listed shares, not applicable to unlisted shares, is that the shares must be held for a period of at least one year.

An exception from the capital gains tax exemption applies for the sale of shares in a ‘shell company’, which is a company or partnership where the fair market value of cash or liquid assets, shares and other marketable instruments (other than shares held for business purposes), and similar assets, exceeds 50 per cent of the consideration paid for the shares. The sale of a shell company results in punitive taxation where the entire consideration, and not just the gain, is taxed. The tax can be completely avoided by filing a shell company tax return within 60 days of signing or closing.
The participation exemption rules also apply to dividends received on shares held for business purposes and on qualifying holdings via partnerships.

**ii IP regimes**

There are no specific tax advantages in respect of holdings of IP rights, etc., but costs for research and development are deductible provided that the expenses are significant, or can be projected to have, significance for the business. Costs for the acquisition of, *inter alia*, patents and know-how may, as mentioned above, be deducted in accordance with the rules concerning the depreciation of machinery and equipment.

**iii State aid**

State aid is not provided in shape of tax benefits. However, the government takes part in the financing of growth companies by providing venture capital through, *inter alia*, Industrifonden, Fouriertransform and ALMI Invest.

**iv General**

There are no specific tax incentives in Sweden for corporations. However, some generally applicable favourable regimes exist. For example, Sweden has an accruals reserve regime. The accruals reserve regime allows for a tax-deductible appropriation for corporations of 25 per cent of the taxable profit before appropriation to a reserve. Each year’s appropriation forms a separate untaxed reserve that must be reversed to income no later than the sixth year following the appropriation. Standardised interest income is imposed on former years’ appropriations at 72 per cent of the interest rate on governmental debt notes.

Furthermore, considering the generous rules regarding tax exemptions for dividends and capital gains on shares, Sweden is a suitable country to establish holding companies (as discussed above).

As of 1 January 2018 new favourable tax rules for employee stock options granted by start-ups were introduced. Several requirements are set out in order for the rules to apply, for example, the company must in the year of grant have a maximum of 50 employees on an average, revenues of a maximum 80 million kronor and it must have operated its business for less than 10 years. The total value of all stock options granted cannot exceed 75 million kronor and the value of each employee’s stock options may not exceed 3 million kronor.

Certain types of start-ups, such as banks or financial companies, insurance companies, real estate companies and companies providing tax or auditing services are ineligible to apply the new rules. Employees holding such employee stock options will be subject to capital income tax (effective rate 25 per cent) when the underlying shares are sold instead of salary income tax (progressive rate 29–60 per cent) when the stock options are exercised. However, if the company is a closely held company with qualified shares, gains on such shares are taxed at 20–60 per cent.

**VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS**

**i Withholding on outward-bound payments (domestic law)**

Sweden imposes withholding tax on dividend paid from a Swedish limited company to foreign investors. The tax rate is 30 per cent, but is often reduced or completely omitted.
Sweden does not impose withholding tax on interest payments from a Swedish limited company to a foreign creditor.

A foreign legal entity that receives a royalty from a Swedish company or from a permanent establishment in Sweden may be deemed to have a permanent establishment in Sweden to which the royalty is attributed. However, in some situations such royalty may be exempt from taxation in Sweden.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

A reduced withholding tax rate (or no withholding tax at all) is applied on dividend distributions from a Swedish limited company to a foreign legal entity in accordance with applicable tax treaties. No withholding tax is applied when a foreign legal entity domiciled in the EU holds at least 10 per cent of the shares in the Swedish company paying the dividend, and that company satisfies the conditions in Article 2 of the EU Parent–Subsidiary Directive; and a foreign company that is the equivalent of a Swedish company holds shares in a Swedish company, and the shares are held as a capital asset, provided the shares are not listed or, if the shares are listed, the holding of shares represents at least 10 per cent of the voting interests in the company and the shares have been held for at least one year.

A foreign company deemed to have a permanent establishment in Sweden because it receives royalty payments from Sweden may be exempt from such tax on these payments under rules based on the EU Interest and Royalties Directive.

iii Double tax treaties

Sweden has one of the most extensive tax treaty networks in the world. With few exceptions, the treaties follow the OECD Model Tax Convention on Income and Capital. Withholding taxes are generally reduced or completely omitted under the treaties.

iv Taxation on receipt

Dividends from foreign companies are generally treated the same way as domestic dividends, and thus are often tax free under the participation exemption rules (see Section V).

Other cross-border income is generally subject to taxation in Sweden. To the extent a Swedish company has paid tax on income in another jurisdiction, such tax is normally deducted from or credited against Swedish tax paid on that income.

VII TAXATION OF FUNDING STRUCTURES

i Thin capitalisation

There are currently no formal thin capitalisation or debt-to-equity rules in Sweden. Compulsory liquidation will, however, be triggered under the Swedish Companies Act if the equity falls below 50 per cent of the registered share capital unless the equity is immediately restored to an amount corresponding to at least the entire registered share capital. Hence, it is often recommended to keep the registered share capital limited compared to the amount of share premium or free equity.

Furthermore, as of 1 January 2019 Sweden has introduced earning stripping rules. The rules are based upon the EU Anti-Tax Avoidance Directive (ATAD), which in turn is based upon BEPS Action 4. The new rules limit interest expense deductions to –
much simplified – net interest expenses of up to 30 per cent of earnings before interest, tax, depreciation and amortisation (EBITDA). This limitation only applies – also much simplified – to net interest expense exceeding 5 million kronor (in a group). Equalisation of interest deduction capacity within a group is possible, provided the companies qualify for Swedish tax consolidation. Negative net interest not possible to deduct in one year may be carried forward for up to six years, but is forfeited in the event of a change of control.

ii Deduction of finance costs
Interest accrued on third-party loans is generally tax deductible provided the interest is not related to profits or distribution of profits.

Interest between affiliated parties must be at arm's length to be deductible. Interest paid between affiliated companies that are in excess of an arm's-length interest rate is not tax deductible to the extent it exceeds an arm's-length interest rate. Provided the interest on intercompany loans is properly benchmarked and documented, interest costs are normally deductible.

There are interest deduction limitation rules in Sweden covering intercompany loans between affiliated companies and interest costs on such loans. Expenses related to such a loan will only – much simplified – be tax-deductible if the beneficial owner of the interest is taxed at a level of at least 10 per cent, and the loan was not exclusively, or as good as exclusively (at least 90 per cent), put in place for tax reasons.

The scope of the interest deduction limitation rules covers all loans from affiliated companies regardless of the purpose of the loan. Companies are considered to be affiliated if they could be seen as predominantly jointly managed, or if one of the companies, directly or indirectly, has significant influence over the other company.

A company is defined as a legal entity or as a Swedish partnership. Foreign equivalents also fall under the definition in the Swedish Income Tax Act of a company if the association has the ability to acquire rights and undertake obligations; the ability to institute legal obligations before a court and other authorities; and separate partners cannot freely dispose over the association's assets.

Finally, an interest deduction restriction in the form of anti-hybrid rules was also introduced as of 1 January 2018. The rules target related-party debt in cross-border situations where a company in another state obtains a tax deduction for the same interest expense or when the corresponding interest income is not subject to tax owing to the classification of the income for tax purposes.

iii Restrictions on payments
Dividend distributions (including a reduction of the share capital for repayment or other transfers benefiting the owners) or other transfers not of an entirely commercial nature for the company must be fully covered by the company's restricted equity after the transfer. Furthermore, the transfer must be defensible taking into consideration the requirements imposed by the nature, scope and risks of the business.

iv Return of capital
A distribution to shareholders in connection with a reduction in the share capital without a reduction of the number of shares is taxed as a dividend. A reduction in the share capital in connection with a reduction of the number of shares is, as a general rule, taxed as if the shares
have been divested. Exceptions apply to certain closely held companies and with regard to taxation of foreign shareholders insofar as a reduction in the share capital in connection with a reduction of the number of shares is treated as a dividend for tax purposes.

As a main rule, companies are not allowed to acquire their own shares. Certain exceptions apply to listed companies.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Local Swedish acquisition vehicles are usually established as limited companies. The acquiring company is normally financed through a combination of equity, external loans and shareholder loans. As previously mentioned, Sweden does not have thin capitalisation rules, so generally equity is kept fairly low. Interest deduction limitations rules (including the new earning stripping rules) may, however, limit the tax deduction of interest paid; see Section VII.

The acquisition vehicles and the target company are often merged to get the acquisition financing into the target company. Should this not be done, the financing costs may still be set off against the taxable income in the target company in subsequent years using group contributions with fiscal effects; see Section III.

ii Reorganisation

Swedish tax law provides for a number of tax-neutral restructuring measures.

Under a merger, one or more limited companies transfer all of their assets and liabilities to another company and are subsequently dissolved without liquidation; or two or more limited companies transfer all of their assets and liabilities to a newly formed company and are subsequently dissolved without liquidation. Correctly structured, a merger should in most situations not trigger any adverse tax consequences. Cross-border mergers are possible, but only tax-exempt if the transferred business remains taxable in Sweden (i.e., is allocated to a permanent establishment in Sweden).

Under a share-for-share exchange, a company acquires shares in another company in exchange for payment in the form of shares in itself. Correctly structured, a share-for-share exchange does not trigger any immediate tax consequences. For the seller, the tax base of the sold shares is transferred to the new shares while any cash payment is taxed in its entirety.

A demerger occurs where one limited company transfers all of its assets and liabilities to two or more limited companies and is subsequently dissolved without liquidation. Correctly structured, a demerger should in most situations not trigger any adverse tax consequences.

An intra-group sale below fair market value occurs when a limited company transfers assets at a price below fair market value to another limited company within the group. Correctly structured, an intra-group sale below fair market value does not trigger any adverse tax consequences. Cross-border sales are possible, but only tax-neutral if the transferred assets remains taxable in Sweden (i.e., are allocated to a permanent establishment in Sweden).

A 'Lex Asea dividend' is when a listed limited company transfers all of the shares in a subsidiary to the shareholders through a dividend distribution. Correctly structured, a Lex Asea dividend does not trigger any adverse tax consequences. For the shareholders, the tax base of the shares is apportioned between existing shares and the new shares received.
Exits are usually structured through a tax-exempt sale of Swedish shares; see Section V. Capital gains in an asset sale constitute taxable income.

**IX ANTIV AVOIDANCE AND OTHER RELEVANT LEGISLATION**

i **General anti-avoidance**

**Substance over form**

The substance over form concept is somewhat unclear in Swedish tax law. It is sometimes called recharacterisation, relabelling or general assessment. It is not clear if substance over form is to be seen as a label to be used for all of these 'principles'. When applying these 'principles', there is, however, one common denominator: legal actions are recharacterised and taxed accordingly.

It is our interpretation that a substance over form view means that legal actions are analysed from a civil law point of view. Should the true meaning of the legal action be other than the one suggested by the involved parties, the courts may recharacterise the legal actions and, thus, tax them according to their true substance. According to this interpretation, no special substance over form view exists for tax purposes; instead, it should be noted that the civil law substance of actions taken should determine the fiscal effects.

Furthermore, when the concept of substance over form is examined, discussions sometimes tend to focus on chains of transactions that are pre-planned, preordained, or both, where some of the transactions have no real meaning or seem pointless unless all of the transactions are viewed as a whole. The fact that a chain of events is pre-planned is generally not enough to recharacterise the events using a substance over form view as long as each transaction entitles the parties true rights (or duties) for a certain period of time.

**Tax Avoidance Act**

According the Tax Avoidance Act, legal action should not be considered if:

- **a** the legal action, alone or together with other legal actions, is a part of a procedure resulting in a substantial tax benefit for the tax subject;
- **b** the tax subject has directly or indirectly taken part in the legal action or actions;
- **c** the tax benefit, considering the circumstances, can be assumed to be the main reason for the procedure; and
- **d** taxation on the basis of the procedure would be in conflict with the purpose of the law, as clear from the tax rules' general design and from the rules directly applicable or circumvented by the procedure.

The Tax Avoidance Act is only applicable if all of the above prerequisites are fulfilled. If fulfilled, taxation should be made as if the legal actions had not been undertaken. If the procedure, considering the economic outcome, appears to be a detour in comparison to the procedure closest at hand, then the tax subject will be taxed as if the tax subject had chosen that procedure instead.

It should be noted that the rules in the Tax Avoidance Act, its preparatory works and the relevant case law are considered exceedingly difficult to interpret and very vague, foremost because it has to be determined whether something that cannot yet be derived from the applicable laws shall be considered to be encompassed by the purpose of the law under the
general design of the law. In the preparatory works of the Tax Avoidance Act, it is emphasised that it is first and foremost the general design of the laws, and not their preparatory works, that shall be used when interpreting the law.

ii Controlled foreign corporations (CFCs)

A Swedish taxpayer directly or indirectly controlling at least 25 per cent of a foreign legal entity’s equity or voting interest may be taxed for the foreign company’s taxable result if the foreign legal entity is low-taxed (CFC taxation).

Income is considered to be low-taxed if the net income, calculated on the basis of the rules that would apply to taxation if the entity was Swedish, is subject to less than approximately 11.8 per cent tax. The net income is not deemed to be low-taxed if the foreign legal entity is domiciled and subject to taxation in a country identified on a ‘white list’. Furthermore, CFC taxation within the EEA is limited to financing and insurance of risks encountered by associated companies.

A legal entity domiciled in a state within the EEA that conducts commercially motivated activities from an actual establishment are excluded from CFC taxation.

iii Transfer pricing

Cross-border transactions between companies that are associated must be carried out on an arm’s-length basis. Otherwise, the Swedish company will be taxed as if the transactions had been carried out on market terms.

The Swedish transfer pricing rules are, essentially, worded in accordance with the corresponding provisions in the OECD framework.

As of 2007, Sweden implemented transfer pricing documentation rules. Hence, the pricing mechanism of all cross-border transactions between related parties must be appropriately documented. In October 2016, the government submitted a proposal to extend these rules by incorporating country-by-country reports based on the OECD base erosion and profit shifting (BEPS) project and EU Directive 2011/16/EU (DAC 4). The new rules came into force in 2017 and are applicable to companies that are part of a multinational group with a turnover exceeding 7 billion kronor.

iv Tax clearances and rulings

See Section III.

X YEAR IN REVIEW

In the past year, the Swedish government has introduced certain tax increases, and the total tax pressure is now 44.4 per cent of gross national product. The most significant change going forward includes the introduction of earning stripping rules (and other adaptations to ATAD) that took effect as of 1 January 2019. As a compensation for the introduction of the earning stripping rules, the corporate income tax was reduced. This means that an equity financed business will likely pay less tax, while a capital intensive business, relying upon debt financing, will suffer an increased tax burden as non-deductible interest costs will raise the effective tax rate.
XI OUTLOOK AND CONCLUSIONS

Going forward, the corporate income tax rate will be further reduced to 20.6 per cent as of 1 January 2021. Apart from that, no other significant tax reforms have been announced.

The September 2018 election to the Parliament failed to create a clear winner insofar as no party or coalition has – nine weeks after the election – been able to present a government alternative that has gained the acceptance of the majority of the Parliament. Consequently the previous administration has stayed on as an interim administration. An interim administration is not to drive policy change. Hence, the budget proposition for 2019 (presented on 15 November 2018) in principle contains no new tax proposals (save for lower tax on pensions, a non-controversial proposal supported by all political parties).

It is currently impossible to foresee the political direction the Parliament, and thus the tax situation, may take. The next administration could be variations of a left, centre or right coalition. A new election is also a very real possibility.
Chapter 32

SWITZERLAND

Frédéric Neukomm and Floran Ponce

I INTRODUCTION

Switzerland is a federal democracy. As such, corporate taxes are levied on the federal, cantonal and communal levels.

Switzerland is a stable, liberal country with a business-friendly environment, relatively low corporate income tax and an extensive double tax treaty (DTT) network.

Current tax incentives include special cantonal statuses for holding companies and administrative companies. However, these special cantonal statuses will be abolished in the near future if the Tax Reform and Social Security Funding Act (the Tax Reform Act) enters into force. In order to keep Switzerland attractive to businesses, the Tax Reform Act provides other benefits, such as IP boxes, and most cantons will lower their ordinary corporate income tax rates.

Additionally, tax rulings allow businesses to secure a specific tax treatment prior to relocating to Switzerland. Additionally, tax rulings may inform businesses of the tax consequences related to specific transactions.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate

The most common corporate structures in Switzerland are the company limited by shares and the limited liability company (LLC). However, large companies, with the exception of US multinational enterprises (MNEs) (check the box), generally do not use LLCs.

Companies limited by shares require a minimum share capital of 100,000 Swiss francs, while LLCs require a minimum share capital of 20,000 Swiss francs.

Although less common than the two aforementioned types of companies, Swiss law also permits partnerships limited by shares.

Companies are legal persons, and thus are subject to Swiss taxes. Direct corporate taxes include federal and cantonal corporate income tax and cantonal capital tax. Companies are also responsible for collecting withholding tax on dividend distributions.

ii Non-corporate

Non-corporate entities include general partnerships and limited partnerships. They are rarely used by large businesses, since general partners must be individuals.

1 Frédéric Neukomm and Floran Ponce are partners at Lenz & Staehelin.
Collective investment schemes include investment companies with variable capital (open-end), fund contracts (open-end) and limited partnerships for collective investments (closed-end).

The above structures are transparent for income tax purposes (except for real estate funds), so the assets and income derived therefrom are attributed to the partners or fund participants based on their share of the partnership or fund; Swiss collective investment schemes must pay withholding tax on the income they realise (irrespective of whether such income is distributed or accumulated).

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

Corporate taxpayers are subject to corporate income tax on worldwide income, with the exception of income from foreign immovable property, permanent establishments and business enterprises. Corporate income tax is levied on the net profit.

In principle, the taxable income is the same as the profit listed in statutory financial statements, which is determined on an accrual basis. Generally, all expenses are deductible, provided they are commercially justified. Corrections are allowed when tax law stipulates that a value different from that in the books of account should be used. For instance, if the tax authorities consider depreciations or provisions excessive, they will be reduced or denied.

Companies may record depreciations using either the declining-balance method or the straight-line method, but for tax purposes certain minimum rates must be respected (e.g., for industrial buildings 3–4 per cent using the declining-balance method and 1.5–2 per cent using the straight-line method, for intangibles 40 per cent using the declining-balance method and 20 per cent using the straight-line method).

A provision for one-third of the inventory value is permitted for federal and cantonal tax purposes. Further provisions for liabilities and dubious receivables are allowed if commercially acceptable. The standard amount is 5 per cent for Swiss receivables and 10 per cent for foreign receivables.

If a company concludes a contract with a shareholder or related party, it must be at arm’s length. If not, consideration in excess of the arm’s-length consideration is reclassified as a constructive dividend. Amounts reclassified as constructive dividends are not considered justified expenses, so they cannot be deducted from the company’s taxable profit. Additionally, withholding tax (35 per cent) may be levied on the constructive dividend.²

Capital and income

As a rule, both income and capital profit are subject to federal, cantonal and communal corporate income taxes.

However, income (e.g., dividends) from and capital gains on qualifying participations benefit from participation relief.

Participation income is eligible for participation relief if the receiving company owns at least 10 per cent of the equity in the distributing company, if the participation is worth at least 1 million Swiss francs (for dividends) or if the receiving company is entitled to at least

² See Section VI.i.
10 per cent of the distributing company’s profit and reserves. Participation relief is granted for capital gains if one of the above conditions is fulfilled and the participation has been held for at least one year.

Additionally, some cantons levy a separate real estate capital gains tax on gains arising from the sale of real estate in lieu of ordinary cantonal and communal corporate income tax.

**Losses**

Under Swiss tax law, losses may be carried forward for seven years; there are no provisions for carry-back. Losses must be carried forward using the first in, first out (FIFO) method.

Older losses (more than seven years) may be carried forward during a financial restructuring due to insolvency, if carrying forward said losses will allow the company to balance its books of account.

Losses survive changes in ownership. Additionally, in the event of a merger, the losses from both companies may be carried forward, except in the case of tax avoidance or abuse of a right (e.g., merger with a company that has liquidated most or all of its assets).

**Rates**

The federal corporate income tax rate is 8.5 per cent on profit after tax; cantonal and communal corporate income tax rates vary from 5.55 per cent to 23.36 per cent (statutory rates on profits after tax). Since corporate income tax is a deductible expense, the effective rates are between 11.19 per cent and 24.41 per cent (federal, cantonal and communal taxes included).

The current effective rates are: 22.18 per cent in Basle; 24.16 per cent in Geneva; 22.09 per cent in Lausanne (canton of Vaud); 14.60 per cent in Zug; and 21.15 per cent in Zurich (federal, cantonal and communal taxes included).

Many cantons will reduce their corporate income tax rates if the Tax Reform Act enters into force. For instance, the proposed, new effective rates are: 13.04 per cent in Basle; 13.79 per cent in Geneva and Lausanne (Vaud); 12.09 per cent in Zug; and 18.19 per cent in Zurich (federal, cantonal and communal taxes included).

**Administration**

The federal tax authority is the Federal Tax Administration (FTA). The FTA is responsible for federal taxes, including withholding tax. Each canton has its own tax authorities; the cantonal tax authorities are responsible for income tax, including federal income tax.

Taxpayers are required to file an annual tax return during the three months following the close of the business year; extensions may be requested.

Both the tax authorities and the taxpayer participate in the tax assessment process; taxes are assessed based on the tax return submitted by the taxpayer.

The tax authorities are responsible for determining relevant facts and applicable legal provisions. They are allowed to conduct investigations, including inspections of the books of accounts and any supporting documents. The tax authorities determine the taxes due; this decision is communicated to the taxpayer in writing and includes the tax basis, tax rate and taxes due.

Tax assessments can be challenged before the tax authorities (formal complaint). If the dispute is not resolved, the taxpayer can appeal; the matter then goes to court (federal or cantonal, depending on the matter being appealed). The Swiss Federal Supreme Court is the highest Swiss court.
Tax rulings are very common in Switzerland. However, certain types of rulings are now subject to spontaneous exchange under spontaneous exchange of information agreements and in accordance with the BEPS rules.

**Tax grouping**

Swiss tax law does not allow for tax consolidation (except for VAT). Companies that are part of a group are taxed as individual companies, subject to ordinary tax rules.

**ii Other relevant taxes**

**Capital tax**

Capital tax is a direct tax that is levied on companies’ net equity (paid-up capital, as well as open reserves and taxed hidden reserves). Capital tax is levied annually and rates vary (0.001–0.525 per cent) between cantons. Some cantons permit corporate income tax to be credited against capital tax, meaning capital tax is levied only if it exceeds the cantonal corporate income tax due. There is no federal capital tax; it is only levied by the cantons.

In the event of thin capitalisation, the part of the loan reclassified as equity is subject to capital tax.3

**Issuance stamp duty**

Issuance stamp duty is levied on capital contributions from shareholders to Swiss companies, meaning it is levied on both the initial creation of share capital as well as subsequent increases of share capital and contributions without issuance of new shares. Stamp duty is levied at 1 per cent. The first 1 million Swiss francs in share capital is exempt from stamp duty. Exemptions are also granted following a merger or similar restructuring.

**Transfer stamp duty**

Transfer stamp duty is levied when there is a transfer against consideration of a security subject to stamp duty and the transfer involves a Swiss securities dealer. Securities subject to stamp duty include Swiss and foreign bonds, shares, participation certificates, dividend rights certificates and units in collective investment schemes. A Swiss securities dealer is defined as a bank, securities trader or professional intermediary (individual or legal person) or a company holding over 10 million Swiss francs in taxable securities. Transfer stamp duty is levied at 0.15 per cent for securities issued by Swiss residents and 0.3 per cent for foreign securities.

**VAT**

The ordinary VAT rate is 7.7 per cent. VAT on accommodation is 3.7 per cent and VAT on essential goods is 2.5 per cent.

**Payroll taxes**

A social security contribution of 10.25 per cent is levied on employment income; half is paid by the employer and half is paid by the employee (via withholding). Unemployment insurance is also levied on employment income.

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3 See Section VII.i.
Additionally, employers are required to levy tax at source on salaries paid to employees not resident in Switzerland or to foreign employees without a long-term resident permit.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence
Companies with either their statutory seat or their place of effective management in Switzerland are considered Swiss tax residents for tax purposes.

A company is considered to have its place of effective management in Switzerland if its economic centre is located in Switzerland.

In determining the economic centre, the tax authorities consider a variety of factors and the presence of multiple connecting factors with Switzerland is sufficient to consider that the place of effective management is in Switzerland. The predominant factor is the place where management is carried out (i.e., the day-to-day actions required to carry out the company's statutory purpose). Secondary factors include the place where fundamental decisions are made and the place where administrative work (e.g., accounting, correspondence) is carried out. A passive company's (e.g., a group financing company) place of effective management is where its strategic decisions (e.g., decisions about refinancing, loans and loan conditions) are made.

The place of effective management for companies created by individuals for asset management purposes is the jurisdiction in which the controlling individual or individuals reside.

ii Branch or permanent establishment
Non-resident companies are liable to Swiss corporate income tax and capital tax on income and capital allocated to a Swiss permanent establishment.

For Swiss direct tax purposes, the definition of permanent establishment is similar to the definition in the OECD Model Tax Convention on Income and on Capital (the OECD MC). It is defined as a ‘fixed place of business through which the business of an enterprise is wholly or partly carried on’ (Article 51, paragraph 2 of the Swiss Federal Income Tax Act of 14 December 1990). Examples include branches, factories, dependent agents with a fixed place of business and construction projects lasting at least 12 months.

Switzerland has an extensive network of DTTs, most of which follow the OECD MC, which provide allocation rules for permanent establishments.

Swiss tax rules stipulate that the direct (objective) method should be used when determining a Swiss permanent establishment’s profit. The Swiss permanent establishment’s profit is thus based on its books of account and is independent of the entity’s total profit.

Switzerland does not levy branch profit tax. Consequently, the remittance of branch profits to a foreign company with its place effective management outside of Switzerland is not subject to Swiss withholding tax.
V  TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i  Holding company regimes
Currently, holding companies are exempt from cantonal and communal corporate income taxes, with the exception of income and capital gains from Swiss real estate, which are taxed at the ordinary rate.

Holding company status is granted to companies whose statutory purpose is the long-term management of participations in other companies, provided the participations equal at least two-thirds of the company’s assets or the income derived from the participation rights equals at least two-thirds of the company’s income. Holding companies may not have commercial activity in Switzerland.

If the Tax Reform Act enters into force, the special cantonal statuses (i.e., holding companies and administrative companies) will be abolished as of 1 January 2020.

Federal corporate income tax participation reduction
As explained above, qualifying participation income and capital gains on qualifying participations benefit from participation relief.  

ii  IP regimes
Currently, only the canton of Nidwalden has introduced a patent box regime. However, the Tax Reform Act includes a mandatory cantonal patent box regime as a replacement measure for the elimination of the special tax statuses. The cantonal patent boxes may provide tax relief for up to 90 per cent of patent-related income; however, total relief from Tax Reform Act deductions (e.g., patent box, R&D deductions, step up) is limited to 70 per cent of a company’s taxable profit.

Currently, mixed company status is granted to companies with only minimal commercial activity in Switzerland and is commonly used for the exploitation of IP in Switzerland, in particular by MNE headquarters; it is also used by commodities trading companies. The effective tax rate is between 9 per cent and 12 per cent.

Likewise, principal companies may be used to exploit IP. Principal companies carry out specific tasks on behalf of non-resident, affiliated companies, such as the purchase and sale of goods and supply chain management, and may be used for IP ownership.

Principal companies may allocate 35 to 50 per cent of their profit to deemed foreign permanent establishments. The allocated profit is tax-exempt in Switzerland, resulting in an effective corporate income tax rate of between 5 and 8 per cent.

Principal company status will be abolished by the Tax Reform Act. Starting in 2019, tax authorities will no longer grant principal company status to companies applying for the first time.

Holding companies may be used as well, as long as exploitation of IP does not qualify as a business activity; the effective tax rate is approximately 8 per cent.

See Section III.i.
State aid
State aid is granted in the form of federal and cantonal tax holidays. The Swiss Federal Act on Regional Policy provides federal tax incentives for creating or preserving jobs in certain regions of Switzerland. Tax relief is limited to an annual amount of 95,000 Swiss francs per job created or 47,500 Swiss francs per job preserved, for a maximum of 10 years. The companies profiting from such tax relief and the number of jobs to be created or preserved are made public.

Cantonal tax holidays are granted for up to 10 years, but contrary to the federal tax holidays, cantonal tax holidays are not restricted to specific economic sectors or geographical areas. Cantonal tax holidays are based on the nature of the planned investment, its economic importance to the canton and the number of new jobs the company will create. Tax relief can take the form of a full or partial exemption from cantonal and communal corporate income and capital taxes.

Manufacturing and industrial businesses typically qualify for tax holidays. Other businesses (e.g., commercial, finance, services) may qualify if they complement existing local business and industries and create significant new employment opportunities.

General
Switzerland has relatively low corporate income tax rates and, currently, businesses relocating to Switzerland can benefit from the aforementioned special cantonal statuses. If the Tax Reform Act enters into force, the special cantonal statuses will be abolished, but most cantons will lower their corporate income tax rates as compensation.

Further, Switzerland’s extensive DTT network eliminates many instances of double taxation, and dividends paid by Swiss resident companies are often eligible for a full or partial refund under a relevant DTT.

Additionally, the Tax Reform Act includes a step up for foreign companies relocating to Switzerland; companies will be able to disclose their hidden reserves without Swiss tax consequences and additional depreciation deductions will be granted during the initial few years following relocation to Switzerland.

WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

Withholding on outward-bound payments (domestic law)
Swiss companies must levy a 35 per cent withholding tax on profit distributions (including constructive dividends and liquidation proceeds) to shareholders or related parties, irrespective of whether the beneficiary is a Swiss tax resident.

Although interest on bonds and other debt certificates issued by Swiss companies is subject to Swiss withholding tax, generally, withholding tax is not levied on interest paid on private loans.

Under the 10/20/100 non-bank rule, loans from 10 non-bank lenders with identical terms (loan debentures) and loans from 20 non-bank lenders with variable terms (cash debentures) are treated as bonds, provided that the financing exceeds 500,000 Swiss francs. Exceptions exist for intercompany loans.
Further, a company shall be deemed a bank for withholding tax purposes if it has at least 100 non-bank lenders or private placements, or both, and its financing or placements, or both, exceeds 5 million Swiss francs. Interest paid by banks is subject to withholding tax; some exceptions apply.

Royalty payments are not subject to withholding tax.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

Swiss taxpayers (companies and individuals) may request a withholding tax refund. The refund will be granted if certain conditions are fulfilled (e.g., the taxpayers have fulfilled all of their reporting obligations).

Non-resident taxpayers may claim a partial or total refund of Swiss withholding tax if there is a DTT between Switzerland and their country of residence.

A simplified notification procedure can be requested for intra-group distributions to Swiss parent companies or to parent companies resident in a DTT country.

iii Double tax treaties

Switzerland has an extensive network of DTTS, most of which closely follow the OECD MC. Switzerland has concluded treaties with over 80 jurisdictions, including most European countries, the United States, Russia, Japan and China. On 3 May 2018, Switzerland and Brazil signed a DTT.

Additionally, an agreement between Switzerland and the European Union eliminates withholding tax if the parent company has directly held 25 per cent or more of the subsidiary’s share capital for at least two years.

To qualify for treaty benefits, certain conditions must be met. The foreign parent company must be the beneficial owner of the dividend income. Further, the withholding tax refund will not be granted if the FTA determines that there is DTT abuse. In assessing whether a structure is abusive, the FTA examines whether there is sufficient capitalisation (30 per cent) and whether the parent company has substance (personnel and premises) in its country of residence. Generally, holding companies must demonstrate that they hold multiple companies, not just the Swiss company requesting treaty relief.

Maximum withholding tax rates

<table>
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<th>Dividends</th>
<th>Interest</th>
<th>Royalties</th>
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<td>Ordinary maximum (per cent)</td>
<td>Minimum required ownership in subsidiary (per cent)</td>
<td>Holding period (years)</td>
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<tr>
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</table>
TAXATION OF FUNDING STRUCTURES

i  Thin capitalisation
Swiss federal and cantonal tax rules contain thin capitalisation safe harbour provisions (maximum debt rule per asset class based on their book or fair market value); for example, 100 per cent for cash, 85 per cent for accounts receivable and inventory, 70 per cent for investments in subsidiaries, 50 per cent for furniture and equipment, 70 per cent for property and plants (commercially used) and 70 per cent for intangibles.

Furthermore, the FTA publishes annual safe harbour interest rates for loans granted to related parties. Interest paid on debt exceeding the maximum allowable debt and interest rates exceeding the safe harbour rates are reclassified as constructive dividends if paid to a shareholder or related party. Consequently, such interest is not a deductible expense for federal and cantonal income tax purposes and is subject to withholding tax at a rate of 35 per cent (which may be reduced under an applicable tax treaty).

However, the rules set out above are merely safe harbour rules and the taxpayer may prove that a different arm’s length debt-to-equity ratio or interest rate should be used.

ii Deduction of finance costs
As mentioned above, companies may not pay interest on loans from shareholders or related parties in excess of what would be paid to an unrelated third party. Generally, there are no other restrictions on interest deductions.

In the case of a leveraged acquisition, the absence of consolidated taxation for company groups means interest on the acquiring company’s debt cannot be deducted by the target company if the latter does not have operational income. Further, the Swiss tax authorities may treat debt push down strategies in a leveraged acquisition as tax avoidance.

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5 See Section III.i.
6 See Section VII.i.
7 See Section VIII.i.
iii Restrictions on payments
Swiss company law states that dividends ‘may be paid only from the disposable profit and from reserves formed for this purpose’ (Article 675 of the Swiss Code of Obligations). Thus, interim dividends are not permitted.

Swiss accounting rules now permit a parent company to temporarily record dividends paid by a subsidiary in the business year in which the subsidiary earned the profit distributed as dividends, rather than in the year in which the subsidiary decided on the dividend amount. This practice is accepted by the Swiss tax authorities provided that upon distribution the dividends are recorded in the income statement and certain procedural conditions are met.

iv Return of capital
Repayments of capital contributions are not subject to withholding tax and are tax-exempt for individuals who are Swiss tax residents; this includes both share capital and share premium. Share premium can be distributed without capital reductions. However, share premium must be listed in a clearly marked share premium reserve and validated by the FTA.

However, if adopted, the Tax Reform Act would limit listed companies from distributing share premium reserves, unless they first distribute an equal or greater dividend.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Acquisition vehicle
Acquisitions can be carried out using a local or non-local entity.

When using a foreign parent company to acquire a Swiss company, investors should ensure that the foreign parent company is located in a jurisdiction that has a DTT with Switzerland so as to reduce or eliminate withholding tax on dividend distributions. Otherwise, it is advisable to use an intermediary holding company located in a jurisdiction that has a DTT with Switzerland, provided it complies with the criteria for treaty relief.8

Additionally, investors should be aware of the ‘old reserves theory’. Under this theory, if a foreign shareholder transfers shares in a Swiss company to a shareholder located in a jurisdiction with a more favourable DTT, withholding tax may continue to be levied on distributable reserves at the same rate applicable to a tax resident of the first jurisdiction if at the time of the transfer, the company had commercially distributable reserves and assets not economically required.

Acquisition structure
Acquisitions may be structured as either a share deal or an asset deal.

Asset deals tend to be more favourable for buyers, since a step-up in basis is allowed, while share deals are beneficial for sellers, in particular for individual sellers, since individuals are not subject to capital gains tax on gains arising from private assets, but are subject to income tax on dividends.

Asset deals permit the company to record part of the purchase price as goodwill. Payment in excess of the assets’ market value is recorded as goodwill; goodwill can be depreciated.9

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8 See Section VI.iii.
9 See Section III.i.
Transferred assets may be subject to VAT and transfer stamp duty (for transfers of securities).

In the case of a share deal, the purchase price is recorded in the books of account as the share value. This value cannot be decreased (unless the market value decreases). The acquiring company may carry forward the target company’s losses for seven years and is responsible for the target company’s tax liabilities. If the buyer or seller is a professional securities dealer then transfer stamp duty will be levied.

Special attention must be paid to rules concerning indirect partial liquidation and transposition during share deals involving sales by individuals resident in Switzerland, since tax-free capital gains can be retroactively reclassified as taxable participation income.

The criteria for indirect partial liquidation are: (1) sale of at least 20 per cent of the share capital in a Swiss or foreign company to a third party; (2) the shares are transferred from the seller’s private assets to a company or to the acquirer’s business assets (in the case of acquisition by an individual); (3) the target company has commercially distributable reserves at the moment of the transfer and assets beyond those required to run the business; and (4) these assets are distributed to the acquirer during the five years following the acquisition.

Generally, indirect partial liquidation can be avoided by adding a clause to the share purchase agreement that prevents distributions during the five years following the transfer.

Transposition occurs under the following conditions: (1) transfer of at least 5 per cent of the share capital of a company; (2) from the private assets of an individual to a partnership or company in which said individual holds at least 50 per cent of the capital after the transfer; and (3) the consideration is worth more than the nominal value of the transferred shares.

Income resulting from transposition is taxed as participation income, rather than as a capital gain. The Tax Reform Act will abolish the 5 per cent threshold.

Financing structure

Financing can be provided through either equity or debt.

Stamp duty is levied on the creation of equity in excess of the 1 million Swiss francs exemption. Additionally, there is no notional interest deduction. Ordinarily, interest on debt is a tax-deductible expense.

As previously mentioned, loans granted by shareholders and related parties must be at arm’s length. Further, thin capitalisation will result in increased corporate income taxes and capital tax.

As mentioned above, debt pushdown in a leveraged acquisition may be regarded as tax avoidance by the Swiss tax authorities, so an acquisition company cannot acquire a target company, merge with it and then deduct interest on loans taken out by the target company. If the Swiss tax authorities consider the debt push down to be tax avoidance, interest on the loan may not be deducted.

If the acquiring company intends to acquire multiple target companies, one solution is to structure the acquisition as a cascade purchase. In a cascade purchase, a target company first acquires another target company, which in turn acquires another target company, and so
on. Since the target companies have operational income and assets that can be leveraged, they can take out loans to fund the acquisition of other target companies and deduct the interest on these loans.

ii Reorganisation
In principle, reorganisations (mergers, demergers, conversions and the transfer of assets) are tax-neutral. The following conditions must be respected for a reorganisation to be tax-neutral: (1) the company remains subject to tax in Switzerland; and (2) there is no re-evaluation of commercial assets.

Additionally, in the event of a demerger, a business unit or part of a business unit must be transferred. Likewise, the intra-group transfer of assets is tax-free, but only for operational assets; there is blocking period of five years (participations and assets that were part of the reorganising cannot be sold for five years).

iii Exit
In the event of a reorganisation that leads to downsizing or closing Swiss operations, all transactions between associated enterprises resulting from the reorganisation must be at arm’s length, as enumerated in Chapter IX of the OECD Transfer Pricing Guidelines.

Exit tax is levied on hidden reserves upon emigration. Likewise, withholding tax is levied on distributable reserves and hidden reserves. The Tax Reform Act provides a clear legal base for levying exit tax on hidden reserves.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION
i General anti-avoidance
In Switzerland, general anti-avoidance rules (GAARs) are not contained in a specific act. However, the Swiss Federal Supreme Court has developed a general principle of tax avoidance and abuse of rights, applicable to all Swiss taxes. In accordance with this principle, in certain situations, tax authorities have the right to tax a taxpayer’s structure based on its economic substance, rather than its legal structure.

According to case law, there is tax avoidance if: (1) the taxpayer has chosen an abnormal structure; (2) it was done with the intention to save on taxes; and (3) the taxpayer would save on taxes if permitted to use the structure.

ii Controlled foreign corporations (CFCs)
Switzerland does not have CFC rules. However, the case law of the Swiss Federal Supreme Court stipulates that a company whose statutory seat is located abroad, but has little or no substance abroad and is effectively managed from Switzerland, may be deemed a Swiss taxpayer.

iii Transfer pricing
The Swiss tax code contains very few rules relating to transfer pricing.

The Swiss tax authorities do not require specific transfer pricing documents, but Swiss tax law states that a company’s expenses must be commercially justified and that profits not shown in the company’s profit and loss statement still must be included in the taxable profit. Based on these general rules, Swiss tax authorities can correct intra-group transactions that are not at arm’s length. In determining whether an intra-group transaction is at arm’s length, the Swiss tax authorities follow the OECD Transfer Pricing Guidelines.
It is possible to request an advance pricing agreement from the Swiss tax authorities; the competent authority is the State Secretariat for International Financial Matters.

iv Tax clearances and rulings
Tax rulings are common in Switzerland and help eliminate uncertainty and avoid future disputes.

Generally, it is recommended to request a ruling before entering into a complex transaction or other situation where tax uncertainty could arise.

Rulings concerning tax planning or preferential tax regimes are now automatically exchanged under automatic exchange of information agreements and in accordance with the BEPS rules. This has led to a reduction in the number of rulings, some of which were not necessary in the first place. Conversely, rulings concerning the treatment of specific transactions, generally, are not part of the automatic exchange of information and continue to be commonplace.

X YEAR IN REVIEW
Switzerland offers a stable, BEPS-compliant environment for companies looking to make inward investments. Increased pressure for companies to demonstrate actual substance in their stated country of residence, combined with Switzerland's attractive living and working environment for employees has led to an increase in companies looking to onshore in Switzerland.

Switzerland is committed to implementing the BEPS minimum standards. On 7 June 2017, Switzerland signed the OECD’s Multilateral Instrument. Switzerland is a signatory to the Multilateral Competent Authority Agreement and the Common Reporting Standard and the first automatic exchanges of information started in autumn 2018. Switzerland has also signed the Multilateral Competent Authority Agreement for the automatic exchange of country-by-country reports, so as of 2018, MNEs in Switzerland have to submit country-by-country reports; the first automatic exchanges of country-by-country reports are scheduled to take place in 2020.

XI OUTLOOK AND CONCLUSIONS
Switzerland is in the process of reforming its corporate tax system to bring it in line with OECD and EU requirements. On 12 February 2017, Swiss voters rejected the Corporate Tax Reform III. In response to the vote, the Federal Council formed a steering committee to develop a new proposal – Tax Proposal 17. During parliamentary debate, members of Parliament agreed to include funding for social security. The bill was renamed the Tax Reform and Social Security Funding Act (the Tax Reform Act). The Tax Reform Act was adopted by Parliament.

The Tax Reform Act will abolish the special cantonal statuses, as well as the principal company reduction. The Tax Reform Act will introduce mandatory IP boxes in all cantons and cantons may offer additional R&D deductions. It is expected that most cantons will lower their corporate income tax rates to compensate for the loss of the special cantonal statuses; some cantons will lower their capital tax rates.

If 50,000 Swiss voters request a referendum on the Tax Reform Act prior to 17 January 2019, which is likely, a referendum will be held on 19 May 2019. If the Tax Reform Act is not rejected by Swiss voters, it is expected to enter into force on 1 January 2020.
I  INTRODUCTION

Taiwan used to offer lavish tax incentives, mainly tax holidays and income tax credits, to attract foreign direct investment. However, since the expiry of the last tax incentive schemes at the end of 2009, the government has changed its policy and does not offer any significant income tax incentives except for an income tax credit on R&D expenditures.

Instead, Taiwan lowered its corporate income tax rate from 25 to 17 per cent in 2010, among the lowest in the region, to attract foreign investments. While the 17 per cent tax rate may be relatively competitive for a foreign business investing in Taiwan, it does not make Taiwan attractive as a regional holding centre. Not only are offshore dividends remitted to Taiwan taxed, subsequent remittances of the profit from Taiwan also trigger a dividend withholding tax. Taiwan also taxes a company’s retained earnings that are not fully appropriated before the end of the following year. Taiwan raised its corporate income tax to 20 per cent in 2018 as a remedy for reduced personal income tax collections.

In addition to the above taxes, Taiwan does not have a comprehensive network of tax treaties. Owing to its political relationship with China and its unique political standing in the world, Taiwan is not recognised as a country by most states. As a result, Taiwan historically could not enter into tax treaties with major economies around the world. However, that has changed in recent years, and Taiwan now has tax treaties with many major economies, including Japan, the United Kingdom, France, Germany, Switzerland, the Netherlands and Australia. However, it still does not have a tax treaty with the United States, one of its largest trading partners.

Again as a result of political obstacles, Taiwan’s tax authority is relatively isolated from the tax community in the rest of the world. Taiwan is not a member of the OECD. Although the Taiwan tax authority always maintains that it generally follows OECD guidelines and practices, in reality it tends to cherry-pick OECD guidelines in its favour, and in many instances does not follow the generally accepted international interpretation of tax law. The aggressive demand for the withholding tax for cross-border payments outbound from Taiwan is the most notable example of this.

1 Michael Wong is a principal partner and Dennis Lee is a senior consultant at Baker McKenzie.
II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate

To conduct businesses in Taiwan, a foreign company often sets up a subsidiary or a branch office in Taiwan.

A subsidiary can be a limited company or a company limited by shares. There is a less onerous administrative and corporate maintenance burden for a limited company. However, if the foreign shareholder needs to carry out merger and acquisition projects in Taiwan, or if the Taiwan subsidiary is a joint venture, then a company limited by shares is more appropriate, because the Taiwan Company Law provides extensive corporate governance guidance for a company limited by shares (the requirements for a limited company are less sophisticated) and only a company limited by shares can participate in merger and acquisition activities under the Company Law and the Business Mergers and Acquisitions Law. Effective from 4 September 2015, a new entity type – a closely held company limited by shares – was added to the Taiwan Company Law. The reason behind adding this new variety of company limited by shares is to relax certain requirements of a traditional company limited by shares that assume that such a company will have many shareholders, and that most of these are general and small investors who need statutory protection. For instance, for a closely held company limited by shares, compared to a traditional company limited by shares, the scope of non-cash contributions is broader, there are more approaches to convene a shareholders’ meeting (i.e., a written resolution or video conference is permissible) and profits can be distributed semi-annually (where only an annual distribution is permissible for a traditional company limited by shares).

The foreign company can also set up a branch office in Taiwan to conduct business. Currently, from a business-conducting perspective, a branch is generally the same as a subsidiary. The administrative and corporate maintenance burden for a branch is even lighter than for a subsidiary. However, the main legal concern is that a branch office is part of the headquarters and is not an independent legal entity.

In practice, a branch is more popular because of tax reasons. For example, the profit of a subsidiary is subject to Taiwan corporate income tax (currently at a rate of 20 per cent), but when remitting dividends outbound from Taiwan, a 21 per cent (if no tax treaty exists between Taiwan and the destination country) withholding tax will also be imposed. On the other hand, although the profit of a branch office is subject to the same corporate income tax, there is no dividends withholding tax equivalent when the branch office remits back the profits.

ii Non-corporate

A partnership under the Civil Code is a possible format for a foreign company to conduct business activities in Taiwan. However, this is not a suitable format for a foreign company. A partnership under the Civil Code is not an independent legal entity. It is a contract between individuals or companies. As a result, partners under the partnership contract are subject to unlimited liability. This is one of the reasons why partnerships are not a popular business format. The profit earned by the partners through a partnership will be included as part of the partner’s income and subject to the partner’s income tax rate.
III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

Taxable profits are based on accounting profits and are adjusted for by tax law. Profits are taxed on an accrual basis. In principle, taxpayers are taxed on worldwide-source profit. For any profit-seeking enterprise operating within Taiwan, profit-seeking enterprise income tax shall be levied. For any profit-seeking enterprise with its head office within Taiwan, profit-seeking enterprise income tax shall be levied on its total profit-seeking enterprise income derived from both within and outside of Taiwan. On the other hand, a branch of a foreign company is taxed only on its Taiwan-sourced income.

Depreciation is tax-deductible based on a table of service lives for various categories of assets. Service lives actually adopted cannot be shorter than those in the table, and an estimated residual value is required to calculate the annual depreciation. Depreciation methods allowed include straight line, fixed percentage on a declining base, sum of the years’ digits, units of output and service hours. Any other method adopted requires advance approval from the tax authority. Amortisation of intangibles is provided on the following useful lives:

a operating rights: 10 years;
b copyright: 15 years; and
c trademarks, patents and other franchise rights: the remaining statutory lives.

Capital and income

Generally, all profits are taxed on an actual realised basis with only two exceptions:

a Land: gains on sales of land are free from regular income tax but subject to a land increment tax based on a special formula and government-regulated prices. However, starting 1 January 2016, capital gains of foreign nationals derived from the disposition of real estate acquired after 31 December 2015 will be taxed at a rate of 45 per cent for real estate held for less than one year. This rate will be reduced to 35 per cent if the real estate is held for more than one year.
b Securities: gains from the trading of securities are generally free from regular income tax but subject to an alternative minimum tax.

Losses

Tax losses are allowed to be carried forward for 10 years. No loss carry-back is allowed under Taiwan law.

Rates

The current corporate income tax rate is 20 per cent.

Administration

There is only one level of corporate income tax in Taiwan, known as the profit-seeking enterprises’ income tax. An enterprise is required to pay an interim income tax based on 50 per cent of the previous year’s income tax payable in the ninth month of the year. Alternatively, under certain circumstances, an enterprise can choose to pay the interim tax based on the actual operating results of the current year’s first six months.
An enterprise is then required to file an annual income tax return in the fifth month of the following year. The return should be filed along with the simultaneous payment of any taxes due.

Enterprises are encouraged to have their income tax returns certified by certified public accountants (CPAs) prior to filing. Income tax returns filed with a CPA’s certification are in theory less likely to be chosen for a tax audit by the tax authority. This certification involves a limited audit of the balance sheet accounts and a more extensive audit of the profit and loss accounts.

The tax authority does not have a fixed audit cycle and will only choose targets for audit randomly. The statute of limitations is five years if the tax return is filed on time and no tax fraud is involved.

It is possible to obtain advance rulings from the tax authority for clarification of tax treatments.

There are clear administrative remedy procedures to resolve disputes with the tax authority. In Taiwan, tax litigation cases are handled by two levels of administrative courts, the high administrative courts and the supreme administrative courts.

**Tax grouping**

Taiwan does not have consolidated tax grouping rules except for financial holding companies, and for companies that have been through a merger, acquisition or spin-off executed in accordance with the Business Merger and Acquisitions Law. All group companies with holdings over 90 per cent shall be included if tax grouping is selected. The company’s taxable income and loss are allowed to be offset with each other. Other than that, there is no other meaningful tax benefit under a tax grouping. Basically, this is simply a combination of group companies’ taxable income and loss, and thus is not a true consolidated tax grouping.

**ii Other relevant taxes**

Other than corporate income tax, business tax is the other major tax of interest to multinational companies doing business in Taiwan. Sales of goods and services in Taiwan are subject to business tax, which comes in two forms: value added tax (VAT) and gross business revenue tax (GBRT), currently at a rate of 5 per cent of gross revenues. GBRT mainly applies to financial institutions and is borne by sellers. VAT applies to other general industries, and is to be collected from buyers of goods and services by the sellers. Sales of certain products and services are exempt from VAT, whereas exports of goods and services are generally entitled to a zero rate of VAT.

Net profit not appropriated before the end of the following year will be subject to a surplus tax on retained earnings at a rate of 5 per cent. Unlike in the past, any surplus tax paid can no longer be creditable against the dividends withholding tax when the profit is subsequently distributed.

**IV TAX RESIDENCE AND FISCAL DOMICILE**

**i Corporate residence**

Corporate residence is determined based on where the corporate entity is incorporated regardless of the place of effective management (PEM) under current law.

However, Taiwan introduced a new provision regarding the PEM in July 2016 through the addition of Article 43-4 to the Income Tax Act. Prior to the amendment, only companies...
incorporated under Taiwan laws will be subject to corporate income tax in Taiwan, and foreign companies will not be taxed in Taiwan unless they maintain a fixed place of business or a business agent in Taiwan. With the introduction of the PEM rules, foreign companies will be taxed in Taiwan if they are construed as having their PEM within Taiwan. According to Article 43-4 of the Income Tax Act, foreign companies will be deemed Taiwan tax residents if all of the following conditions are met:

2.1 Decision makers (individual and corporate) for significant operation management, financial management, and human resource management are residents in Taiwan or incorporated in Taiwan; or such decisions are made within the territory of Taiwan;

2.2 Creation and storage or financial statements, accounting records and shareholders'/directors' meeting minutes are within the territory of Taiwan; and

2.3 Main business activities are executed within Taiwan.

Nevertheless, it should be noted that the effective date of this new provision is still pending.

ii Branch or permanent establishment
Foreign companies can do business in Taiwan through a branch, and will only be taxed on the profit of that branch in Taiwan. The tax will be limited to the branch’s Taiwan-sourced income, and head office expenses can be allocated to Taiwan through a special mechanism.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT
Apart from income tax credits granted for R&D, Taiwan no longer offers any tax incentives to attract foreign investment.

Taiwan companies can either get an income tax credit at a rate of 15 per cent of their annual R&D expenditure in the current year, or at a rate of 10 per cent of the R&D expenditure to offset the profit-seeking enterprise income tax payable in the ensuing three years. The R&D tax credit is capped at 30 per cent of the annual taxable income.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS
i Withholding on outward-bound payments (domestic law)
Payments of dividends are subject to a 21 per cent withholding tax rate and payments of interest and royalties are subject to a withholding tax at a rate of 20 per cent unless there is an applicable tax treaty that offers preferential withholding rates.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments
No exemption is available for payments of dividends.

Interest payments to foreign governments and interbank interest payments are free from the Taiwan withholding tax.
Royalties paid for the introduction of patents, trademarks and computer programs to 20 designated industries can qualify for an income tax exemption with advance approval from the competent authority.

### iii Double tax treaties

Taiwan has entered into 32 tax treaties, and the following table shows the withholding rates applicable under the respective tax treaties as of 20 November 2018. Without a tax treaty, the withholding rate for dividends is 21 per cent, whereas the withholding rate for both interest and royalties is 20 per cent.

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Dividends (per cent)</th>
<th>Interest (per cent)</th>
<th>Royalties (per cent)</th>
<th>Effective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>10, 15</td>
<td>10</td>
<td>12.5</td>
<td>1 January 1997</td>
</tr>
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<td>Austria</td>
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<td>1 January 2006</td>
</tr>
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<td>Canada</td>
<td>10, 15</td>
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<td>19 December 2016</td>
</tr>
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<td>Denmark</td>
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<tr>
<td>France</td>
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<td>zero, 10</td>
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<td>1 January 2011</td>
</tr>
<tr>
<td>Gambia</td>
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<td>1 January 1999</td>
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<td>Germany</td>
<td>10, 15</td>
<td>10, 15</td>
<td>10</td>
<td>1 January 2013</td>
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<tr>
<td>Hungary</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>1 January 2011</td>
</tr>
<tr>
<td>India</td>
<td>12.5</td>
<td>10</td>
<td>10</td>
<td>1 January 2012</td>
</tr>
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<td>Indonesia</td>
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<td>1 January 1996</td>
</tr>
<tr>
<td>Israel</td>
<td>10</td>
<td>7, 10</td>
<td>10</td>
<td>1 January 2010</td>
</tr>
<tr>
<td>Italy</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>31 December 2015</td>
</tr>
<tr>
<td>Japan</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>13 June 2016</td>
</tr>
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<td>Kiribati</td>
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<td>10</td>
<td>1 January 2001</td>
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<tr>
<td>Netherlands</td>
<td>10</td>
<td>10</td>
<td>Nil**</td>
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<tr>
<td>New Zealand</td>
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<td>1 January 1998</td>
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<td>Paraguay</td>
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<td>1 January 2010</td>
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<td>Poland</td>
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<td>3, 10</td>
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</tr>
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<td>Senegal</td>
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<td>12.5</td>
<td>1 January 2005</td>
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<tr>
<td>Singapore</td>
<td>40*</td>
<td>Nil**</td>
<td>15</td>
<td>1 January 1982</td>
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<tr>
<td>Slovakia</td>
<td>10</td>
<td>10</td>
<td>5, 10</td>
<td>1 January 2012</td>
</tr>
<tr>
<td>South Africa</td>
<td>5, 15</td>
<td>10</td>
<td>10</td>
<td>1 January 1996</td>
</tr>
<tr>
<td>Swaziland</td>
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<td>10</td>
<td>10</td>
<td>1 January 2000</td>
</tr>
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<td>Sweden</td>
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<td>10</td>
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<td>1 January 2005</td>
</tr>
<tr>
<td>Switzerland</td>
<td>10, 15</td>
<td>zero, 10</td>
<td>10</td>
<td>1 January 2011</td>
</tr>
<tr>
<td>Thailand</td>
<td>5, 10</td>
<td>10, 15</td>
<td>10</td>
<td>1 January 2013</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>1 January 2003</td>
</tr>
<tr>
<td>Vietnam</td>
<td>15</td>
<td>10</td>
<td>10</td>
<td>1 January 1998</td>
</tr>
</tbody>
</table>

* The total tax imposed on the dividend together with profit-seeking enterprise income tax should not exceed 40 per cent of pre-tax income.

** There is no provision for a reduced withholding tax rate under the treaty.
iv  Taxation on receipt
Local dividends from one Taiwan company to another Taiwan company are free from the
Taiwan income tax. In Taiwan, dividends are only taxable when they reach the hands of
Taiwan individual shareholders or foreign shareholders.

Foreign dividends received by Taiwan companies are subject to the regular corporate
income tax at a rate of 20 per cent. Dividends withholding tax paid at source can be used
to credit against corporate income tax in Taiwan, but only to the extent of the additional
income tax incurred by the inclusion of the foreign dividends in the taxable income.

VII  TAXATION OF FUNDING STRUCTURES

i  Thin capitalisation
Taiwan has thin capitalisation rules that set the debt-to-equity ratio at 3:1. Only debts from
related parties or guaranteed by related parties count, and interest expenses on excessive
borrowing are not tax deductible.

ii  Deduction of finance costs
The law itself is general and vague. It only stipulates that expenses necessary for the operation
of the business shall be tax deductible, and interest expenses are generally regarded as necessary
for generating taxable income and are, therefore, tax deductible.

iii  Restrictions on payments
Dividends can only be declared from retained earnings. Companies with a cumulative deficit
are not allowed to declare dividends.

Ten per cent of annual earnings must be set aside as a legal reserve before the declaration
of dividends until the accumulative legal reserve set aside equals the paid-in capital. Certain
chartered industries, such as banking and insurance, have higher reserve requirements for
setting up various reserves before dividends can be declared.

iv  Return of capital
Return of capital is tax-neutral. The main barrier to capital reduction is that there might be a
minimum capital requirement for some chartered businesses.

VIII  ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i  Acquisition
A foreign company will normally have its existing subsidiary or a newly incorporated special
purpose vehicle in Taiwan acquire a majority holding and follow up with a statutory merger
with the target. There are two main reasons behind this acquisition structure. The first is
to ensure a 100 per cent acquisition. A direct acquisition cannot guarantee a 100 per cent
buyout, whereas a statutory merger can legitimately squeeze out the minority shareholders.
On the financial side, the acquisition fund can be a mix of capital and intercompany loans,
bearing in mind that the thin cap rule sets the debt-to-equity ratio at 3:1.
ii Reorganisation

Mergers and demergers (or spin-offs) are allowed under the Business Mergers and Acquisitions Act and can be executed on a tax-free basis. Shareholders’ dividend withholding tax may be triggered under certain special circumstances. A merger with a foreign company is possible, and will require statutory approval from both sides.

iii Exit

Taiwan law does not permit the change of domicile of a Taiwan corporate entity into a non-Taiwan corporate entity. Thus, if a foreign business decides to relocate from Taiwan, it can only liquidate its Taiwan business and pay whatever tax is due before relocating to another country. Other than the tax liabilities that may be due following the liquidation, there are no additional tax penalties from this process.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

Controversies and even litigation cases have often arisen in the past when the tax authorities assessed tax liabilities by relying on the ‘form over substance’ principle for lack of a more precise legal basis for its position. To fill that void, the legislature enacted Article 12-1 of the Tax Collection Act on 15 May 2009, which mandates that the application of tax law and regulations shall be based on the concept of taxation by law, taking into consideration the legislative purpose of the relevant applicable tax laws, economic meaning and fair tax in substance. Article 12-1 further stipulates that when construing tax events and objects, the tax authority will base its construction on substantive economic substance and the related ownership and sharing of the substantive economic benefit. Finally, Article 12-1 stipulates that the tax authority shall bear the burden of proof for the application of substance over form.

Taiwan does not have any tax regulations that target low-tax jurisdictions. It does not have controlled foreign corporation (CFC) rules, although the government has considered the idea on several occasions.

ii CFCs

Taiwan introduced CFC rules in July 2016 through the addition of Article 43-3 to the Income Tax Act, which requires a Taiwan corporate taxpayer to include in its taxable income its pro rata share of the taxable profits of its CFC. For the purposes of Article 43-3 of the Income Tax Act, CFCs are defined as corporations established in low-tax territories that are more than 50 per cent owned (directly or indirectly) or dominantly influenced by a Taiwan business entity. Exemptions apply when a CFC has actual business activities in the jurisdiction of its incorporation or its profits do not reach the threshold prescribed by the Taiwan tax authorities. The adoption of CFC rules would eliminate the deferral of taxation on those overseas profits and would discourage businesses from leaving earnings in foreign jurisdictions.

Nevertheless, it should be noted that effective date of this new CFC regime is still pending.
Taiwan introduced its transfer pricing rules in 2004, which follow the general principles and concepts adopted by the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and the United States of America Inland Revenue Code Sections 482-1 to 482-6 and their corresponding regulations.

Since then, Taiwan taxpayers have been required to explicitly state on their income tax returns whether related-party transactions are executed within an arm’s-length range. However, a comprehensive contemporaneous transfer pricing report will only be required within one month of the receipt of a transfer pricing audit notice from the tax office if the safe harbour threshold is exceeded.

Under the current safe harbour rules, taxpayers will not be required to prepare a comprehensive contemporaneous transfer pricing report if:

- their annual turnover is below NT$300 million;
- their annual turnover is between NT$300 million and NT$500 million without the utilisation of loss carry-forward or any income tax incentive; or
- the total of related-party transactions is below NT$200 million.

Advance pricing agreements are available to qualifying taxpayers. An advance pricing agreement is usually valid for three to five years. An extension of up to five years is available.

To keep up with the international trend, Taiwan introduced the three-tiered reporting requirement in 2017, where companies exceeding the safe harbour threshold summarised below are required to file master file and country-by-country reports (CbCRs) at the end of the following year.

A Taiwan entity that meets any one of the following conditions will be exempt from filing the master file:

- the Taiwan entity’s total annual turnover (including operating and non-operating) does not exceed NT$3 billion; or
- the Taiwanese entity’s total cross-border controlled transaction amount does not exceed NT$1.5 billion.

An enterprise in Taiwan meeting any of the following conditions will be exempt from CbCR filing:

- the ultimate parent entity (UPE) of a multinational enterprise (MNE) group is a Taiwan entity and with annual consolidated group revenue in the immediately preceding fiscal year of less than NT$27 billion; or
- a Taiwan subsidiary or branch with a UPE outside of Taiwan, which meets one of the following conditions:
  - the jurisdiction of tax residence of the UPE has statutory provisions to file the CbCR, and also meets the exemption requirements for filing the CbCR;
  - the jurisdiction of tax residence of the UPE does not have the statutory provisions to file the CbCR, the MNE appoints one of the members to act as a surrogate parent entity (SPE) to file the CbCR, which meets the exemption requirements for filing the CBCR; or
• the jurisdiction of tax residence of the UPE does not have the statutory provisions to file a CbCR, nor do they appoint any other members as an SPE, but meet the exemption requirements to file the CBCR in Taiwan (annual consolidated group revenue during the fiscal year immediately preceding the reporting fiscal year that does not exceed NT$27 billion).

iv Tax clearances and rulings
The taxpayer can apply for advance tax rulings to secure certainty. No tax clearance or ruling will be required for the acquisition of a local business.

X YEAR IN REVIEW
Taiwan introduced a number of significant reforms to its income tax law effective in 2018: the imputation system was abolished, corporate income tax was raised from 17 per cent to 20 per cent, the highest tax bracket for personal income tax was dropped from 45 per cent to 40 per cent, and the surplus tax on retained earnings was cut from 10 per cent to 5 per cent, among other items.

Income tax on non-resident companies that sell electronically supplied services to Taiwan was introduced. This is the first regime in the world to levy income tax on the cross-border digital economy.

XI OUTLOOK AND CONCLUSIONS
Following the passage of significant tax reform in 2018, we expect that the Ministry of Finance (MOF) will not make any substantial changes to the law in 2019. The first challenge for the MOF in 2019 will be to cope with any social outcry to reduce the income tax burden on salary income. The other test for the MOF is how to keep up with the Common Reporting Standard. With its unique political standing in the world, it is extremely difficult for Taiwan to engage with the international tax community to exchange information. Taiwan’s first target is to sign a multilateral competent authority agreement with countries that currently have tax treaties with Taiwan as a first step towards the exchange of information.
Chapter 34

THAILAND

Panya Sittisakonsin and Sirirasi Gobpradit1

I INTRODUCTION

Thailand is a top destination for foreign direct investment (FDI). With its strategic location in the centre of Asia, which is the fastest-growing economic market in the world and offers great business potential, Thailand serves as a gateway to South East Asia and has become a hub for multinational companies.

Despite internal political unrest, Thailand continues to maintain investor confidence and welcome investment from all over the world. The government has actively encouraged FDI, especially investment that contributes to the development of the economy and employment, as well as technology transfer. The World Bank’s Ease of Doing Business 2019 report ranked Thailand as the 27th-easiest country in which to do business out of 190 countries worldwide, which is higher than Japan, China, India and most of the Association of Southeast Asian Nations.

The government supports FDI through various vehicles. For example, foreign businesses promoted under the Board of Investment (BOI) scheme may be granted tax and import duty exemptions for a specified period, permission to bring in foreign expatriates, permission to own land and permission to transfer foreign currency, as well as other support services.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate

Businesses generally adopt a corporate form. The principal forms of corporate organisation are limited liability companies (either private or public), registered partnerships, branch offices, representative offices and regional offices.

Limited liability companies

The nature and form of a limited liability company in Thailand are essentially the same as in many other jurisdictions. The capital of a limited liability company is divided equally and is represented by shares of a designated (par) value. The liability of each shareholder is limited to the unpaid portion of the shares held. Limited liability companies can be private limited companies, which are subject to the Civil and Commercial Code (CCC), or public limited companies, which are subject to the Public Limited Companies Act, BE 2535 (1992) (PLCA). Companies are subject to corporate income tax (CIT) on their net profits.

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**Private limited companies**

At least three natural persons (not necessarily Thai citizens) must act as promoters to establish a private limited company, with each promoter holding at least one share and thus becoming a shareholder upon incorporation. The par value of a share of a private limited company is at least 5 baht, and each share must be at least 25 per cent paid up. The incorporation of a private limited company can be completed in one day, provided that all conditions under the CCC are met. Generally, there are no restrictions as to the nationality of the directors, except for companies that engage in certain commercial activities.

Shares in a private limited company may not be offered publicly. However, a private limited company may issue certain debt instruments to the public, subject to approval from the Securities and Exchange Commission (SEC) under the authority of the Securities and Exchange Act, BE 2535 (1992) (the SEC Act).

**Public limited companies**

There must be at least 15 promoters to apply to incorporate a public limited company. The promoters must subscribe to at least 5 per cent of the total shares, and must hold such shares for two years from the company's incorporation date, unless approval has been obtained otherwise by a shareholders' meeting. In addition, at least 50 per cent of the promoters must be residents of Thailand. The shares in a public limited company must be fully paid up. The board of directors must have no less than five members, at least half of whom must reside in Thailand. The directors must make full disclosure of their shareholdings in the company or its affiliates, and generally have greater responsibility than directors of private limited companies.

The SEC, under the authority of the SEC Act, is responsible for approving the offering of securities to the public or any person, and for supervising the Stock Exchange of Thailand (SET). Only shares of public limited companies may be offered publicly and traded on the SET. Public limited companies may also issue debentures and other forms of securities to the public.

**Registered partnerships**

In a partnership, two or more parties join for a common business purpose and share the profits. Partnerships may be ordinary or limited. In ordinary partnerships, all partners have joint and unlimited liability for the debts and obligations of the partnership. In a limited partnership, some partners have only limited liability for the obligations and debts of the partnership. Limited partnerships must be registered, while ordinary partnerships may be unregistered. Registered partnerships are classified as juristic partnerships and are subject to CIT on their net profits.

**Branch offices**

A foreign enterprise may establish a branch office in Thailand. Such branch office, in terms of its status and liability, is considered to be the same legal entity as its head office overseas. The branch can carry on any or all of the activities within the scope of the head office's business objectives, subject to certain restrictions under the Foreign Business Act BE 2542 (1999) (FBA). A branch office is subject to CIT on net profits generated from business carried on in Thailand.
Representative offices
A foreign enterprise can establish a representative office in Thailand with the primary function of providing information and assistance to its foreign head office. The representative office must not generate income from its activities, and must have no power to accept purchase orders, make sale offers or carry out business negotiations. A representative office has a limited scope of activity in that it may only provide the following support services to its head office located offshore:

- finding sources from which the head office can purchase goods or services in Thailand;
- checking and controlling the quality and quantity of goods purchased, or contracted to be manufactured, by the head office in Thailand;
- giving advice on various aspects concerning goods that the head office has sold to distributors or consumers;
- disseminating information concerning new goods or services of the head office; and
- reporting on business movements in Thailand to the head office.

Regional offices
A foreign enterprise can establish a regional office in Thailand, provided that it is a juristic person incorporated under foreign law carrying on business in other countries, and it has at least one branch or affiliate in Asia, which may include Thailand.

The regional office in Thailand must not generate income from its activities, and must have no power to accept purchase orders from, make sale offers to, or carry out business negotiations with, persons or juristic persons in Thailand. Furthermore, the regional office’s expenses can only be funded by the head office. A regional office is permitted to carry out duties in communicating, coordinating and directing the operations of branches and affiliates located in the same region on behalf of the head office, and to provide the following services on behalf of the head office:

- consulting and management;
- training and personnel development;
- financial management;
- marketing control and sales promotion planning;
- product development; and
- research and development.

Non-corporate
Unregistered ordinary partnerships
Unregistered ordinary partnerships are not regarded as juristic persons under Thai law. Income generated by unregistered ordinary partnerships is subject to personal income tax at progressive rates of 5 to 35 per cent. Certain allowances and deductions are allowed under the conditions prescribed in the Revenue Code. Partners are no longer exempt from income tax on profit-sharing distributions by unregistered ordinary partnerships, with effect from 1 January 2015 onwards.

Non-juristic groups of persons
Non-juristic groups of persons are defined in the Revenue Code as two or more persons agreeing to jointly perform acts but are not regarded as an ordinary partnership. Income generated by non-juristic groups of persons is subject to personal income tax at progressive
rates of 5 to 35 per cent. Certain allowances and deductions are allowed under the conditions prescribed in the Revenue Code. Members of the groups are no longer exempt from income tax on profit-sharing distributions by non-juristic groups of persons, with effect from 1 January 2015 onwards.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

CIT is usually imposed on the net profits of a business for one tax year (the tax year can be any 12-month period selected by each taxpayer). Net profits are ascertained according to conditions imposed under the Revenue Code. An all-inclusive concept of income is used, and all realised economic gains are treated as income (including capital gains), whether they occur regularly or only occasionally.

CIT is generally computed on an accrual basis – that is, income accruing in any accounting period (whether or not it has been received) is included as income for that period, and expenses may be deducted as they accrue (whether or not they have actually been paid out).

As a general matter, expenses incurred exclusively for the purpose of acquiring profits, or from conducting business in Thailand (other than those expenses specifically excluded), are deductible expenses for determining net profit. Therefore, normal business expenses, interest incurred during the normal course of business operations, qualifying bad debts and depreciation at maximum rates ranging from 5 to 20 per cent per annum are allowed as deductions. Any generally accepted accounting method may be used to calculate depreciation, as long as the resulting depreciation rate is not greater than that provided by using the straight-line method at the rate prescribed in the Revenue Code. The following items, inter alia, are not allowed as deductions:

- the portion of the purchase price of assets that exceeds the normal price, without justifiable reasons;
- private expenses, including gifts for customers;
- gifts to charitable institutions exceeding 2 per cent of net profit;
- capital expenditures;
- CIT, penalties, surcharges and criminal fines under the Revenue Code;
- the portion of salary paid to shareholders that exceeds a reasonable amount; and
- any expenses not exclusively incurred for the purpose of making profits or business.

Entertainment expenses up to a maximum of 0.3 per cent of gross revenues or the paid-up capital of the company (whichever is higher) are deductible if they are generally necessary for that type of business, but only up to 10 million baht. Certain bad debts can generally be written off if reasonable efforts have been made to recover them under criteria set out in relevant regulations. For example, where a lawsuit has been filed against the debtor, the court has issued an order or injunction, and the debtor has no assets to repay the debt.

Losses

Net losses may be carried forward for five consecutive years. However, there is no provision for the carry-back of losses. Losses survive a change in ownership, such as a change of
shareholders of the company. However, in changes of ownership where the company is dissolved and liquidated (e.g., in an amalgamation), losses of the dissolved company are not transferred to the new company.

Rates

In general, all companies and registered partnerships pay CIT at a flat rate of 20 per cent of net profits. However, the following progressive rates have applied to net profits derived by small and medium-sized enterprises (companies or juristic partnerships with paid-up capital of not more than 5 million baht, and with an annual income from the supply of goods and services of not more than 30 million baht), for the accounting period beginning on 1 January 2017 onwards:

<table>
<thead>
<tr>
<th>Amount of net profits (baht)</th>
<th>CIT rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 to 300,000</td>
<td>Exempt</td>
</tr>
<tr>
<td>300,001 to 3 million</td>
<td>15 per cent</td>
</tr>
<tr>
<td>3,000,001 upwards</td>
<td>20 per cent</td>
</tr>
</tbody>
</table>

Standard deductions are allowed depending on the type of business activity that give rise to the income. Net profits are taxed at the normal rate. Any Thai or foreign-incorporated company or registered partnership conducting business in Thailand that fails to file a return in accordance with the law may be assessed to owe income tax at a rate of 5 per cent of the aggregate of either its gross receipts or total sales, without any deductions. Certain types of business are subject to CIT on their gross receipts or gross sales instead of their net profits. For example, foreign-incorporated companies engaged in the business of international transportation of passengers or goods pay 3 per cent CIT on gross receipts of fares collected in Thailand, or gross freight collected in or outside Thailand with regard to goods carried out of Thailand. Foundations and associations pay CIT at a rate of either 2 or 10 per cent of their gross income, depending on the type of income they have received.

Administration

CIT is payable twice a year. The first instalment is 50 per cent of the total tax, normally based on estimated net profits for the year. This is due within two months of the close of the first half of the financial year of the company. An annual income tax return must be filed within 150 days of the close of the company’s financial year. In the case of failure to file, a penalty of twice the amount of tax due is imposed when an official conducts an assessment. If tax is to be paid on the basis of net profits, then the return must be accompanied by an audited financial statement. If tax is to be paid on a gross-receipts basis, then a statement of gross receipts must be filed along with the return. Currently, filing can be done either by paper return or an electronic form.

The Revenue Department of the Ministry of Finance is responsible for tax under the Revenue Code (e.g., income tax, value added tax (VAT), specific business tax (SBT) and stamp duty). Other taxes (e.g., customs duty, excise tax, property tax, and signboard tax) are the responsibility of other government authorities.
There is a standard appeal procedure for grievances arising from income tax assessments. To qualify for consideration, an appeal must be filed with the Board of Appeals within 30 days of receiving the notice of assessment. A further appeal can be made to the tax court against the Board’s decision within 30 days of the date of receipt of the decision on appeal.

**Tax grouping**

There is no concept of consolidated tax grouping in Thailand. All corporate entities are treated as separate taxable entities and are subject to tax on their own merits.

**ii Other relevant taxes**

**VAT**

VAT is essentially a consumption tax on goods and services, operating at each stage of production and distribution. In effect, VAT covers all retailers, manufacturers, wholesalers, producers and importers of goods, as well as service providers, other than those excluded by the Revenue Code.

VAT is currently levied at a reduced rate of 7 per cent; however, this rate will increase to a standard rate of 10 per cent from 1 October 2019 onwards (unless the reduced rate is extended). Municipal tax at a rate of one-ninth of the VAT is already included in the VAT rate. VAT on exported goods and services, under the terms and conditions of the Revenue Code, is rated at zero per cent.

Certain businesses are exempt from VAT, including the following:

- enterprises with annual gross sales of less than 1.8 million baht;
- private and government healthcare services;
- educational services;
- religious and charitable organisations; and
- leasing of immovable property.

**SBT**

Eight categories of businesses are subject to SBT:

- banking and similar businesses;
- finance, securities and *credit foncier* businesses;
- life insurance brokers;
- pawnbrokers;
- traders of immovable property;
- securities repurchase businesses;
- factoring businesses; and
- selling securities on the SET (currently exempt).

SBT is imposed on gross receipts at rates ranging from 0.01 to 3 per cent, according to the nature of the services provided. Businesses that are subject to SBT must also pay municipal tax at a rate of 10 per cent of the SBT. As such, the effective SBT rates vary from 0.011 to 3.3 per cent.

**Stamp duty**

Stamp duty is levied on the execution or importation of 28 dutiable documents listed in the Stamp Duty Schedule of the Revenue Code, including share transfer instruments and hire-of-
work contracts. Rates and payment procedures depend upon the type of instrument. Penalties for failure to stamp documents can be imposed at a rate of up to six times the original duty. Furthermore, documents that have not been properly stamped are not admissible as evidence in civil court proceedings.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence
An entity becomes resident for Thai tax purposes if it is incorporated under Thai law, regardless of where management and control are exercised. A Thai tax-resident entity is subject to CIT in Thailand on a worldwide-income basis.

ii Branch or permanent establishment
A non-locally incorporated entity can have a fiscal presence in Thailand through a branch, agency relationship or permanent establishment. A branch of a foreign company carrying on business in Thailand is subject to CIT on net profits generated from business carried on in Thailand. Profits attributable to a permanent establishment in Thailand are subject to CIT.

Income derived in or from Thailand by an offshore principal as a result of an agency relationship with a person in Thailand is usually subject to CIT. The appointment of an agent (or an employee, representative or go-between) in Thailand exposes the overseas business entity to the risk of being deemed to be ‘conducting business in Thailand’, and results in a tax burden. However, where the Thai agent does not act solely for the overseas company, but acts as a general agent for various companies (i.e., he or she is an independent agent), income tax liability may not be incurred. There may also be relief effective under applicable agreements for the avoidance of double taxation.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes
A Thai company holding shares in another Thai company for at least three months before and after the dividends distribution is eligible:

- to include only half of the received dividends as income for CIT purposes; or
- not to include the entire dividends received as income, provided that:
  - the recipient of dividends is a company listed on the SET; or
  - the recipient of dividends holds at least 25 per cent of voting shares in the company paying dividends, and there is no cross-shareholding, either directly or indirectly, between the two companies.

Dividends received by a Thai company from a foreign company are exempt from CIT if a Thai company holds not less than 25 per cent of the total shares with voting rights in the foreign company for not less than six months from the share acquisition until the dividends distribution; and the dividends are paid from net profits that are subject to tax in the country of the foreign company at a rate of not less than 15 per cent (regardless of any reduction or exemption granted under the tax law of the country in which the foreign company is incorporated).
General

**BOI incentives**

Under the Investment Promotion Act, the BOI is able to provide BOI-promoted enterprises with various tax incentives, which include the following:

- *a* import duty exemptions or reductions on imported machinery, imported raw materials and components;
- *b* a CIT exemption for three to eight years from the date on which income is first earned, with permission to carry forward losses and deduct them as expenses for up to five years; and
- *c* exemptions from withholding tax on dividends derived from promoted projects during the CIT exemption period or within six months from the date on which the CIT exemption period expires.

**International headquarters (IHQ)**

The IHQ scheme is similar to that of the previous Regional Operation Headquarters (ROH) scheme. IHQs, however, will operate under a broader scope of services, looser conditions and increased tax benefits.

Examples of tax incentives for IHQ include the following:

- *a* income from qualifying service fees, royalties and dividends received from foreign affiliates are exempt from tax;
- *b* capital gains from a qualifying disposal of shares in foreign affiliates are exempt from tax;
- *c* income from qualifying service fees and royalties received from Thai affiliates are taxed at a reduced rate of 10 per cent;
- *d* interest from loans provided to foreign and Thai affiliates in respect of financial management services is exempt from SBT; and
- *e* dividends and loan interest paid by the IHQ to foreign company shareholders not doing business in Thailand are exempt from tax in Thailand.

Nevertheless, on 10 October 2018, the Cabinet approved concepts of a draft royal decree cancelling the IHQ scheme. Based on the news and information available, an application for new IHQs would not be accepted by the Revenue Department from such date onwards. Existing IHQs would still be eligible for tax privileges until completion of 15 accounting periods.

**International trade centre (ITC)**

A Thai company conducting procurement and sale of goods, raw materials, accessories and assembly parts, or providing international trading services, may apply for the tax incentives under the ITC scheme. Tax privileges under the ITC scheme are granted with the satisfaction of similar rules and conditions required for an IHQ, except that a foreign affiliate requirement is not compulsory. The income from 'out-out transactions' and international trading services provided to foreign entities, whether affiliated or not, is exempt from CIT.

Nevertheless, on 10 October 2018, the Cabinet approved concepts of a draft royal decrees cancelling the ITC scheme. Based on the news and information available, an
application for new ITCs would not be accepted by the Revenue Department from such date onwards. Existing ITCs would still be eligible for tax privileges until completion of 15 accounting periods.

**International business centre (IBC)**

On 10 October 2018, the Cabinet approved concepts of a draft royal decree introducing a new tax scheme called IBC. An IBC should be able to provide support services functions and financial management services under a treasury centre licence granted by the Bank of Thailand. Existing IHQs may opt to convert to an IBC.

Examples of tax incentives for IBCs include the following:

- **a** reduced CIT rates to 8, 5 or 3 per cent of net profits, depending on amount of expenditure in Thailand (60 million, 300 million or 600 million baht, respectively);
- **b** exemption on CIT for dividend received from an affiliate;
- **c** reduced personal income tax rate to 15 per cent for expatriates working for an IBC;
- **d** exemption on SBT for income from a treasury centre function; and
- **e** exemption on withholding tax for offshore affiliates receiving dividend or interest paid from an IBC.

Note that the above-mentioned tax incentives are based on the news and information available, and the concepts of the draft royal decree may be changed upon further consideration of the relevant authorities.

**VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS**

**i Withholding on outward-bound payments (domestic law)**

The Revenue Code requires certain payments, made from or in Thailand to an offshore entity not carrying on business in Thailand, to be subject to withholding tax. Payments subject to withholding tax include dividends, interest and royalties. The withholding tax rate is 10 per cent for dividends, and 15 per cent for interest and royalties. The withholding tax rate is 10 per cent for dividends, and 15 per cent for interest and royalties.

**ii Domestic law exclusions or exemptions from withholding on outward-bound payments**

There are no domestic law exclusions or exemptions from withholding on outward-bound payments of dividends, interest and royalties to an offshore entity.

**iii Double tax treaties**

The withholding tax rate on dividends, interest and royalties, paid to a foreign entity that is a tax resident of a country that has a DTA with Thailand, may be reduced.

**Dividends**

Normally, the 10 per cent withholding tax rate on dividends would still be applicable under the DTAs to which Thailand is a party. However, certain DTAs provide for a reduction of the withholding tax on dividends. For example, the DTA between Thailand and Taiwan reduces the withholding tax rate on dividends to 5 per cent if the beneficial owner directly holds at least 25 per cent of the capital of the company paying the dividends.
**Interest**

Depending on the terms of each DTA, the withholding tax rate on interest can be reduced to 10 per cent if the interest is paid to financial institutions or insurance companies.

**Royalties**

Depending on the terms of each DTA, and the type of royalties, the withholding tax rate on royalties can be reduced to 5, 8 or 10 per cent.

**iv Taxation on receipt**

Thai companies must include income received, or receivable, from offshore entities in their taxable income for the calculation of CIT. However, foreign-sourced dividends may be exempt from CIT. See Section V.i for more details.

Thai companies are entitled to a CIT exemption equal to the tax paid in a foreign country from carrying on business in such foreign country. The tax exemption must not exceed the CIT imposed on such income.

Regarding tax paid in a country with which Thailand has a DTA, such amount could be used as a tax credit. Such tax credit will be given only on the portion not exceeding the CIT imposed on such income.

**VII TAXATION OF FUNDING STRUCTURES**

Entities in Thailand are funded either by equity or by a combination of equity and debt.

**i Thin capitalisation**

There are no specific rules regarding thin capitalisation under the Revenue Code. The debt-to-equity ratio may, however, be limited by the FBA, which governs the business conduct of the company.

**ii Deduction of finance costs**

Finance costs may be deductible if incurred for the purpose of making profits, or for the business in Thailand. Acquisition finance costs will generally be treated as capital expenditure; thus, depreciation deduction would be allowed.

**iii Restrictions on payments**

A company can pay dividends only if it has accumulated profits and has obtained approval from the shareholders’ meeting. At each distribution of dividends, a company must retain a legal reserve of at least 5 per cent of its profits until the legal reserve reaches 10 per cent of the capital of the company.

**iv Return of capital**

Capital can be returned to shareholders in two ways: capital reduction and liquidation. The company is required to comply with the procedures prescribed under the CCC or PLCA to proceed with a capital reduction, and cannot reduce its capital to less than one-quarter of its total capital.
The return of originally invested capital under liquidation is not subject to tax. However, the amount of capital returned via a capital reduction will be included as income of the shareholders if the amount of reduced capital does not exceed the retained profits or reserves at the time of making the distribution. In such event, said distribution may be deemed as being made out of the company’s profits or reserves, which are subject to tax.

**VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES**

**i Acquisition**

Generally, the acquisition of a business in Thailand can be conducted through a share deal or asset deal. It is important to take into account several laws and regulations that govern the extent of foreign participation in business activities in Thailand. The main governing law is the FBA. Under the FBA, if a company is deemed to be foreign, the debt-to-equity ratio must not exceed 7:1 in order to obtain a licence to conduct business in Thailand.

Gains derived from the sale of shares or assets in a business acquisition transaction are subject to Thai taxes. In the case of foreign shareholders disposing of their shares in a Thai company to a Thai-resident buyer, withholding tax at a rate of 15 per cent will be imposed, unless exempted or reduced by a relevant DTA.

**ii Reorganisation**

In a reorganisation, whether via a merger or demerger, the transferor may be subject to CIT if it has gains arising from the transfer of shares or assets. In addition, transfers of businesses, assets or assignments may trigger VAT, SBT and stamp duty. However, qualified business transfers will be entitled to tax benefits as discussed below.

**Entire business transfer (EBT)**

A business transfer under the EBT scheme is exempt from CIT, SBT and stamp duty, and is not subject to VAT. To qualify for tax benefits, the following criteria must be met:

- both the transferor and the transferee must be companies incorporated under Thai laws, and must not owe any outstanding tax or duty to the Revenue Department as of the date of the transfer, unless there is a bank guarantee or other form of security provided;
- the transferor must transfer its entire business (e.g., all assets, licences, contracts, liabilities and employees) to the transferee;
- the transferor must submit its dissolution application to the Ministry of Commerce in the same fiscal year as the EBT; and
- the transferee must report the names of its shareholders, and the number of shares and their par value, of both the transferor and the transferee, to the Revenue Department within 30 days of the EBT.

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2 The FBA limits the rights of foreigners to engage in certain business activities in Thailand, and investors must carefully consider the FBA before attempting to acquire any business in Thailand. A foreigner may wholly own a business in Thailand unless the specific activity of that business is restricted under the FBA or is otherwise prohibited by another law.
Partial business transfer
VAT, SBT and stamp duty are exempt for a qualifying partial business transfer. The tax exemption does not cover CIT; therefore, the transferor may be subject to CIT on the gains arising from the transfer.

iii Exit
As a company is treated as a Thai tax resident if it is incorporated in Thailand, ceasing such status can be achieved by the dissolution and liquidation of the company. There is no specific tax imposed on the company ceasing to be a tax resident of Thailand; therefore, tax provisions concerning liquidation will apply.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance
There are no specific anti-avoidance rules stated in the Revenue Code. However, the principle of substance over form, and the sham transaction concept under the CCC, are generally applied by the Revenue Department and Thai courts.

ii Controlled foreign corporations (CFCs)
There are no specific controlled foreign corporation tax rules in Thailand. Thus, a company’s Thai-resident shareholders are not subject to taxation on the income earned by an offshore company until such time as the company distributes income to such shareholders.

iii Transfer pricing
Under Section 65 bis (4) of the Revenue Code, Thai companies are required to sell goods, provide services or lend money for a consideration of not less than the market rate. Otherwise, the assessment officer is empowered to assess CIT against such companies.

Under Departmental Instruction No. Por 113/2545, the Revenue Department accepts two kinds of transfer pricing methods: traditional transactional methods, namely the comparable uncontrolled price, resale price and cost plus methods, which are the preferred methods; and other methods, such as the profit split, transactional net margin and other internationally accepted methods.

Departmental Instruction No. Por 113/2545 also provides guidelines on the bilateral advance pricing arrangement (APA). A taxpayer who wishes to conclude an APA with the Revenue Department for any transaction may request this in writing, together with the relevant documents. Generally, an APA will be effective for three to five fiscal years.

In addition, on 22 November 2018, the Act amending the Revenue Code (No. 47) B.E. 2561 regarding transfer pricing (the Transfer Pricing Act) came into force. The Transfer Pricing Act added three sections in the Revenue Code which will apply to accounting periods that commence on or after 1 January 2019. Key contents of the Transfer Pricing Act include (1) definition of the term ‘related party’; (2) authority of the Revenue Department to adjust income and expenses on an arm’s-length basis; (3) the right to claim refunds for excess taxes paid as a result of tax assessment; (4) the time period and threshold for taxpayers required to prepare a report on the relationship between companies and the total amount of related-party transactions.
transactions (the threshold will be determined later by subordinated regulations, with a minimum gross income threshold of 200 million baht); and (5) a fine for not complying with obligations to prepare a report of not more than 200,000 baht.

iv Tax clearances and rulings
It is possible to obtain an advance tax ruling from the Revenue Department. However, there is no requirement to acquire any tax clearance or tax ruling to acquire a local business in Thailand.

X YEAR IN REVIEW

i Base erosion and profit shifting
There have been developments in the field of international taxation to tackle base erosion and profit shifting (BEPS), which refers to tax avoidance strategies that exploit gaps and mismatches in tax rules in different countries to artificially shift profits to low- or no-tax countries. There are currently 15 action plans that can be undertaken by each country to address weaknesses in the current domestic laws effectively and efficiently.

Although Thailand is not an OECD member, Thailand has joined the Inclusive Framework on BEPS on 2 June 2017. As a member of the Inclusive Framework, Thailand will develop a monitoring process for the four minimum standards of the BEPS action plans, and put in place the review mechanisms for other elements of the BEPS.

Four minimum standards of the BEPS consist of:

a Action 5: Harmful tax practices;
b Action 6: Treaty abuse;
c Action 13: Transfer pricing documentation; and
d Action 14: Dispute resolution.

The Revenue Department is currently studying and researching the implementation of the BEPS action plans. For example, in order to comply with BEPS Action 5 on harmful tax practices, the Cabinet approved concepts of four draft royal decrees cancelling tax incentive schemes, namely ROH, IHQ and ITC, and introducing the IBC scheme. Note that the concepts of the draft royal decrees may be changed upon further consideration of the relevant authorities. See Section V.ii for more details.

ii Transfer pricing
There have been significant developments on transfer pricing law in Thailand. On 22 November 2018, the Transfer Pricing Act came into force. See Section IX.iii for more details.

iii FATCA
On 24 June 2014, Thailand and the US initialled a draft Model 1 IGA agreement, and have been treated as having an IGA in effect since then. However, the agreement was signed on 4 March 2016. As of this date, Thailand is considered to be a Model 1 IGA country, and subject to all of the benefits and burdens associated with such an agreement.
On 18 October 2017, the Act on the Agreement between the Government of the United States of America and the Government of the Kingdom of Thailand to Improve International Tax Compliance and to Implement FATCA, BE 2560 (the Act) was published in the Royal Gazette, with effect from 19 October 2017. In summary, the Act requires the reporting Thai financial institutions to gather and deliver reportable information to the Minister of Finance. A failure to report the information will result in a fine of up to 100,000 baht, and a daily fine of up to 10,000 baht throughout the non-compliance period. The Minister of Finance is responsible and is empowered to exchange and disclose reportable information according to the agreement, as well as to instruct the relevant persons to report or provide documents and information.

On 13 February 2018, the Cabinet approved the draft royal decree on persons responsible to make a report under the Act. However, the draft royal decree has not come into force yet, and subordinated laws specifying the detailed rules and procedures have not yet been issued.

**XI OUTLOOK AND CONCLUSIONS**

The DTA between Thailand and Cambodia became effective on 26 December 2017, and is applicable to the tax year beginning 1 January 2018 onwards. In addition, the revised DTA between Thailand and the Philippines came into force on 5 March 2018 for the tax year beginning on 1 January 2019, replacing the existing 1983 DTA. One of the key changes is that the applicable tax rates under the revised DTA are generally reduced. For example, tax rates imposed on royalties have been revised from 15 or 25 per cent to only one rate of 15 per cent.
UNITED ARAB EMIRATES

Gregory J Mayew and Silvia A Pretorius

I INTRODUCTION

The United Arab Emirates (UAE) was established in 1971 under a written constitution as a federation of the seven emirates of Abu Dhabi, Ajman, Dubai, Fujairah, Ras Al Khaimah, Sharjah and Umm Al Quwain. The significance of the UAE economy is based on the discovery, in the 1950s in Abu Dhabi and the 1960s in Dubai, of major quantities of crude oil and the subsequent generation of very substantial revenues from its export, especially following the price increases in 1973.

Abu Dhabi is the federal capital of the UAE, and the site of a number of federal ministries, the UAE Central Bank, and other government institutions and agencies.

Under the Constitution of the UAE, each of the seven emirates retains a very substantial measure of control over the conduct of governmental affairs within the emirate. The important subjects over which the federation exercises control are defence, foreign affairs, communications, education and health. In addition, the federation has legislative authority with regard to a number of matters, including commercial and corporate law. The individual emirates retain control over all matters not specifically stated in the Constitution to be under federal authority.

The UAE attracts substantial foreign direct investment (FDI). The Institute of International Finance reported that the UAE remained the main destination of FDI inflows at about US$11 billion in 2017, accounting for 22 per cent of total foreign direct investment to the Middle East and North Africa region. Key advantages for investing and doing business in the UAE include the fact that the UAE has a stable economic and political background, and that it provides a unique geographical location for worldwide business opportunities. Many financial institutions and international industrial companies have taken advantage of the location’s appeal. Other factors include no income tax (with limited exceptions), fast population growth in recent years and the absence of exchange control or of any constraint relating to repatriation of funds.

Despite the recent global economic crisis, the UAE has in excess of 97 billion barrels of proven oil reserves, or about 8 per cent of the world’s proven oil reserves, and Abu Dhabi commands one of the wealthiest sovereign investment funds in the world. Furthermore, the UAE has one of the highest incomes per capita in the world, and the UAE ranked 26th out of 190 countries in the 2017 Doing Business ranking published by the World Bank. All of

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these factors should see the UAE continue to have a per capita income in the foreseeable future that is among the highest in the world, and continue to remain a preferred jurisdiction for inward investment.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

The types of business entity most commonly used in the UAE by inward-investing corporates and non-residents are companies or branch offices of foreign companies created under UAE Federal Law No. 2 of 2015 on Commercial Companies (the Companies Law). Another commonly used option is establishing an entity in one of the many free zones in the UAE.

Prior to discussing these various corporate structures in more detail, it is important to note that there is no federal income tax law in the UAE, and although all but one of the emirates have statutory income tax laws providing for tax on corporate bodies that are still technically effective with certain exceptions (principally oil-producing businesses and banks), a foreign business currently investing inwardly can safely conclude that its activity will not be subject to taxation.

i Corporate

The Companies Law applies to all companies established in the UAE, and to foreign companies with one or more branches in the UAE. It regulates existing branch offices of foreign companies, and contains regulations for the establishment of new branch offices of foreign companies. It does not apply to sole proprietorships or to non-commercial entities.

The following provisions of the Companies Law are of particular importance: all companies organised in the UAE are required to have a minimum of 51 per cent UAE national ownership; all branch offices of foreign companies are required to have a national agent unless the foreign company has established its offices pursuant to an agreement with the federal government or an emirate government; and all general partnership interests must be owned by UAE nationals.

The Companies Law provides for the organisation of five types of businesses: joint liability company, simple partnership company, limited liability company (LLC), public shareholding company and private shareholding company.

The LLC is the preferred choice of corporate vehicle in the UAE. An LLC must have at least one and not more than 50 owners. Foreigners (individuals or corporate entities) are permitted to hold minority shareholdings of up to 49 per cent of the capital of the LLC.

At the time of writing, a new law regarding foreign investment in the UAE has been announced, Federal Decree-Law No. 19 of 2018 On Foreign Direct Investment. A detailed analysis of the new Foreign Direct Investment Law is beyond the scope of this chapter.

The Foreign Direct Investment Law provides that a Foreign Direct Investment Committee (the Foreign Direct Investment Committee) shall be formed by a decision of the

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3 Citizens of other Cooperation Council for the Arab States of the Gulf (GCC) countries are generally treated like UAE citizens for the purposes of meeting the 51 per cent ownership requirement, although there is a small list of exceptions for certain types of businesses. The GCC Member States are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE.
The Foreign Direct Investment Committee shall have the authority to study and provide recommendations to the UAE Cabinet, after coordinating with the local governments, regarding the following:

- setting out a list of economic activities that may be carried out by a company wholly owned by foreign investors in the United Arab Emirates (the Positive List);
- adding certain sectors and activities to the list of the sectors and activities that are not available to foreign investors;
- approving foreign investment projects to conduct activities that are not set out in the Positive List following recommendations made by the relevant licensing governmental departments; and
- deciding on the benefits granted to foreign direct investment projects in the UAE.

While permitting majority or 100 per cent foreign ownership in certain sectors would be a major development, it is currently unclear which activities will fall under the Positive List and what restrictions will be imposed on the foreign direct investment companies.

The Companies Law gives the shareholders considerable freedom in structuring the articles of association for the LLC, and particularly those provisions regarding the management and governance of the LLC, according to their particular needs. *Inter alia*, the parties are free to include provisions allowing the minority shareholder to retain considerable management control of the LLC. This makes the LLC a useful vehicle for foreign companies wishing to set up subsidiaries in the UAE. An LLC may be licensed to conduct any lawful activity, except for the business of insurance, banking and investment of money for the account of others.

Despite the restriction of foreign ownership to 49 per cent, foreign investors continue to invest in local companies. To facilitate this, practices have developed to work around the 51 per cent local shareholder requirement. Various contractual arrangements and powers of attorney are often put in place between the UAE shareholder and the foreign owner confirming that the foreign party has the right to receive all distributions, including profits and assets on a liquidation, to exercise all voting rights and to manage the business. In turn, the UAE shareholder agrees not to interfere with the management of the business, not to make any claim for profits, capital, assets, equipment, dividends, ownership or voting rights, not to transfer or pledge his or her shares, and to provide all reasonable assistance required from him or her.

In exchange for this, the foreign party will pay an annual fee to the UAE shareholder, and accept all liabilities of the company and indemnify the UAE shareholder in respect of any claims and losses brought against him or her as shareholder (as long as he or she is not at fault or in breach).

Although such contractual arrangements are widely used in the UAE, they have not been fully tested in the courts and remain an uncertain tool. In practice, such arrangements are not often challenged, and a court could seek to give effect to such agreements as a private agreement between the parties where third-party interests are not thereby prejudiced. However, a law that came into effect in 2009 may have potential implications for such agreements.4

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4 UAE Federal Law No. 17 of 2004 concerning Commercial Concealment came into effect in late 2009 and, although its intended purpose and implications are open to interpretation, has raised concerns about the validity and enforceability of such contractual arrangements.
The second preferred choice, a branch of a foreign company, is required by Article 329 of the Companies Law to have a sponsor (termed a national agent). The national agent must be a UAE national or a company wholly owned by UAE nationals. The national agent has no ownership rights in the branch, and is responsible only for rendering certain basic services, but is not responsible for any financial or other liabilities or obligations of the foreign company. In exchange for this, the foreign party will pay an annual fee to the national agent (usually called a sponsorship fee), and accept all liabilities of the branch and indemnify the national agent in respect of any claims and losses brought against him or her as national agent (as long as he or she is not at fault or in breach). Terminating a relationship with a national agent can often be difficult as a practical matter, and will require the continuing cooperation and consent of the national agent.

The national agent is not the same as a commercial agent, and the provisions of Federal Law No. 18 of 1981 Regulating Commercial Agencies Law (Commercial Agencies Law) (discussed below) should not apply to the national agent.

The term ‘free zone’ refers to one of the many areas designated as such within the UAE. Free zones are often established to cater to particular types of businesses.

Foreign companies are generally permitted to establish branches in free zones, and such branches are exempt from the requirement to appoint a local agent. Legislation in each of the free zones also permits the incorporation of corporate entities that exist and operate outside the purview of the Companies Law, and that do not require the involvement of a UAE national partner (i.e., 100 per cent foreign ownership is permitted). The establishment of a free zone branch or a corporate entity is handled by the relevant free zone authority. Free zones generally guarantee freedom from corporate and income taxes for a specified period.

Conceptually, companies operating in a free zone are treated as offshore or foreign companies for non-export purposes, and are not permitted to conduct business activities within the rest of the UAE without complying with the rules generally applicable to the establishment of a foreign business presence. Normal import duties are payable on sales by free zone companies to customers within the UAE.

In 2005, the Emirate of Dubai launched the Dubai International Financial Centre (DIFC). The DIFC represents a radical development, in that it is designed to operate independently of UAE civil and commercial laws generally, and it has its own legislation and court system modelled generally on English common law. The language of the DIFC is English, and a majority of DIFC judges have common law experience. Similarly, the Abu Dhabi Global Market (ADGM) was established pursuant to Abu Dhabi Law No. 4 of 2013 as a financial free zone in the Emirate of Abu Dhabi, with its own civil and commercial laws. The ADGM commenced operations in 2015.

As an alternative option, many foreign companies will appoint a commercial agent to offer their goods and services to consumers in the UAE through local agents and distributors. The Commercial Agencies Law governs the relationship between foreign principals and local agents and distributors. It offers significant protections to the local party if the agency or distributorship is registered with the Ministry of Economy. To register the agency or distributorship, the agent or distributor must be a UAE national or a company wholly owned by UAE nationals. The statutory protections to the local party flowing from registration include, inter alia, exclusivity, restrictions on the foreign party’s right to terminate or withhold renewal of the relationship, and the right to receive compensation on termination or non-renewal of
the relationship. Although there are a number of disadvantages to registration of an agency or distributorship from the foreign party’s perspective, certain government departments may insist on dealing only with registered agents or distributors.5

ii Non-corporate

All general partnership and limited partnership interests can only be owned by UAE nationals. They are not subject to any taxation and are not fiscally transparent as, unlike other companies, they are not required to have their annual financial statements audited by accountants registered in the UAE and to submit such audited statements to the Ministry of Economy.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

There is no federal income tax law in the UAE, or any federal taxes on income (except as noted further below in this section). Accordingly, the pre-federation income tax decrees of the individual emirates remain applicable.

Corporate income tax statutes have been enacted in each of the emirates, but they are not implemented. Instead, corporate taxes are collected with respect to branches of foreign banks (at the emirate level) and courier companies (at the federal level). Further, emirate-level ‘taxes’ are imposed on the holders of petroleum concessions at rates specifically negotiated in the relevant concession agreements. There is no personal income tax.

Dubai and certain other emirates impose taxes on some goods and services (including sales of alcoholic beverages, hotels, restaurant bills, and residential and commercial leases).

Although there is currently no sales tax or value added tax (VAT) in the UAE, notable headway has been made in the move to introduce VAT and corporate tax in the UAE.

On 27 November 2016, the Member States of the GCC signed the Unified VAT Agreement for the Cooperation Council for the Arab States of the Gulf (the GCC VAT Framework Agreement). The GCC VAT Framework Agreement provides that each GCC state will be allowed to introduce its own VAT regime, providing that common principles are adopted by all GCC states.

The UAE has introduced a number of new laws to be able to prepare for the implementation of VAT. The Federal Tax Authority was established under Federal Law No. 13 of 2016, and will be in charge of managing and collecting federal taxes and related fines, distributing tax-generated revenues and applying the tax-related procedures in force in the UAE.

Following on the Federal Tax Authority, the Tax Procedures Law was then issued as Federal Law No. 7 of 2017. The Tax Procedures Law establishes the framework for federal taxes administration in the UAE.

Thereafter, Federal Decree-Law No. 8 of 2017 (the VAT Law) was issued, and a dedicated tax website launched for the Federal Tax Authority. The VAT Law is based on the common principles agreed in the GCC VAT Framework Agreement, and sets the general rules for the implementation of the new tax and includes some details on the goods and

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5 Many agency relationships in the UAE are not registered, and non-registration generally works to the foreign principal’s advantage.
services subjected to VAT, as well as those that will receive special treatment. The VAT Law introduced a 5 per cent VAT starting January 2018, and this is imposed on a taxable supply of goods or services for consideration and deemed supplies by a taxable person conducting business in the UAE and the import of taxable goods. The supplier of the goods or services, the importer of taxable goods and the taxable person registered for VAT who acquires goods will be required to account for VAT. Registration is mandatory for any taxable person if the total value of its taxable supplies made within the UAE exceeds the mandatory registration threshold of 375,000 dirhams over the previous 12-month period or if it is anticipated that the taxable supplies will exceed the threshold in the next 30 days. VAT registration will be optional if the mandatory registration threshold requirement (375,000 dirhams) is not met, but the voluntary registration threshold (187,500 dirhams) has been exceeded. The VAT Law provides for tax grouping, which allows companies with common control or ownership to be combined together into one entity for the purposes of VAT. Zero-rated supplies include certain exports, international transportation, supply of certain education and healthcare services and related supplies, certain investment grade precious metals, supply of crude oil and natural gas, supply of newly constructed residential properties within three years of completion and supply of certain land, sea and air means of transportation. Exempt supplies will include certain financial services, residential supplies, bare land and local passenger transport. Provision is made for reverse charging VAT on certain transactions between entities within the GCC. As of October 2017, the Federal Tax Authority has commenced accepting registrations for VAT through its online portal.

While the VAT Law provides a framework for implementation of VAT in the UAE, the operative provisions are contained within the VAT Law’s Executive Regulations, issued as Cabinet Decision No. 52 of 2017. The Executive Regulations provide additional legislative and procedural guidance to the application of VAT within the UAE, specifically where it concerns the tax treatment of free zone entities. Cabinet Decision No. 52 of 2017 also outlines supply of goods and services in all cases, including supply in special cases, supply of more than one component and exemption related to legal supply. The regulation also defines the mandatory and voluntary tax registration thresholds, exceptions from registration, tax grouping, as well as the process to apply for deregistration.

The UAE Ministry of Finance (MOF) has announced that it expects to generate US$2.7 billion in revenues collected from VAT in the first year of implementation alone. Separately, the MOF has announced that it is still studying reforms to the UAE corporate tax regime, that the tax rate is under study and that businesses will be given at least one year to prepare for any changes. As there are still many stages to go through before a corporate tax law is enacted, there is still no firm timeline in place for the implementation of this corporate tax law.

Each emirate, except for Umm Al Quwain, has an income tax decree. The income tax decrees of the emirates of Fujairah (1966), Sharjah (1968), Ajman (1968), Dubai (1969) and Ras Al Khaimah (1969) are based on and broadly similar to the Emirate of Abu Dhabi Income Tax Decree of 1965 (together, as amended, Income Tax Decrees), which will be the basis for discussion here.6 No other taxes are imposed on corporate income.

6 The official language in the UAE is Arabic; as such, all legislation is promulgated in Arabic. The discussion in this chapter is based largely on unofficial translations of this legislation, although the official Arabic texts of the Abu Dhabi Income Tax Decree of 1985 (as amended) (Abu Dhabi ITD) and the Dubai Income Tax Decree...
Taxable persons are defined as juristic entities or any branches thereof,\(^7\) wherever organised, that conduct trade or business\(^8\) at any time during the tax year through a permanent establishment\(^9\) based in the respective emirate, whether directly or through the agency of another juristic entity, unless exempted.\(^10\) The Income Tax Decrees make no distinction between resident and non-resident corporations, but instead define a taxable person as, *inter alia*, having a permanent establishment within the respective emirate.

**Banks**

The principal difference in the treatment of local and foreign commercial banks is that local banks are not subject to any taxation on their income, whereas foreign banks may be subject to taxation at the emirate level. Additionally, a foreign bank may not establish more than eight branches in the UAE. The tax paid by banks varies from emirate to emirate and also within each emirate where certain banks are allowed to make annual payment of an agreed sum without reference to the level of profits or losses. In Abu Dhabi, banks are required to pay a tax of 20 per cent on net profits.

The government of Dubai issued Regulation No. 2 of 1996 (Regulation No. 2) setting out guidelines to be used by branches of foreign banks in calculating income tax due to the government of Dubai from taxable income arising from the conduct of business in the Emirate of Dubai.

Foreign banks operate in the Emirate of Dubai without local equity participation pursuant to special arrangements with the government. Generally, foreign banks are required to pay 20 per cent of their net profits to the government of Dubai as an income tax. Regulation No. 2 enumerates the permissible deductions that foreign banks may take in determining taxable income. For example, a foreign bank may not deduct more than 2.5 per cent of its total revenue in any year for head office charges and regional management expenses combined. Furthermore, centralised or shared expenses (including regional management expenses) of foreign branches of banks operating in Dubai may be deducted on a prorated basis. Head office expenses must be reflected in the Dubai branch's books and certified by the external auditors of the bank's head office.

\(^7\) Abu Dhabi ITD, Article 2(3) refers to a 'body corporate', a term that does not refer solely to corporations. Dubai ITD, Article 2(3) refers to any 'body having juristic personality' as being a taxable person.

\(^8\) Conduct of trade or business encompasses the sale of goods or rights therein; the operation of any manufacturing, industrial or commercial enterprise; the leasing of property; and the rendering of services. The simple purchasing of goods or rights therein is excluded (Abu Dhabi ITD, Article 2(4)). Dubai ITD, Article 2(6)(e) specifically includes the production of petroleum or other hydrocarbons. The Fujairah Income Tax Decree of 1966 (Fujairah ITD), Article 1 provides that only entities engaged in oil production or extraction of other natural resources are taxable persons.

\(^9\) 'Permanent establishment' is defined as a branch, place of management or other place of business. It does not include an agency relationship unless the agent is authorised, and habitually exercises this authority, to conclude contracts on behalf of the principal (Abu Dhabi ITD, Article 2(10)).

\(^10\) Abu Dhabi ITD, Article 2(3).
The guidelines also set out acceptable methods for calculating ‘doubtful debts’, losses, amortisation of assets and capital expenditures. Losses may be carried forward and set off against taxable profits in the next tax year. Losses, however, may not be deducted from a previous year’s tax obligation.

Branches must file an annual tax declaration together with audited financial statements. The financial year for foreign banks operating in Dubai must be 1 January to 31 December. Taxes are due and payable to the Dubai Department of Finance no later than 31 March of the following year. The penalty for late payment has been fixed at 1 per cent for each 30-day period that such payment is in arrears.

**Oil companies**

The revenue of oil-producing companies is subject to the payment of both a royalty and an income tax. Royalties are calculated as a percentage of total revenue derived from production, while the income tax is calculated on net profit after depreciation.

In the Emirate of Abu Dhabi, the Supreme Petroleum Council (SPC), created pursuant to Abu Dhabi Law No. 1 of 1988, was designated as the supreme authority responsible for petroleum affairs in Abu Dhabi in charge of formulating and implementing policy in the oil sector. However, Law No. 1 of 1988 did not delegate to the SPC any powers of the Ruler to, *inter alia*, levy taxes on petrochemical activities in Abu Dhabi according to the Abu Dhabi ITD. Accordingly, any royalties levied by the SPC on concessions in the Emirate of Abu Dhabi are not taxes levied in accordance with the Abu Dhabi ITD, but duties levied pursuant to the SPC’s role as a petroleum policy and regulatory body, and distinct from the power of the sovereign or ruler of Abu Dhabi to impose taxes.

A taxpayer’s taxable income is defined as its net income arising in the respective emirate from the conduct of trade or business, after making permitted deductions.\(^{11}\) Taxable income is to be computed by the method of commercial accounting regularly used by the taxpayer for its own records, provided that such method fairly reflects taxable income. Such method may be on either a cash basis or an accrual basis.\(^{12}\) Costs and expenses incurred in the production of income are treated as deductions.\(^{13}\) Such deductions include:

- \(a\) the direct costs to the taxable person of producing goods sold or of providing services rendered by it;\(^{14}\)
- \(b\) other costs and expenses incurred by the taxable person for the purpose of carrying on trade or business;\(^{15}\)
- \(c\) a specified annual allowance in respect of depreciation, obsolescence, exhaustion or amortisation of physical and intangible assets;\(^{16}\)

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11 Abu Dhabi ITD, Articles 2(5) and 6.
12 Id., Articles 5(1) and 5(2).
13 Id., Article 6(1). In Dubai, banks are expressly permitted to treat as deductions head office overhead expenses charged to branches in Dubai (government of Dubai, Circular to All Banks Subject to Dubai Tax, 24 December 1984).
14 Abu Dhabi ITD, Article 6(1)(a).
15 Id., Article 6(1)(b).
16 Id., Article 6(1)(c).
uninsured losses sustained by the taxable person in connection with carrying on trade or business;\textsuperscript{17} and

any net operating loss of the taxable person incurred in carrying on trade or business that is carried forward from a previous tax year.\textsuperscript{18}

Deductions allowed to a taxable person dealing in oil\textsuperscript{19} as costs and expenses incurred for the purpose of carrying on trade or business are specifically defined\textsuperscript{20} to include certain costs and expenses incurred for the exploration for and development of petroleum or other hydrocarbons,\textsuperscript{21} and certain royalties paid on crude petroleum dealt in by such taxable person,\textsuperscript{22} but not to include any sums included in the credit aggregate\textsuperscript{23} or certain sums paid to the ruler of the respective emirate as the ruler’s share in profits from oil under an agreement between the taxpayer and the ruler.\textsuperscript{24}

The following amounts may not be deducted from the taxable income of a taxable person dealing in oil: expenses deemed to be contributions to capital by agreement with the ruler of the relevant emirate,\textsuperscript{25} sums included in the credit aggregate,\textsuperscript{26} and certain sums paid to the ruler of the respective emirate as the ruler’s share in profits from oil under an agreement between the taxpayer and the ruler.\textsuperscript{27} No non-deductible business expenses are specifically enumerated with respect to taxable persons not dealing in oil.\textsuperscript{28}

An annual deduction in respect of the depreciation, obsolescence, exhaustion or amortisation of physical and intangible assets calculated as a reasonable percentage of the

\textsuperscript{17} Id., Article 6(1)(d).

\textsuperscript{18} Id., Article 6(1)(e). Dubai ITD does not provide for loss carry-forward, but does provide for deduction of losses on sales of certain depreciable property (Article 4(1)(d)), and of 10 per cent of certain expenses incurred prior to commencing trade or business in Dubai (Article 4(1)(e)).

\textsuperscript{19} ‘Dealing in oil’ is defined by Abu Dhabi ITD, Article 2(15) as ‘dealing [...] in oil or in rights to oil’.

\textsuperscript{20} But not in Dubai ITD.

\textsuperscript{21} Id., Article 6(2)(a)(i).

\textsuperscript{22} Id., Article 6(2)(a)(ii). The royalty payable under all concession agreements is 14.5 per cent pursuant to Article 1 of Federal Decree No. 55 of 1974.

\textsuperscript{23} Abu Dhabi ITD Article 6(2)(a)(iii). Article 2(18) provides as follows: ‘[...] credit aggregate’ means in relation to oil of a producing company the aggregate value of all royalties (other than royalties on Crude Petroleum equal to one eighth of the value, or such greater amount as may from time to time be agreed between the Ruler and such producing company, at the applicable posted price in Abu Dhabi, of crude petroleum produced in Abu Dhabi and exported therefrom) and rentals, and of all taxes (other than the tax imposed by this Decree), duties, imposts and other exactions of a like nature and of any payments in lieu of any tax which accrue from or are paid by whomsoever to the Ruler or to any State, governmental or other public authority in Abu Dhabi (whether central or local) in respect of the relevant income tax year in connection with the production, transportation, sale, shipment or export of such oil.

\textsuperscript{24} Abu Dhabi ITD, Article 6(2)(a)(iv).

\textsuperscript{25} Id., Article 6(2)(a)(i).

\textsuperscript{26} Id., Article 6(2)(a)(iii). See footnote 24 for a definition of credit aggregate.

\textsuperscript{27} Abu Dhabi ITD, Article 6(2)(a)(iv).

\textsuperscript{28} The corresponding non-deductible business expenses apply to all taxpayers under Dubai ITD, Article 4(1)(b).
original cost of such assets, and any additions thereto, are allowed. For certain specified assets, a straight-line depreciation in percentages stipulated in the Abu Dhabi ITD is presumed reasonable, subject to proof to the contrary.  

The total of deductions for depreciation and losses in any tax year in respect of any asset may not, when added to the total of deductions previously allowed in respect of that asset, exceed the actual cost to the taxable person of such asset.  

The Income Tax Decrees do not specifically address accounting issues relating to stock and inventory as a discrete category of asset. Therefore, valuation of stock and inventory may be accomplished by the method of commercial accounting regularly used by the taxpayer in maintaining its own records, provided that it fairly reflects the taxpayer’s taxable income.  

The Income Tax Decrees do not specifically refer to the depreciation of stock and inventory.  

Since the Income Tax Decrees do not specifically address the treatment of reserves, such treatment is to be governed by the method of commercial accounting regularly followed by the taxpayer in keeping its own records, provided that such method fairly reflects the taxpayer’s taxable income.  

The Income Tax Decrees do not provide that dividends paid affect the taxpayer’s taxable income; nor do they require a dividend-paying taxpayer to withhold a portion of the dividend as a withholding of the recipient’s income tax.  

Dividends received and income from capital gains are treated no differently from other types of income.

**Losses**

Net operating losses not allowed to be deducted from a taxpayer’s income in a tax year may be carried forward indefinitely.

**Rates**

<table>
<thead>
<tr>
<th>Taxable amount (dirhams)</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero to 1 million</td>
<td>10 per cent</td>
</tr>
<tr>
<td>1,000,001 to 2 million</td>
<td>20 per cent</td>
</tr>
<tr>
<td>2,000,001 to 3 million</td>
<td>30 per cent</td>
</tr>
<tr>
<td>3,000,001 to 4 million</td>
<td>40 per cent</td>
</tr>
<tr>
<td>4,000,001 to 5 million</td>
<td>50 per cent</td>
</tr>
<tr>
<td>5,000,001 and over</td>
<td>60 per cent</td>
</tr>
</tbody>
</table>

29 Abu Dhabi ITD, Article 6(1)(c)(i).  
30 Id., Article 6(c)(iii).  
31 Id., Articles 5(1) and 9.  
32 Id., Article 6(1)(c).  
33 Abu Dhabi ITD, Articles 5(1) and 9.  
34 Id., Article 6(2)(c). In Dubai, banks are not permitted to make general provisions for bad debts, but are permitted to make specific provisions in respect of doubtful customer accounts (government of Dubai, Circular to All Banks Subject to Dubai Tax, 24 December 1984). A bank may carry forward losses no more than two years (Id.).  
35 Abu Dhabi ITD, Article 4(1); Ajman Income Tax Decree of 1968 (Ajman ITD), Article 4(1); Dubai ITD, Article 2(19)(a); Sharjah Income Tax Decree of 1968 (as amended) (Sharjah ITD), Article 4(1). Fujairah ITD omits this progressive tax on non-petroleum producing entities. Under the Dubai ITD, a taxpayer whose income reaches a particular tax bracket has the rate of that bracket imposed on his or her entire income. In contrast, the other income tax decrees impose the progressive tax rates only on that portion of the taxpayer’s income that falls into the relevant brackets.
The rate of tax payable on income of oil-producing taxpayers in the emirates are as follows:

a  Ajman and Fujairah: 50 per cent;36
b  Abu Dhabi and Dubai: 55 per cent;37 and
c  Sharjah: 65 per cent.38

Ras Al Khaimah has no separate provision governing petroleum-producing taxpayers.39

Administration

All foreign companies, public and private shareholding companies, LLCs and share partnership companies are required to have their annual financial statements audited by accountants registered in the UAE, and to submit such audited statements to the Ministry of Economy. Branch offices of foreign companies are required to prepare their annual accounts on an independent basis for operations in the UAE, and to maintain the necessary books and documents of account within the UAE. Pursuant to the recently enacted new Companies Law, every LLC or joint-stock company is now required to keep its accounting books in its head office for a period of at least five years from the end of the financial year of the company.40

Within three months of the end of each tax year (1 January to 31 December), taxable persons are required to file a provisional income tax return. Taxable persons with taxable income below the threshold of 1 million dirhams are exempted unless specifically directed to file. The returns are filed with the respective director of tax appointed pursuant to the Income Tax Decrees.41

Income tax is to be paid in quarterly instalments based upon the provisional declaration. Within nine months of the end of the tax year, taxable persons are required to file a final income tax declaration. Discrepancies between the provisional and final declarations are to be reconciled by adjustment of the final quarterly tax instalment and, if necessary, a partial tax refund.42

Failure to file the declaration or to pay income tax without reasonable cause incurs liability for a fine of 1 per cent of the amount payable for each 30-day period or portion thereof during which the failure continues. Extensions of time for filing may be granted upon proof of a justifiable reason.43

The director of tax has power to inspect relevant books and records.44 Penalties for falsification of records or making false statements include imprisonment or a fine, or both. A taxable person affected by such falsification, if legally responsible, is also liable to a fine.45

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36  Ajman ITD, Article 4(2); Fujairah ITD, Article 1; Ras Al Khaimah Income Tax Decree of 1969 (as amended), Article 4(2).
37  Abu Dhabi ITD, Article 4(2); Dubai ITD, Article 2(19)(b).
38  Article 4(2), Sharjah ITD.
40  Companies Law, Article 26.
41  Id., Article 8(1).
42  Id., Article 8(2).
43  Id., Article 8(3).
44  Id., Article 11.
45  Id., Article 12.
Disputes as to the application of the tax laws are subject to the jurisdiction of the UAE courts or, by agreement, to arbitration.\footnote{Id., Article 13.}

**ii Other relevant taxes**

Establishment of a branch office or an LLC in the UAE will entail payment of various fees in the course of the licensing and registration process. Although these fees are not taxes as such, the amounts involved can be significant and should be taken into consideration as a potential cost of doing business in the UAE.

Establishment of a branch office in the UAE will also mean payment of sponsorship fees to the national agent of such branch.

Customs duties are generally low. Under the GCC agreement to impose uniform rates for customs duties, the UAE imposes a uniform 5 per cent customs duty on the import of goods from outside the GCC.\footnote{In 2003, the GCC became a customs union (i.e., a free trade area with a common 5 per cent external customs tariff).} Limited exemptions apply to military and security purchases and some foodstuffs.

Federal Decree Law No. 7 of 2017 introduced an excise tax in the UAE on certain products and became effective as of 1 October 2017. A reasonably high rate of tax on a limited number of goods is imposed by way of an excise tax. This includes a 50 per cent excise on carbonated drinks and a 100 per cent excise on energy drinks and tobacco products.

**IV TAX RESIDENCE AND FISCAL DOMICILE**

**i Corporate residence**

Tax residency is not clearly defined under UAE law in the absence of any enforced income tax legislation. The Income Tax Decrees make no distinction between resident and non-resident corporations, but instead define a taxable person as, \textit{inter alia}, having a permanent establishment within the respective emirate. In addition, double taxation treaties provide a basis for determining tax residency under the applicable treaty. Eligible foreign companies can obtain tax residency certificates from the MOF.

**ii Branch or permanent establishment**

Entities incorporated outside of the UAE can have a fiscal presence through licensed branches in the UAE. Indeed, a branch of a foreign company is treated the same as a company incorporated in the UAE under the Income Tax Decrees, as both constitute permanent establishments in the UAE. However, with limited exceptions (discussed above), there are no UAE tax consequences as a result of such fiscal presence.

Tax residence may be relevant to tax considerations in the foreign company's home jurisdiction under the relevant double taxation treaty.
V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes
While the recent enactment of the new Companies Law has introduced the concept of a holding company, whereby a holding company can be incorporated as either a joint-stock company or an LLC, and can establish subsidiaries inside the UAE or abroad, or has control of existing companies by holding shares or stocks enabling such holding company to control the management of the subsidiary and to have influence on the resolutions of the subsidiary, the applicable laws and regulations in the UAE do not provide for any special holding company regimes.

ii IP regimes
Similarly, there are no special IP regimes in the UAE.

iii State aid
Tax law should be considered in the context of any major project, notwithstanding that the UAE is generally a tax-free jurisdiction. The tax treatment that will be extended to the project should be negotiated in detail and in advance. For major projects, tax holidays or the extension of national treatment may be available for a specified period of time.

Some entities that would otherwise be taxable persons have been expressly exempted by the respective rulers, by federal legislation or by their location in a free zone. For other taxable persons, the Income Tax Decrees have in practice only been enforced against oil companies and certain foreign banks. This selective application, however, is neither codified nor assured for the future.

As discussed above, free zones in the UAE generally provide inward investors guaranteed freedom from corporate and income taxes for a specified period.

iv General
As noted above, the UAE is essentially a tax-free jurisdiction, and the absence of corporate or personal income tax is one of the UAE’s most attractive features for foreign investors.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)
There are currently no withholding taxes on dividends, interest and royalties paid out by a company or other business entity.

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48 Companies Law, Article 266.
49 The reason for seeking a tax holiday is to guard against the possibility of income tax being implemented before completion of the project.
50 See, for example, the order exempting the Middle East Bank from income tax, Dubai Official Gazette No. 129 of 1979. Such exemptions are expressly contemplated by the Income Tax Decrees (Abu Dhabi ITD, Article 2(3) and Dubai ITD, Article 2(3)).
51 As noted previously, courier companies are also taxed by the federal government.
ii  **Domestic law exclusions or exemptions from withholding on outward-bound payments**

There are currently no withholding taxes, and accordingly the issue of exemptions does not apply.

iii  **Double tax treaties**

The UAE has an extensive and growing list of double taxation treaties with more than 90 countries. Under these treaties, profits derived from shares, dividends, interest, royalties and fees are taxable only in the contracting state where the income is earned. Although corporate income tax is not levied in the UAE, the provisions of the treaties do not state that such income must be taxed to qualify for benefits. Thus, dividend income paid by a UAE company to a company that has a double taxation treaty with the UAE may not be taxable in the hands of the foreign parent corporation; however, it is wise to study the text of the treaties themselves before assuming anything about the tax treatment of untaxed income flows originating in the UAE.

It is possible to make an application and pay a fee to obtain a tax residency certificate issued by the MOF to confirm a company’s residence in the UAE, and to qualify for the benefits that may accrue to it in another tax jurisdiction with which a double tax treaty has been signed.

iv  **Taxation on receipt**

As noted previously, the UAE is essentially a tax-free jurisdiction, and most businesses are not taxed at all. Companies falling into the small list of exceptions (foreign banks, foreign petroleum companies and courier companies) are not subject to taxation on receipt.

VII  **TAXATION OF FUNDING STRUCTURES**

i  **Thin capitalisation**

There are no thin capitalisation rules (restrictions on loans from foreign affiliates) applicable in the UAE.

ii  **Deduction of finance costs**

For most types of business, the absence of corporate taxation in the UAE renders the issue of deductions meaningless. However, for foreign banks and oil companies there may be

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52 This network includes treaties with Albania, Algeria, Antigua and Barbuda, Argentina, Armenia, Austria, Azerbaijan, Barbados, Belarus, Belgium, Belize, Benin, Bermuda, Bosnia and Herzegovina, Brunei, Bulgaria, Burundi, Canada, Cameroon, Chile, China, Comoros, Croatia, Cyprus, the Czech Republic, Egypt, Equatorial Guinea, Ethiopia, Fiji, Finland, France, Gambia, Georgia, Germany, Greece, Honduras, Hong Kong, Hungary, India, Indonesia, Iraq, Italy, Japan, Jersey, Jordan, Kazakhstan, Kenya, Korea, Kosovo, Kuwait, Kyrgyzstan, Latvia, Lebanon, Libya, Liechtenstein, Luxembourg, Macedonia, Maldives, Malaysia, Malta, Mauritius, Moldova, Mongolia, Montenegro, Morocco, Mozambique, the Netherlands, New Zealand, Nigeria, Pakistan, Palestine, Panama, the Philippines, Poland, Romania, Russia, Saint Kitts and Nevis, Senegal, Serbia, the Seychelles, Singapore, Slovakia, Slovenia, Spain, Sri Lanka, Sudan, Switzerland, Syria, Tajikistan, Thailand, Tunisia, Turkey, Turkmenistan, Ukraine, the United Mexican States (Mexico), the United Kingdom of Great Britain and Northern Ireland, Uruguay, Uzbekistan, Vietnam, Venezuela and Yemen.
relevant considerations relating to deduction of finance costs. These will vary depending on the emirate and the type of business. For example, for foreign oil companies in Abu Dhabi, finance costs may be deductible if they reflect costs incurred in the production of income and are computed by the method of accounting regularly used by the company, provided such method fairly reflects taxable income.

iii Restrictions on payments
Any rules that may prevent the payment of dividends are not tax-driven, and would depend on the provisions in a company's constitutional document (such as its articles of association) or whether the shareholders have specifically agreed conditions that may prohibit paying dividends (e.g., unless the directors are satisfied the paying company can pay debts as they fall due).

iv Return of capital
There are no applicable tax rules or regulations relating to equity capital, and accordingly no UAE tax consequences.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition
Foreign companies acquiring interests in a local business generally use foreign entities for the acquisition. The reason is not tax-driven, but rather a result of local ownership requirements. As noted above, UAE law requires 51 per cent UAE ownership of companies incorporated in the UAE.

UAE tax considerations are not relevant to the structuring of the financing of the transaction. Note that share capital must be paid in cash at the time the shares are issued. Some investors contribute capital through a combination of equity and shareholder loans. The reasons for using shareholder loans rather than equity are generally to lower statutory reserve requirements and facilitate return of investments to shareholders without having to go through the process of applying to reduce the share capital of the company.

ii Reorganisation
There is no taxation levied when a business in the UAE merges with (or demerges from) an existing local business.

iii Exit
Should a business decide to exit from the UAE, this will not give rise to any taxes or penalties as such. It will, however, attract fees in the course of the deregistration process, and the amounts involved can be significant.

Where an inward investor has done business in the UAE through a local agent or distributor (and which has been registered pursuant to the Commercial Agencies Law), the statutory protections to the local party flowing from such registration include, inter alia, exclusivity, restrictions on the foreign party's right to terminate or withhold renewal of the relationship, and the right to receive compensation on termination or non-renewal of the relationship.
IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance
There are no applicable general avoidance rules owing to the fact that the majority of businesses are exempt from taxation.

ii Controlled foreign corporations
There are no controlled foreign corporation rules in the UAE.

iii Transfer pricing
No transfer pricing rules apply in the UAE.

iv Tax clearances and rulings
It is possible to obtain advance tax rulings to secure a measure of certainty. Although the UAE is generally a tax-free jurisdiction, taxes are imposed on foreign oil companies.\(^{53}\) The tax treatment that will be extended to, for example, a specific petroleum project must be negotiated in detail and in advance, and a legislative relief required to implement the desired tax relief must be validly obtained under local law. For major projects, tax holidays or the extension of national treatment may only be available for a specified period of time.

X YEAR IN REVIEW

In order to improve international tax compliance, and in preparation for implementing the Foreign Account Tax Compliance Act (FATCA), the UAE signed an agreement with the United States on 17 June 2015. The MOF has announced that the UAE will begin implementing the standards of joint disclosures and the exchange of information for tax purposes set out by the G20 and the Organisation for Economic Co-operation and Development, in accordance with the FATCA from 2018. This follows the UAE Cabinet’s decision for the MOF to coordinate with various government authorities to collect financial information in order to implement exchange of information for tax purposes, whereby foreign financial institutions are required to submit information about financial accounts held by US persons or by foreign companies with one or more US shareholders owning more than 10 per cent of the company to the MOF. Failure to comply could see any non-US financial organisation facing a 30 per cent penalty on certain financial returns of its operations in the US.

As the International Monetary Fund and World Bank have continued to recommend the introduction of taxes in various oil-rich Gulf nations to reduce subsidies and consider adopting alternative sources of revenue, and potential changes in taxation policy, discussed publicly on and off for many years, this gathered momentum in the UAE during 2017 with the establishment of the Federal Tax Authority and the issuance of the VAT Law, as well as the excise tax.

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\(^{53}\) As discussed above, foreign banks and courier companies are also subject to taxation.
Other incentives outlined by the MOF in its 2015 Annual Report published on 2 May 2016\textsuperscript{54} includes a draft law framework on selective taxation with GCC countries similar to the GCC VAT Framework Agreement.

XI OUTLOOK AND CONCLUSIONS

The UAE has long been a tax-free haven, but lower oil prices and a desire to diversify the economy have changed the landscape. The introduction of VAT is likely to change the way business is conducted and administratively maintained in the UAE and the GCC. This is a paradigm shift in a region that was largely free of taxation and the associated tax infrastructure. Although the rate of VAT imposition is set at a low 5 per cent initially, and as such its effect economically will not be severe, the development and eventual maturity of a tax regime will have a much more pronounced effect on the economy and businesses alike. Moreover, it is possible that corporate tax may be introduced in the future.

\textsuperscript{54} www.mof.gov.ae/En/Media/Lists/PublicationsLib/Attachments/18/MOF\%20Annual\%20Report\%20En\%202015\%20Hi\%20Res.pdf.
I INTRODUCTION

Over a number of years the United Kingdom has developed a very competitive tax system for business with low tax rates and wide-ranging reliefs and exemptions, but the future of the UK as an attractive business location is under a cloud of uncertainty. The implications of Brexit for UK taxation, notably in the area of import and export duties and tariffs, is unclear. The Labour Party manifesto makes a number of pledges that, if implemented, would reverse some of the measures referred to above, notably: increasing corporation taxes in stages to 26 per cent (21 per cent for small businesses) and increasing income taxes to 50 per cent above £123,000 and to 45 per cent above £80,000. In addition the Labour Party has proposed tightening the regime for public issuance of debt, advance tax rulings and general tax avoidance rules. Although recent surveys suggest that businesses already in the UK continue to find it a good location, it remains to be seen what effect these factors will have on business confidence and whether businesses looking to relocate will be deterred, or at least defer making a decision until the immediate future looks more certain.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

There are many different entities and business organisations through which business can be conducted in the United Kingdom. Numerous factors influence the final choice, notably market practice in the business sector, regulatory requirements and tax treatment. The most common types are described below.

i Companies

The most commonly adopted vehicle for doing business in the United Kingdom is a limited liability company. Such companies can be incorporated quickly and cheaply, subject to agreeing the preliminary details such as the names of its officers, its registered address and its name; it is common to buy pre-formed or ‘off-the-shelf’ companies.

Although such companies can be limited by guarantee or unlimited, businesses generally use a ‘limited liability’ company, which is liable for all its debts and obligations without limit but where the investing shareholders’ liability is limited to the share capital they invest. This reflects the fact that generally, under UK law, a company and its shareholders are separate

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legal persons. In very limited circumstances, notably where a person seeks to deliberately avoid an existing liability or restriction by interposing a company they control, a court may look through the corporate veil to the controlling person.

There are two forms of limited company: the private limited company (designated with the suffix ‘Limited’ or ‘Ltd’) and the public limited company (designated with the suffix ‘PLC’).

Limited companies can issue share capital of different classes, if required, with each share class conferring different rights (to dividends, on voting, etc.). Share capital in a UK company can be denominated in a currency other than sterling. There are no minimum capital requirements for private companies, but a public limited company must have a minimum share capital to comply with UK company law, which is derived from the Second Company Law Directive (77/91/EEC). A UK public company has a minimum capital requirement of either £50,000 or €57,100, and this must initially be satisfied entirely in either sterling or euros (although only one-quarter, or £12,500, of this needs to be paid up, and the company may have shares denominated in currencies other than euros or sterling).

Only public companies can offer shares to the public, so it follows that all listed companies will be PLCs. Not all PLCs, however, are listed on recognised investment exchanges, or for that matter offer their shares to the public.

In return for providing the shareholders with limited liability, the law requires a degree of disclosure, and limited companies must file annual information that is kept on a public register, notably annual audited accounts (with some exceptions for small companies), details of its directors and shareholders, and details of share transfers.

Unless prohibited by the company’s constitution, the directors and the company secretary can conduct the company’s affairs and bind it. The directors are subject to statutory obligations that ensure that when they act they pay proper regard to the interests of shareholders, creditors and employees; thus, for example, if a director allows a company to continue to trade while insolvent, such director may be held personally liable for the company’s debts.

Directors of UK limited companies do not have to hold shares in the companies or reside in the United Kingdom, and no professional qualifications are required.

Taxation

A detailed description of how companies are taxed is set out below. Broadly, however, a UK-resident company is taxed on its worldwide profits calculated on the basis of the profits shown in its audited accounts as adjusted in accordance with tax principles.

ii Partnerships

Partnerships are used by many businesses in the United Kingdom, notably by professions such as accountants, lawyers and doctors, and as investment vehicles for private equity. They can take several forms: contractual or general partnerships, limited partnerships and limited liability partnerships (LLPs).

A straightforward contractual partnership has no separate legal personality (although a Scottish partnership is an exception), and the partners are liable for the acts of the partnership. For tax purposes, a contractual partnership is transparent.

A limited partnership must have a ‘general’ partner, which has unlimited liability for the partnership and which generally manages the partnership’s business affairs. The limited
partners’ liabilities are limited to their capital contributions, rather like a shareholder in a limited company, and they are not permitted to participate in the general management of the partnership.

The Limited Liability Partnerships Act 2000 introduced LLPs. An LLP has similar disclosure and filing requirements to UK limited companies, including the filing of an annual return and accounts. An LLP has separate legal personality from its members, but for tax purposes is transparent provided it carries on a trade (profession) or a business for the purpose of making a profit. Her Majesty’s Revenue & Customs (HMRC) has confirmed that the word ‘business’ may be widely interpreted, so, for example, it would only be in exceptional circumstances that holding and managing a portfolio of investments, or letting a building on a commercial basis, would not be considered a business.

**Taxation**

UK general partnerships, limited partnerships and limited liability partnerships are all generally transparent for UK tax purposes. The activities of the partnership are treated as being carried on by the individual partners and not by the partnership as a body. Partners are individually responsible for reporting and paying the tax due on their share of the partnership’s profit and gain.

Although generally one partner is nominated to complete and file a tax return for the partnership showing the aggregate taxable profits and the partners’ allocated shares, the only purpose of such return is to enable the partners to extract their share of the profit from it to include in their tax returns. The partnership tax return is not used to pay tax for the partnership, as happens when a corporate entity submits its tax return. One complication of this system is that the partnership must calculate its profits and losses on the same technical basis as applies to its partners. Thus, a partnership comprising UK resident companies and individuals and non-UK-resident companies and individuals would have to prepare a tax computation under the rules applicable to each type of partner, so four different tax computations. To simplify the system provisions were introduced in the Finance (No. 2) Act 2017 that broadly calculate the partnership profits as if each partner is the same then allocates profits to each partner based on their profit share.

A partner is normally self-employed for tax purposes, so there are more liberal rules about offsetting expenses, and since partners are not employees (although salaried partners may be), no employers’ national insurance contributions (NIC) will be payable and partners will be subject to a different rate of NIC.

There are rules that counter some perceived abuse in the use of partnerships in certain areas that cause loss of tax to the UK Treasury. In particular, these rules apply where firms disguise what in reality are employment relationships as self-employed arrangements by making employees partners in limited liability partnerships (to benefit from the above NIC advantages). Also where there are partnerships with non-individual members, in certain circumstances profits allocated to such non-individual members may be reallocated to an individual member, for example if an individual member forms a company, makes it a partner in the LLP and then artificially diverts his or her profit share to such company.

As regards disguised employments: in broad terms, if three conditions are met by a member of an LLP incorporated under the Limited Liability Partnerships Act 2000, that person will be treated as an employee, but if any of the conditions are not met then the member can be treated as a self-employed partner.
Broadly, the three conditions are:

\( a \) It is reasonable to expect that at least 80 per cent of the total remuneration received by the member during the relevant period is disguised salary (i.e., not linked to the LLP’s profits).

\( b \) The member does not have significant influence over how the affairs of the LLP are run. The logic is that one would expect the owner of a business to have such influence whereas an employee would not.

\( c \) The member’s capital contribution to the LLP is less than 25 per cent of the total amount of the disguised salary.

Although, for tax purposes, the activities of a general partnership are treated as carried out by the individual partners, registration for value added tax (VAT) purposes can be made in the name of the partnership.

iii UK permanent establishment (place of business or branch)

An overseas company can set up a UK permanent establishment (PE). For example, a French company could rent an office and employ staff, and start to trade in the UK through that office. Such a UK PE is the same legal entity as its non-UK parent, which is therefore liable for the obligations incurred by its UK business.

UK law (the Overseas Companies Regulations 2009) governs foreign companies operating in the UK. It provides that foreign companies (but not partnerships or unincorporated bodies) must, within one month of opening a UK establishment, register prescribed particulars of the foreign company and the UK establishment with the Registrar of Companies (the authority charged with the administration of English companies), including:

\( a \) the non-UK company’s corporate name, legal form, register in which it is registered and its registration number;

\( b \) a certified copy of the foreign company’s constitutional documents, together with a certified translation if they are not in English;

\( c \) details of the directors and secretary of the foreign company; and

\( d \) particulars of the UK establishment including its name (if different from the name of the overseas company), address, the date it was opened, the business carried on by it and the name and address of every person resident in the UK who is authorised to accept service of documents on behalf of the foreign company with respect to the establishment.

From 1 October 2011, overseas companies no longer need to register charges they create over their UK assets with Companies House. In general, foreign companies must file with the Registrar of Companies any accounting documents that they are required to prepare and disclose under the law of the country in which they are incorporated. The specific filing requirements vary depending on whether a foreign company is incorporated within or outside the EEA, it is a credit or financial institution or it is a company whose constitution does not limit the liability of its members.

Every foreign company that has registered a UK establishment must, with some exceptions, display at its places of business its name and the country in which it is incorporated. Its name and other prescribed information must also appear on all business letters, websites and other specified correspondence used in its UK activities. There are also restrictions on the name the overseas company can register in the United Kingdom.
**Taxation**

A non-UK-resident company that carries on a trade in the United Kingdom through a UK PE is subject to UK corporation tax on its profits, broadly calculated and charged as if the PE were a UK company. Like a UK incorporated company, a UK PE is taxed on profits, but only to the extent that they are properly attributable to such PE. Agreeing how profits should be allocated can sometimes be an area of dispute. Unlike a UK company, which needs to pay a dividend to extract profits, the net profit of a UK PE can simply be paid to the non-UK owner.

A PE is sometimes used where the non-UK company anticipates that in the early period of UK trading, losses will be made that can be used to offset profits of the non-UK owner if the business is run through a PE.

If a non-UK resident company has a trade of dealing in UK real estate or developing land with a view to disposing of it, such company can be taxed irrespective of whether it is carried on through a UK PE.

**III DIRECT TAXATION OF BUSINESSES**

i **Corporation tax**

UK companies are subject to corporation tax on all worldwide profits, whether such profits are income or capital in nature. Profits for corporation tax purposes must be calculated in accordance with generally accepted accounting principles (GAAP), subject only to any adjustments required or authorised by law. The key adjustments are for losses, allowances and expenditure that, while reflected in the accounting profits, are not allowed for tax purposes so are added back when calculating profits for tax purposes.

**Calculation of taxable profits**

UK-resident companies (see Section IV) are subject to UK corporation tax on their profits, wherever they arise. A non-UK company that trades in the United Kingdom through a PE (branch or agency) is subject to corporation tax on the profits of the branch or agency, which are broadly calculated as if the PE were a stand-alone company in its own right.

Corporation tax is charged on the profits of each financial year, which runs from 1 April (so, for example, the 2016 financial year is the year from 1 April 2016 to 31 March 2017). The tax charged for such financial year is based on the accounts of the company prepared for the accounting period that falls in that financial year (an accounting period is generally 12 months, but while it cannot exceed 12 months, it can be less). Where the company’s accounting period and accounts for such period do not coincide with the financial year, the profit shown in the relevant set of accounts is, when required, apportioned, on a time basis, between the financial years that overlap the accounting period.

**Calculation of income profit**

The most common adjustments to accounting (income) profits before they are taxed are as follows.

**Expenses**

Although all expenses incurred by the company will depress accounting profit, not all such expenses will be allowed for tax purposes. To be deductible, an expense must be ‘wholly and exclusively’ incurred for the purposes of the company’s trade. Whether an expense is so
incurred is a question of the company’s intent in incurring a cost and is thus a question of fact. It is often clear that an item of expenditure was incurred to promote the interests of the trade, such as paying staff salaries or suppliers of raw material used to make products produced by the trade. The position is not always clear, however, and there is a great deal of case law that considers when an item of expenditure, deducted in the accounts, is also deductible for tax purposes; for example, expenditure may be incurred on fees connected with changes to share capital, which would generally be regarded as non-deductible, as such an expense is incurred in connection with the company’s capital structure, not its trading activity. In addition, expenditure incurred with a dual purpose, such as the cost of an airfare of an employee who goes on holiday but visits a customer while on the holiday, would generally be disallowed.

In addition to the general rule that expenditure must be wholly and exclusively incurred for the purpose of a trade to be deductible, there are a few important cases provided for in legislation that make specific items of expenditure deductible or non-deductible for corporation tax purposes, irrespective of whether such cost was incurred in the course of trade. The most important example of this is probably expenditure on client business entertainment. Irrespective of the purpose of incurring expenditure on business entertainment or gifts, the general rule is that it is not deductible. Conversely, incidental costs of obtaining loan finance, such as bank fees and commissions, which under the general rule may be regarded as linked to capital rather than trading, are specifically allowed as a deduction.

**Depreciation (capital allowances)**

Accounting depreciation is generally not the basis upon which tax depreciation is based, and tax depreciation is based on a system of capital allowances. There a number of exceptions, where tax broadly follows accounting amortisation, most notably in the case of intangible fixed assets and loan relationships.

‘Intangible fixed assets’ defined by GAAP include patents, trademark and copyright. Such assets, provided they were acquired or created after 1 April 2002 (internally created goodwill for accounting periods starting after 22 April 2009), will be amortised in accordance with the amortisation in the accounts prepared in accordance with GAAP. However, the Finance Act 2015 introduced measures that denied relief for ‘relevant assets’, notably goodwill and customer information and unregistered trademarks. This made the UK less generous than many other countries, as well as creating tax differences in the treatment of intangibles that was not consistent with their accounting treatment. In response to these concerns, the 2018 Autumn Statement announced that such relief will be introduced for the cost of goodwill in acquiring businesses with eligible intellectual property from April 2019. The Autumn Statement also announced that de-grouping charge rules, applying when a group sells a company that owns intangibles, will be amended effective from 7 November 2018 to align them with the equivalent rules applying to capital gains.

Although not all capital expenditure qualifies for capital allowances, allowances are normally given for expenditure on things such as plant and machinery, and R&D.

Expenditure on plant and machinery is pooled for capital allowance purposes and generally depreciated for tax purposes at 18 per cent per annum on a reducing balance basis. In the case of long life assets (assets with an anticipated working life of 25 years or more), the rate is reduced to 8 per cent per annum (reducing to 6 per cent per annum from 6 April 2019). If assets are sold at a price above their tax-depreciated value, there may be a clawback of allowances, or if assets have been under-depreciated there may be a balancing allowance.
Many companies claim an annual investment allowance that gives tax relief (broadly a 100 per cent offset for cost in the year in which it is incurred) for qualifying business capital expenditure up to a maximum annual sum (currently £200,000 per annum but temporarily increasing to £1 million per annum for expenditure incurred between 1 January 2019 and 31 December 2020).

Trading and income losses

If there is a trading loss in any year, the loss can be offset against total profits (income or capital) for the current accounting period of the company. The trading loss can be set against all profits (including chargeable gains) and not just the profits arising from the same trade as that in which the loss was incurred.

Excess trading losses can also be surrendered to another UK company in the same group or consortium (see below for a description of the taxation of groups), or carried back to set off against the company’s total profits (income or capital) of the preceding year.

Income and trading losses realised prior to April 2017 can also be carried forward indefinitely and offset but only against income profits arising from the same trade. However, the Finance (No. 2) Act 2017 imposes a new restriction on the amount of profits that can be reduced by carried-forward losses. Losses made prior to April 2017 can be carried forward and fully offset against a future accounting period’s profits, but under the new regime only 50 per cent of profits can be reduced by post-April 2017 losses. Companies are entitled to a £5 million allowance against which carried-forward losses can be fully offset before the restriction applies.

R&D tax credit

Relief is available for expenditure on revenue on R&D. The nature and rate of relief depends on whether the company is a large company or a small or medium-sized enterprise (SME).

The relief for SMEs provides a greater than 100 per cent deduction for all qualifying R&D expenditure in computing profits for corporation tax purposes. Relief is given at 230 per cent for SMEs in relation to expenditure incurred on or after 1 April 2015. The enhanced tax benefits used to apply only to small companies but now extend to medium-sized companies (companies with fewer than 500 employees, with an annual turnover not exceeding €100 million or a balance sheet not exceeding €86 million, or both and meets certain independence and going concern tests). If an SME is loss-making after deducting the R&D relief, it can elect to surrender the loss relating to the R&D expenditure and SME R&D relief and take credit in cash from the HMRC, worth up to 14.5 per cent of the surrendered loss. A separate relief, similar to that available to an SME with some modification, existed for large companies but was phased out and replaced by an R&D expenditure credit (RDEC, also known as the ‘above the line’ tax credit) for R&D expenditure incurred on or after 1 April 2016. Large companies may make an irrevocable election to use the R&D expenditure credit for expenditure incurred on or after 1 April 2013.

Under the RDEC regime, large companies work out the eligible costs directly attributable to R&D, reduce relevant subcontractor or external staff payments to 65 per cent of the original costs, and then multiply the figure by 12 per cent (from 1 January 2018) to obtain the expenditure credit. This credit can then be used to settle the company’s corporation tax liability for the accounting period with any excess being reduced by applying a notional
tax charge to it based on the main rate of corporation tax for the accounting period. The remaining amount can be used for various purposes including paying outstanding corporation tax for other accounting periods or surrendered to any group member.

An added attraction of this new regime is the way in which it appears in the company’s accounts. The credit is recognised as part of the company’s profit before tax (hence the reason it is called an ‘above the line credit’) and so will have a favourable impact on a company’s accounting profits.

Expenditure that qualifies for R&D credit is defined by reference to expenditure that qualifies under GAAP, subject to certain exclusions. Most notably, in order to qualify the R&D must seek to achieve a general advance in knowledge or capability in a field of science or technology, not just a company’s own knowledge or capability; furthermore, the research does not have to be successful for the revenue expenditure to qualify for R&D credit.

**Calculation of capital (chargeable gains)**

A company is potentially liable for corporation tax on any chargeable gains arising from the disposal of a capital asset. The gain is taxed at the same rate as an income trading profit, and is the difference between the original acquisition cost and the disposal value minus designated allowable expenses (e.g., the costs of improvements and an allowance for inflation).

If a capital asset qualifies for capital allowances, these are deducted from the acquisition cost, but only to eliminate or reduce a loss so that if, for example, the asset is sold at a gain, capital allowances are ignored.

Unlike trading losses, capital losses can only be set off against chargeable gains in the same or future accounting periods. Capital losses can be carried forward indefinitely, but not back. Under proposals announced in the 2018 Autumn Statement, from 1 April 2020, the proportion of annual capital gains over a £5 million allowance that can be relieved by brought-forward capital losses will be limited to 50 per cent.

Anti-avoidance rules exist that restrict the ability to buy loss-making companies in order to use their capital losses, and the use of capital losses made on transactions with related parties.

Rollover relief is available to companies that reinvest the proceeds from disposals of certain types of capital assets into new capital assets. This allows any gains on such assets to be deferred until the new asset is sold, unless the proceeds of that sale are also reinvested.

Subject to the selling company and company being sold meeting certain trading company criteria, broadly a company that holds at least 10 per cent of the share capital of another, and has held such interest for 12 months, may qualify for SSE on a disposal of those shares so that any gain arising on disposal is completely exempt from tax on the capital gain. The Finance (No 2) Act 2017 introduced certain changes that relax the trading requirements, notably for institutional investors.

**Rates of corporation tax**

The rates of corporation tax are set for each financial year, and if the rate changes during a company’s accounting period, the profits are generally split between the two financial years on a time-apportioned basis and the different rates applied to the relevant part. The corporation tax rate for the financial year commencing on 1 April 2017 is 19 per cent and reduced to 17 per cent on 1 April 2020.
Groups
Unlike the position in some other jurisdictions, a group is not taxed as a single entity in the United Kingdom, and members of a group are taxed on an entity-by-entity basis but with rules to allow sharing of tax reliefs and movements of assets between group members on a tax-neutral basis. The definition of a group for UK tax purposes differs according to the context, but as a broad rule a company will be grouped with another if 75 per cent of a company's ordinary share capital (which gives proportionate economic rights, broadly 75 per cent of the right to any dividend paid and assets distributed on a winding-up) is owned by that other company.

Subject to certain exclusions, UK companies within a capital gains tax group may transfer assets between them without triggering a capital gain or UK stamp duty.

Current year trading losses (not carried-forward losses or capital losses) and certain other deductions such as debits on loans can be surrendered between group members.

Administration and payment
UK companies self-assess by submitting a tax return generally within 12 months of the end of their accounting period. If the return is filed late there is a small fixed penalty, which increases to 10 per cent of the unpaid tax if the return is submitted more than 18 months after the end of the accounting period (over six months late), and then to 20 per cent if the return is more than two years late (over 12 months late). Companies (other than small companies) pay their corporation tax by quarterly instalments: two in the current year and two after it has finished. The first payment is due six months and 14 days after the start of the accounting period; the second three months after the first payment; the third three months after the second payment; and the final payment three months after the third payment. However, for accounting periods starting on or after 1 April 2019 (originally proposed for periods after 1 April 2017) this will change to quarterly payments in the third, sixth, ninth and 12th months of the accounting period.

Compliance and reporting
As part of increased compliance and reporting requirements, companies are required to take action outside of the normal requirements to submit accurate tax returns on a timely basis. Among the most noteworthy of these requirements are: the obligation to publish tax strategy, the obligation to take proactive steps to prevent tax evasion and country-by-country reporting. These are all discussed in more detail below.

Under the UK Finance Act 2016, all large businesses operating in the UK are required (in respect of all financial years commencing on or after 15 September 2016) to publish, before the end of the first relevant accounting period, their UK tax strategy online. This applies not only to UK companies, UK permanent establishments and UK partnerships with turnover exceeding £200 million and having a balance sheet total of over £2 million, but also to multinational groups with a global turnover exceeding €750 million that have any UK presence no matter how small.

The strategy is restricted to UK strategy and need not divulge how much UK tax is paid or commercially sensitive information but must set out the following relation to UK tax:

a  the company’s approach to risk management and governance arrangements;
b  the company’s attitude to tax planning;
c  the level of risk the company is willing to accept;


d the company’s approach towards dealings with HMRC; and

e a statement that the company regards the publication as complying with its duty under the Finance Act 2016.

The strategy must be accessible free of charge on the internet and be republished every subsequent year.

The Criminal Finances Act 2017 introduces new strict liability offences with potentially hefty fines for failing to prevent facilitation of UK and non-UK tax evasion. Businesses in the financial services, legal and accounting sectors are likely to be most affected, but it applies to all companies and partnerships. There is a statutory defence where there are reasonable preventative procedures in place to prevent its associated persons from committing tax evasion facilitation offences. In practice, this will mean that businesses will probably start to introduce policing procedures and start including provisions in commercial contracts, employment contracts, etc., to protect against financial and reputational risk.

The UK country-by-country reporting obligations apply to accounting periods beginning on or after 1 January 2016. UK-parented multinationals with revenues above €750 million or entities with a non-UK parent in a country that has no country-by-country reporting or effective exchange of information mechanism with the UK will need to submit a report (following the OECD template) in respect of the global group or UK subgroup, as appropriate, to HMRC within 12 months of the year end. Following OECD recommendations, a multinational group can file in the UK on a group-wide ‘surrogate’ basis.

ii Other relevant taxes

Stamp duties

The United Kingdom has no capital duties but does levy stamp duties. Stamp duty land tax (SDLT) is charged on the execution of some documents that transfer land in England and Northern Ireland generally at rates of up to 5 per cent on commercial property and 12 per cent on residential property, unless the purchaser is a non-natural person (see below). If the residential property is leasehold and the total rent over the life of the lease is more than £250,000 you also pay 1 per cent on the portion over 1 per cent. SDLT does not apply in Scotland, where land and buildings transaction tax applies, or in Wales, when from April 2018 a land transaction tax will apply. Stamp duty is charged on instruments that transfer UK company shares or securities (usually at 0.5 per cent). Securities generally exclude ordinary commercial loan capital, provided such loan capital has no equity-type characteristics, such as a yield linked to profit. Higher rates of SDLT apply to the purchase of additional residential properties (such as second homes and buy-to-let properties) for chargeable consideration exceeding £40,000. The higher rates are 3 per cent above the current SDLT rates for residential property.

To discourage the practice of buying residential property in an offshore company then transferring shares in such company without paying SDLT, SDLT is charged at 15 per cent on interests in residential dwellings costing more than £500,000 purchased by certain non-natural persons such as companies, collective investment schemes, and partnerships with one or more members who are either a body corporate or a collective investment scheme. In addition, any such non-natural person that owns a residential dwelling will be subject to an annual tax on enveloped dwellings (ATED). The amount of ATED is worked out using a banding system based on the value of the residential property. Properties on which ATED is paid and that were owned on 1 April 2017 need to be revalued to that date for the purposes of the ATED charge. Currently, there are six valuation bands and six corresponding levels
of charge from £3,600 per annum for properties worth between £500,000 and £1 million up to an annual charge of £226,950 for a residential property worth more than £20 million. Capital gains tax applies on a sale of properties in this regime, even for non-UK resident entities. In respect of both the SDLT charge and ATED, there are exclusions notably for companies acting in their capacity as trustees for a settlement and property developers or property rental businesses that meet certain conditions.

Agreements to transfer UK company shares or securities, or shares of a non-UK company that maintains a UK register of such shares or securities, may attract stamp duty reserve tax (SDRT) (usually at 0.5 per cent). If stamp duty is paid on the instrument of transfer within prescribed time limits, the SDRT charge on the contract predating the formal transfer document need not be paid.

**Value added tax**

VAT is a tax on non-business consumers, and for most business is an administrative burden rather than a tax cost. VAT is charged on goods and services supplied in the course of business. If the customer is itself a business, is registered for VAT and uses the supplies it receives for business purposes, the business will receive credit for the VAT it pays (input tax), which it can offset against the VAT it charges (output tax). If a business is charged more VAT than it charges its own customers, it can reclaim the difference, but if it charges more than it is charged, it pays the difference to HMRC. Thus, generally the burden is passed down the supply chain until it reaches the ultimate non-business consumer who bears the cost.

Certain supplies are exempt from VAT, notably supplies of shares and securities (including loans) and certain supplies of land and buildings. Other supplies are zero-rated, such as books, food, transport, children’s clothing and supplies of goods and services outside the United Kingdom. In cash terms, a zero-rated supply (where VAT is charged at zero per cent) is the same as an exempt supply (where no VAT is chargeable), but the difference is that a business can generally recover VAT incurred on costs incurred in connection with a zero-rated supply but may not recover VAT on costs incurred in respect of exempt supplies.

Currently, UK businesses with a taxable turnover greater than £85,000 in the preceding 12 months (it is proposed that the £85,000 limit will apply to April 2020), or where there are reasonable grounds for expecting that turnover in the next 30 days will exceed this limit, must register for VAT. Businesses may also choose to register if they anticipate being able to reclaim material amounts on VAT charged by their suppliers.

VAT has been generally charged at 20 per cent, with some exceptions such as a rate of 5 per cent on home energy. Taxpayers are required to maintain detailed records of output and input tax. Large taxpayers pay tax monthly, as do those who regularly reclaim; others may pay quarterly.

**Income tax and social security contributions**

Unlike corporate tax rates, the United Kingdom’s income tax rates are relatively high and higher still in Scotland; this is a factor that a business thinking of moving into the United Kingdom and relocating staff will need to take into account. In the current tax year (to 6 April 2019), individuals pay tax on total chargeable income at 20 per cent (the basic rate) on the first £34,500 of their income, then at 40 per cent (the higher rate) on income above that figure up to £150,000, then at 45 per cent (the additional rate) on income above £150,000. In Scotland there is a five-band structure with the top two bands charging tax at 41 per cent above £31,850 and 46 per cent above £150,000.
There are personal (tax-free) allowances on the first slice of income (generally £11,850 in the current tax year with different allowances in Scotland). Dividend income above £2,000 is taxed at slightly lower rates and interest is tax free up to £1,000 then taxed above this, although those with incomes in excess of £150,000 pay tax on all of their savings income.

Employers are required to deduct income tax from their employees at source and account to HMRC under a system known as pay-as-you-earn (PAYE).

In addition to income taxes, UK employees (other than the very low paid) and their UK employer are subject to NIC. In the current tax year (to 5 April 2019), a UK employer must pay NIC at 13.8 per cent of their employees’ gross earnings. The self-employed also pay NIC, but at lower rates.

Employees must also pay NIC on their earnings and the employer is responsible for collecting it from their earnings. It is charged at a fixed rate (currently 12 per cent) between a threshold and an upper earnings limit (currently £892 per week), and thereafter at 2 per cent.

IV TAX RESIDENCE AND FISCAL DOMICILE

UK residence is central to the taxation of businesses. A UK-resident company is subject to UK corporation tax on all its worldwide profits, wherever they arise. A non-UK resident company that carries on a trade in the United Kingdom through a UK PE is also subject to UK corporation tax on its profits, wherever they arise, but only to the extent such profits are properly attributable to such PE.

Chapter 3A in Part 2 of the Corporation Tax Act 2009 exempts all profits (including chargeable gains) attributable to non-UK PEs of UK-resident companies from UK corporation tax. To apply, the UK company must make an irrevocable election. Elections are made on an individual company basis, covering all PEs of the electing company. The relevant profits of the non-UK PEs are determined in accordance with the relevant double taxation treaty (DTT) with the jurisdiction where the PE is based. The regime contains anti-avoidance rules to prevent the artificial diversion of profit from the UK to an exempt PE.

If a company is not UK-resident, nor has a UK trade carried on through a UK PE, its exposure to UK tax is limited, primarily to taxes on UK-sourced income.

i Corporate residence

A company can be UK-resident either by being incorporated in the United Kingdom under the UK Companies Acts or, if incorporated outside the UK, by virtue of having its central ‘management and control’ exercised in the United Kingdom.

This test derives from case law, notably the leading case of *De Beers Consolidated Mines v. House*, in which the House of Lords adopted a fact-based test of UK residence, which became known as the central management and control test.

The *De Beers* case laid down two important principles: that a company is UK-resident if managed and controlled in the United Kingdom, and where such management and control is exercised is a question of fact. These principles were expanded and clarified in later cases.

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2 [1906] AC 455; 5 TC 198, 211, HL.
In the case of *American Thread Co v. Joyce*, the House of Lords made it clear that management and control is not day-to-day management but strategic and policy decisions, and that such decisions are generally as a matter of fact taken by directors. HMRC is threatening to change this test so it is more akin to the OECD test for a ‘place of effective management’, which takes into account wider management functions.

However, while the presumption is that management and control are exercised by a company’s board, the facts are still paramount, so if, factually, control is exercised outside the board, one looks to where that control is actually exercised. When considering where the ‘central management and control’ exists, it is essential to distinguish cases where management and control are exercised through a company’s constitutional organs from cases where the decisions of those constitutional organs are usurped, and to further distinguish between cases where an ‘outsider’ proposed, advised and influenced decisions taken by the constitutional organs, and cases where such an outsider dictated the decisions and ‘usurped’ such constitutional organs.

The cases illustrate the importance of ensuring that the board exercises real discretion and does not merely rubber-stamp decisions taken elsewhere, and that contemporaneous records supporting this are kept.

Residence questions are rarely clear-cut, and the determination will be dependent on what occurs in practice and on the supporting evidence.

Sometimes different tests of residence are applied in different jurisdictions, with the result that a company may be regarded as resident in more than one jurisdiction. In such cases the company is dual-resident, and one has to look to DTTs to avoid exposure to double taxation and specifically to provisions often referred to as tiebreaker provisions. Treaties that follow the OECD model usually contain a clause that refers to a company being resident in the jurisdiction where it has its ‘place of effective management’. The OECD commentary states that the place of effective management is the place where key management and commercial decisions necessary for the conduct of the company’s business are made, which is normally where the board of directors makes its decisions, but stresses that one must consider all facts and circumstances. HMRC takes the view that this means that, when looking at the ‘place of effective management’, one has to have regard for the day-to-day management of the company, and not just the highest level of decision-making required by the UK management and control test.

### ii Residence through a UK branch or PE

As stated above, a non-resident company is only subject to UK corporation tax if it carries on a trade in the United Kingdom and such trade is conducted through a UK PE. There are two notable exceptions to this rule: (1) diverted profits tax (broadly where there is manipulation to avoid a UK PE); and (2) where a non-UK resident company has UK real property income. From 6 April 2020 non-UK companies that carry on a UK real property business or have other UK property income will be charged UK corporation tax on such profit (certain capital gains derived from UK real property will also be taxed).

What constitutes a trade is a question of fact determined by looking at certain criteria known as ‘the badges of trade’ laid down by UK case law, as there is no satisfactory statutory definition of what constitutes trading.

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3 (1913) 6 TC 163.
The UK definition of a PE is based on the OECD Model Treaty definition and means a fixed place of business through which its business is wholly or partly carried on. A fixed place of business includes:

- a place of management;
- a branch;
- an office;
- a factory;
- a workshop;
- an installation or structure for the exploration of natural resources;
- a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;
- or
- a building site or construction or installation project.

UK law also follows the OECD model in excluding from the definition of what constitutes a UK PE activities carried on at a place of business that are preparatory or auxiliary in character. For activities to be regarded as preparatory or auxiliary in character they must be sufficiently remote from the actual realisation of profits by the enterprise that it would be difficult to allocate part of that profit to the potential UK PE. Such activities include:

- storing, displaying or delivering the company's goods or merchandise;
- maintaining the company's goods or merchandise for the purpose of storage, display or delivery, or processing by another person;
- purchasing goods or merchandise for the company; and
- collecting information for the company.

In addition, if a non-UK company has a UK agent that habitually exercises authority to conduct the company's business in the United Kingdom, such agent will also be a PE of the company unless such agent has independent status and acts for the non-UK company in the ordinary course of its (the agent's) business.

It is not enough for a company to have a PE in the United Kingdom: it must also be trading in the United Kingdom, not just with it. To determine this, one must look at where the operations take place and where the profits arise, and a key factor is where the contracts are entered into (see *Firestone v. Llewelin*).4

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

As stated elsewhere in this chapter, the United Kingdom can be attractive as it has:

- low corporate tax rates;
- no withholding from dividend payments and a wide exemption from tax on receipt of dividends;
- a wide treaty network that offers treaty relief from withholding from interest and royalties;
- generous rules for allowing deductions for borrowing costs even if such borrowing was for a capital purpose such as acquiring a subsidiary; and

4 (1957) 37 TC 111.
substantial shareholder exemption that can exempt gains on the sale of 10 per cent (or more) shareholdings in trading companies.

The United Kingdom introduced a patent box regime from 1 April 2013 that applies to all patents (but not copyright, know-how, etc.) first commercialised after 29 November 2010. The regime applies a 10 per cent tax rate to all relevant profits (royalties, fees, sale proceeds, sales of products with embedded patent rights and compensation) derived from the active exploitation of qualifying patent rights.

A qualifying patent is restricted to those registered with the European Patent Office or United Kingdom Intellectual Property Office. The party claiming relief need only to have a beneficial interest.

The regime was modified by the Finance Act 2016 to bring it in line with recommendations from the OECD Forum on Harmful Tax Practices. The key change was the introduction of a ‘nexus’ (or R&D) fraction, which takes into account the location, and nature of a company’s underlying R&D activity, in determining the available patent box benefit. This restricts the relief where R&D is subcontracted out even within the UK group.

To date and despite a UK government desire to encourage innovation, the regime has not proved terribly successful. Many reasons have been advanced for its relatively low take-up, most plausible of which is the regime’s sheer complexity, leading to compliance expense that discourages all but the largest companies. Also much modern innovation falls outside the patent regime.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Dividends

There is no UK withholding tax from dividends paid by a UK company irrespective of the status or location of the holder. Since 1 July 2009, the United Kingdom has operated an exemption regime (prior to 2009 it operated a credit scheme) for dividends received by a UK company, the effect of which is broadly that, provided the company is not involved in a tax-avoidance scheme of which the dividend forms part, dividends are exempt upon receipt.

To be exempt, a dividend must meet a number of conditions apart from the tax-avoidance condition. The exemption will not prevent dividends received by share traders and others receiving dividends on trading account being taxed in the normal way.

A small company (one that has fewer than 50 employees, and whose annual turnover or annual balance sheet total (or both) does not exceed €10 million) can receive all dividends free of tax provided the dividend is not capital in nature, is not deductible for the payer and the payer is not based outside the United Kingdom in a non-‘qualifying territory’. A qualifying territory is one with which the United Kingdom has a DTT containing a non-discrimination provision.

All other companies can receive dividends on an exempt basis if, as well as meeting the anti-avoidance test and the dividend being non-deductible for the payer, the dividend falls into an exempt class.

The main exempt classes of dividend are:

a the ‘control exemption’: dividends paid by a company to a company that controls it;
b the ‘ordinary shares exemption’: dividends paid in respect of (non-redeemable) ordinary shares;
c the ‘portfolio exemption’: dividends paid on portfolio shareholdings where the 
shareholder holds less than 10 per cent of the issued share capital of the paying 
company; and  
d the ‘relevant profits exemption’: dividends paid out of ‘relevant profits’ being effectively 
ordinary profits derived from transactions that do not have the effect and main purpose 
of having a more than negligible reduction in UK tax.

Non-exempt dividends are taxed at the normal rates of corporation tax subject to potential 
credits for withholding and underlying taxes. UK individuals are taxed on dividends received, 
and the corporate exemption has no equivalent.

ii Interest

The United Kingdom imposes withholding tax (currently at 20 per cent) on payments of 
annual interest by a UK resident (interest on loans with a term of less than a year can be 
paid gross). There are a number of important exceptions to the obligation on the payer to 
withhold and account for tax, notably on:

a interest paid on bonds listed on a recognised stock exchange;  
b interest paid to UK corporates;  
c interest paid to a UK PE of a non-UK corporate where the UK PE brings such interest 
into the charge to UK tax; and  
d interest paid to a UK ‘bank’ and interest where it is paid without withholding because of 
the application of a relevant DTT.

Many (but not all) UK treaties eliminate UK withholding tax from interest; however, in order 
for the relief under a DTT to be applied, the UK payer and non-UK payee must submit an 
application that can take a number of months to process, and that often causes problems with 
the first interest payment when interest is payable quarterly or more frequently.

Interest is generally deductible for a UK business payer, subject to thin capitalisation 
and corporate interest restriction rules (described below), provided that the loan does not 
have equity characteristics that result in the interest being recharacterised as a distribution 
(e.g., interest that varies in line with the payer’s profits).

iii Royalties

Payments of copyright royalties to non-UK residents and payments of patent royalties are 
subject to withholding tax (currently at 20 per cent), but many UK DTTs eliminate such 
withholding. Certain payments between 25 per cent-associated companies within the EU 
can be made free of withholding from royalties (and interest).

The Finance Act 2016 made some significant changes to withholding from royalties 
paid to non-UK residents, notably where:

a the payment is part of arrangements that exploit the UK’s double tax treaties to ensure 
that little or no tax is paid on such royalties in the UK or elsewhere, in which case a 
withholding may have to be made even if this would normally be reduced or eliminated 
by a double tax treaty. There is an exception where the royalty is covered by the EU 
Royalties Directive (unless broadly the arrangements are designed to avoid tax and have 
been made to fall within the Directive); and
United Kingdom

b a UK PE obtains intellectual property rights as a result of its non-UK parent paying a royalty to another non-UK entity. In such a case, the UK permanent establishment is potentially required to withhold from that non-UK royalty payment (previously such a royalty would not be treated as having a UK source so would not be subject to UK withholding).

iv Tax treaties

The United Kingdom has an extensive network of treaties with all developed non-tax haven countries and the majority of countries in the developing world. Most treaties are based on the OECD model, and some have provisions against treaty shopping.

VII TAXATION OF FUNDING STRUCTURES

i Thin capitalisation

The UK no longer has a specific thin capitalisation rule, although, de facto, there is such a regime included within the transfer pricing regime. Where there are financing transactions between connected parties, transfer pricing rules require tax to be calculated on the basis of what the arm's-length financing provision would have been should the actual financing confer a tax advantage in comparison with an arm's-length result. These rules apply to transactions between UK taxpayers, as well as cross-border transactions.

For the transfer pricing rules to apply, there has to be a 'special relationship' between the companies concerned. A special relationship is defined as a relationship where one company controls the other, or both are controlled by the same person or persons. This is a narrower definition of special relationship than one typically finds in the United Kingdom's DTTs. If there is a special relationship, one has to consider if the financing is at arm's length. One is required to ask a number of questions, most notably:

a whether the loan would have been made at all in the absence of the special relationship;

b the amount of the loan that would have been made in the absence of the special relationship; and

c the rate of interest and other terms that would have been agreed in the absence of that relationship.

Thus, if, for example, X lends its subsidiary Y £300 million at an arm's-length interest rate on normal commercial terms, but the loan would not have exceeded £200 million had there been no special relationship between X and Y, then the interest paid on the £100 million of debt that exceeds the arm's-length facility may be disallowed. If the principal was at an arm's-length amount but the interest rate is, say, 5 per cent, whereas the arm's-length rate would be 4.75 per cent, then the 0.25 per cent excess rate paid by virtue of the special relationship is likely to be disallowed.

In addition to the thin capitalisation rules in the transfer pricing regime described above, interest costs may be disallowed as a tax deduction under specific rules: under the debt cap prior to 31 March 2017 and post 1 April 2017 under rules introduced by the Finance (No. 2) Act 2017 (the corporate interest restriction (CIR) regime) in response to BEPS that replaces the debt cap.  

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The CIR regime applies to companies and their subsidiaries with net tax-interest expense amounts of £2 million or more that are listed on a recognised stock exchange and not more than 10 per cent owned by a single participator. The rules are intended to stop groups placing disproportionately high levels of debt in high-tax countries or using intra-group loans to generate interest deductions that exceed third-party borrowing costs or debt to generate tax-exempt income. The default position is that a UK group’s deductible net tax-interest expense for a period is limited to broadly 30 per cent of its taxable EBITDA that cannot exceed the group’s net finance-related expense plus certain carry-forward amounts from previous periods. A company may elect that, instead of the 30 per cent limit, a percentage is used based, broadly, on the ratio of the group’s net interest expense to its accounting EBITDA (ignoring amounts payable to shareholders and on equity-like instruments); again that cannot exceed the group’s net finance-related expense plus certain carry forwards.

Interest and loan expenses in excess of the limited amounts are not lost but can be carried forward. Where a deduction is denied, the allocation of allowed and denied interest costs can be allocated as the group chooses.

ii Deduction of finance costs

Subject to thin capitalisation and interest limitation rules, the costs of acquisition finance are generally deductible (this includes not only interest but ancillary costs such as arrangement fees). The United Kingdom does not disallow funding costs because they are incurred for a capital purpose rather than for the trade itself.

An exception to the rule that interest costs are deductible is where the debt has equity characteristics that render the interest liable to being recharacterised as a (non-deductible) distribution, such as a coupon that is to any extent linked to the results of the issuer’s business or interest on convertible securities. Apart from the notable exception of interest at an excessive rate, if an interest coupon is liable to be treated as a distribution it generally will not be where the recipient is a UK corporate or a UK PE that brings the coupon received into the charge to UK corporation tax.

iii Restrictions on payments

Apart from potential restrictions on paying dividends in a company’s constitution, its directors are under a duty to safeguard a company’s assets and settle debts as they fall due, so must consider how paying a dividend may affect these areas. Those factors apart, and subject to additional considerations for public companies, the general rule is that a UK company can only pay a dividend to the extent it has ‘distributable reserves’, which are such company’s accumulated, realised profits (as far as not previously used by distribution or capitalisation) less its accumulated, realised losses (as far as not previously written off in a reduction or reorganisation of capital). Whether a profit is a ‘realised profit’ is determined in accordance with GAAP. Thus, unlike many jurisdictions, even if a UK company has material current-year profits, it cannot pay a dividend if it has accumulated deficits that exceed the profit. If the accumulated deficit is, say, £100, and the current year profit is, say, £150, only the excess £50 is distributable, leaving cash of £100 in the company – a situation often referred to as a dividend trap. There are a number of possible solutions, one of which is described below.

Public companies must also beware of an issue called financial assistance, which is designed to stop a target assisting in its own sale (e.g., by waiving debt it is owed by its selling parent). Financial assistance no longer applies to private companies.
iv Return of capital

UK companies can return cash to shareholders by reducing their equity capital. This may be done for a variety of reasons, such as where there are a large number of UK-resident individual shareholders for whom a return of capital is more tax-efficient, but it is often used by companies who have insufficient distributable reserves to return the cash they want to return to their shareholders by way of dividend.

The reserve created by reducing capital is generally treated as a realised profit that can thus be offset against accumulated realised losses, or can increase distributable reserves, or both. Some UK-listed companies have reduced capital to counter the deficits created by their pension funds following changes to the rules on how such funds should be accounted for.

Public companies have to reduce capital through a court scheme, but since 2008 private companies can also use a non-court scheme, provided the directors are satisfied that returning capital will not affect the company’s solvency over the next 12 months. This latter route is known as the solvency statement route.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Often a UK holding company is used to acquire a UK target. This enables the acquirer to push acquisition debt into the holding company, the ongoing cost of which can be surrendered into the target group and offset against future trading profit. In cases where a deduction is also potentially available elsewhere in the acquirer’s group, the taxpayer needs to consider UK anti-avoidance rules that can prevent a double deduction of interest costs.

The amount of debt that can be successfully injected needs careful thought in the light of thin capitalisation and debt cap considerations and, from 2017, the new debt ratio rules. Furthermore, HMRC is aggressively denying deductions for the cost of acquisition debt in situations where it regards debt as pushed into a UK entity without adequate commercial rationale, citing the Corporation Taxes Act 2009 Sections 441–442 that attack debt that has an unallowable purpose.

Subject to certain conditions, UK selling shareholders can roll over gains on the sale of shares to the extent they receive shares in the acquirer or the acquirer’s loan notes. Even if there is a large cash element, a proportionate part of the gain can still be rolled over. The shares or loan notes must be issued by the acquirer (i.e., if X Inc acquires the target but X Inc’s parent Y issues the consideration shares, roll over will not be available; there may be an exception to this rule if the acquisition is structured through a cancellation scheme through the court rather than the more usual tender or exchange offer).

ii Reorganisation

As previously stated, the United Kingdom allows UK companies under a common parent to be grouped even if such common parent is not a UK company. This means that it is generally possible to consolidate any newly acquired UK group into the purchaser’s existing UK group on a tax-free basis. There are also rules that now facilitate merging or consolidation across borders within the EU. It is unclear at the time of writing what impact Brexit will have on such rules.
iii Exit

If the purchaser wants to move parts of a newly acquired group out of the United Kingdom into another part of the group in a non-UK jurisdiction, then the general rule and starting point is that any such transfer will be treated as taking place at market value, and the difference in value between the historical tax basis and current market value will be recognised as a taxable gain. The United Kingdom’s SSE relief may assist, as may the rules facilitating mergers and transfers within the EU.

A point to note in this context is that under UK tax law, if a target company is acquired at market value, the tax basis that the target company has in underlying subsidiaries’ shares and assets remains at the historical tax basis, and assets cannot be rebased to reflect the open market price paid for the shares in the target. The United Kingdom has no equivalent to the US Section 338 election.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

On 17 July 2013, the United Kingdom introduced its first general anti-avoidance rules (GAAR) to ensure that there was a comprehensive rule for combating abusive tax avoidance encompassing present and future tax provisions. A study group commissioned in 2010 to study the benefits of such a regime did not recommend a ‘broad spectrum’ GAAR, which it was felt would undermine sensible and responsible tax planning, and would require an onerous, comprehensive clearance system that would give an excess of power to HMRC. The report recommended a more measured, targeted approach aimed at highly abusive, contrived and artificial schemes that are widely regarded as intolerable, but which would not affect responsible tax planning. This was generally accepted in the Finance Act 2013 and has been confirmed by guidance provided by HMRC, which accepts that there may be tax avoidance arrangements that are not within the scope of GAAR because they are not abusive. Under the United Kingdom’s Tax Code, in many circumstances, there are different courses of action from which a taxpayer may choose; HMRC has emphasised that any reasonable choice of a course of action is outside the scope of GAAR. In contrast, arrangements will fall within its scope if they are demonstrably contrary to the spirit or policy of the law, seek to exploit shortcomings in legislation or are contrived or abnormal arrangements that produce tax results inconsistent with the economic effect of the underlying transactions.

The Scottish government has its own GAAR for taxes devolved to Scotland.

The United Kingdom currently has a wide range of specific anti-avoidance rules contained in both statute and common law that are detailed and complex and beyond the scope of this chapter. Particular points to note are that there is a regime effective from 1 January 2017 introduced in response to Action 2 of the OECD Base Erosion and Profit Shifting (BEPS) that widens previous tax arbitrage rules and targets ‘hybrid mismatches’. The UK also has disclosure of tax avoidance schemes (DOTAS) regime requiring disclosure where certain classic hallmarks of avoidance are present, such as premium fee arrangements and confidentiality agreements surrounding the arrangements.

5 HMRC GAAR Guidance – Paragraph B3.1.
6 HMRC GAAR Guidance – Paragraph B4.2.
7 HMRC GAAR Guidance – Paragraphs D2.6, D2.7 and D2.8.
The UK introduced a diverted profits tax (DPT) from 1 April 2015. The tax (at the rate of 25 per cent, so 6 per cent higher than the normal corporate tax rate), applies in two cases:

a where a UK company (or permanent establishment) enters into arrangements with a related person where that person or the transaction lack economic substance resulting in a reduction of the UK taxable profits; and

b a person carries on an activity in a manner that avoids creating a UK PE.

DPT does not apply to small- or medium-sized enterprises or to a PE with annual sales of less than £10 million or where profit is diverted to a jurisdiction whose tax rate is 80 per cent or more of the UK corporation tax rate.

ii Controlled foreign corporations (CFCs)

The UK CFC regime has been considerably revised and made more taxpayer-friendly (by providing a number of gateways and exemptions), and came into force for accounting periods starting after 1 January 2013. Although quite complicated, the basis of the regime is that most bona fide non-UK companies not being used to artificially divert profit from the UK should fall outside the regime. In response to the final OECD Report on strengthening transfer pricing rules, published in October 2015, the UK government has stated that it is not proposing any change to the UK regime that it regards as already covering the points made by the OECD.

Subject to exceptions, a non-UK company with a UK parent (or one that is controlled by UK persons) is potentially subject to the UK CFC regime. If not excluded by one of the gateways that has to be passed through to be potentially caught by the regime, or if not excluded by one of the many exemptions, a CFC’s profits are deemed apportioned to the UK parent and taxed in the United Kingdom, subject to credit for non-UK tax paid.

There are a series of exemptions, notably:

a the low tax exemption: a company is only subject to CFC treatment if it is subject to a headline tax rate of less than 75 per cent of the equivalent UK tax rate;

b the low profits exemption: a CFC is ignored if it has accounting profits of less than £500,000 and non-trading profits of less than £50,000;

c the exempt activities test: there is a safe harbour if the CFC has business premises in a low-tax jurisdiction, less than 20 per cent of its income, management and exports derive from the United Kingdom, and it has no IP transferred from a related party in the past six years;

d an exemption for certain non-trading finance profits and partial exemption for group financing companies; and

e the excluded territories exemption: the CFC is based in a jurisdiction on a published list provided its total income within certain categories (generally income that is exempt or subject to a reduced rate of tax) does not exceed 10 per cent of the company’s pre-tax profits for the accounting period (or £50,000 if greater).

There is also a high-level gateway and a number of specific gateways that can exclude the application of the regime, but as these are more subjective, an adviser generally prefers to see if one of the exemptions applies in the first instance.

The general gateway is subject to a number of safe harbours that if all the conditions are met mean the gateway is not passed through and the CFC regime does not apply, making it unnecessary to consider other gateways and exemptions. The safe harbour conditions include:
the main purposes safe harbour: broadly, a series of questions aimed at establishing whether arrangements exist that are intended to reduce or eliminate United Kingdom taxation;

b the UK-managed assets or risks safe harbour: broadly, aimed at establishing whether the CFC’s assets and risks are independently managed. The test is failed if assets or risks are significantly managed in the United Kingdom by connected parties unless they could be replaced by non-connected companies; and

c the commercially effective safe harbour: even if assets and risks are UK-managed, the test may still be satisfied if the CFC could effectively commercially manage the assets or risks were the UK-connected company to cease such management.

There are a series of specific gateways that can apply based on specific activities the CFC carries out.

On 26 October 2017, the European Commission opened an investigation into aspects of the UK’s CFC finance company exemption provisions. The investigation is to consider whether the UK rules give a selective advantage constituting state aid. At the time of writing there has been no definitive ruling and the question of how it will be applied depends on where the UK lands under Brexit.

### Transfer pricing

Since 2004, in order to comply with EU laws on discrimination, the UK transfer pricing rules have applied to all transactions even if all the parties are subject to UK tax. The UK transfer pricing rules are expressly based on OECD guidelines and provide that the UK law in this area must be construed in the light of such OECD guidelines. Thus, as one would expect, the UK legislation requires that transactions between related parties be undertaken in accordance with the arm’s-length principle in Article 9 of the OECD Model Law.

**Basic UK law**

The UK transfer pricing regime applies to ‘provisions’ (broadly equivalent to OECD conditions) of transactions (transactions being defined widely to include arrangements, understandings and mutual practices as well as matters such as contracts), or series of transactions, between certain specified parties. In common with many transfer pricing regimes, the UK regime requires comparison of the actual provision (price, terms and conditions of supply, etc.) with the arm’s-length provision that would have applied in the same transaction between independent parties. The basic rule will apply where the actual provision has created a potential UK advantage because income or profits are less or losses greater than they would have been had the transaction been at arm’s length.

The rules apply where one of the parties to a transaction directly or indirectly participates in the management, control or capital of the other, or where the same person (or persons) directly or indirectly participates in the management, control or capital of the parties. A person is treated as directly participating if that person is a corporate or a partnership and ‘controls’ the other person. In evaluating whether a person (e.g., X Ltd) has control, one takes into account not just current voting power exercisable by X Ltd, but also factors including rights and power that X Ltd is entitled to acquire, or will become entitled to acquire, at a future date, and rights and powers held by a person connected with X Ltd.
The transfer pricing rules also apply if X Ltd exercises indirect control over another person through rights held by connected persons, rights exercised on X Ltd’s behalf or through deeming entitlements to future rights to have been exercised, or because X Ltd is a ‘major participant’.

X Ltd is a major participant if it and another person (taken together) have control and each has at least 40 per cent control of the relevant entity – this is particularly relevant to joint ventures.

Where there are two UK companies, it is likely that in many cases there will be no loss to the UK Treasury, as a deduction in one company will be matched by a corresponding receipt in another. In recognition of this, the regime allows the company that is disadvantaged by the pricing adjustment to make a claim to have its tax calculated on the same deemed arm’s-length terms as the company that obtained an advantage as a result of the adjustment, and tax-free compensatory payments to be made.

The United Kingdom adopts OECD methodology to determine an arm’s-length price, notably the transactional methods (the comparable uncontrolled price method, resale price method and cost plus method) and the profit-based methods (the profit split method and transactional net margin method). In the 2016 Finance Act the UK government adopted the OECD guidelines on transfer pricing currently in force or as updated. In addition the UK introduced legislation – the Taxes (Base Erosion and Profit Shifting) (Country-by-Country) Reporting Regulations 2016 – which requires a UK-resident parent company to report prescribed information, so implementing another OECD BEPS recommendation.

The UK does permit advance pricing agreements (APAs) under which the taxpayer agrees with HMRC an acceptable pricing method in advance of the relevant transactions taking place. These are typically used in more complex transactions, and HMRC has detailed guidelines on the mechanics of negotiating and agreeing an APA.

Over recent years, the European Commission has attacked tax rulings given to taxpayers by tax authorities in Member States on the basis that such rulings amount to an illegal tax benefit and so are contrary to EU State Aid rules. There have been a number of well-publicised examples, notably the August 2016 European Commission decision that tax rulings granted to Apple by Ireland amounted to state aid and the decision published on 4 October 2017 that rulings given by Luxembourg to Amazon in 2003 and 2011, amounted to selective tax treatment and state aid. In the light of these attacks, the position of UK APAs, notably those given to large multinational enterprises, needs to be monitored.

iv Tax clearances and rulings

Of particular relevance in the context of this book is that HMRC will provide advance rulings where there is significant inward investment into the United Kingdom amounting to more than £30 million or that, while less than that figure, may be regarded as significant to a particular region or in the wider public interest (SP2/2012). Under such rulings, HMRC will provide written confirmation of how HMRC will apply UK tax law to specific transactions or events. As stated above, the current attacks by the European Commission on tax rulings means the position needs to be monitored.

Statutory clearances can be sought under a number of statutory provisions, notably on share exchanges and certain types of restructuring and merger. Typically, these clearances do not confirm to the taxpayer that the conditions for relief are met, but simply that the relief’s availability will not be challenged on the basis that it is for tax-avoidance rather than for bona fide commercial purposes. Clearances are only effective if the taxpayer makes a full
and frank disclosure. There is generally a clear timetable that requires HMRC to respond within 30 days, although if HMRC feels that more information is needed, it can ask for such information, and when the taxpayer responds, the 30-day clock starts again from zero.

As well as formal statutory clearance, there is a procedure known as a Code of Practice 10 Ruling, which allows a taxpayer to seek clarification on how recent legislation (that being legislation introduced in the past four years) applies to it where there is material uncertainty. It is possible to request such a ruling going back beyond four years, but in such cases the taxpayer must show that the uncertainty is commercially significant to its business. HMRC will not give a ruling where it believes that the transaction that creates uncertainty is not a primarily commercial one, but is rather a tax-driven transaction or a tax-planning exercise.

A taxpayer may also approach HMRC informally, but is only likely to receive a satisfactory response if the informal ruling is a question in respect of a transaction that has already happened and the taxpayer is looking for guidance on how it should deal with an aspect of such transaction in its tax returns.

**X YEAR IN REVIEW**

The major theme in the UK in 2018 was uncertainty. As mentioned in the introduction, the impact of Brexit on trade generally and on trading taxes, notably on customs duty and tariffs, was unknown and remains so at the time of writing, making it difficult for businesses to plan ahead, particularly those engaged in cross-border trade. A change in the governing political party that may be one impact of Brexit would also be likely to result in material changes in the tax system.

On a micro level, the United Kingdom announced in the Autumn 2018 budget its plan to tax the digital economy. Reform of the taxation of the digital economy was identified as a key action point in the 2015 BEPS project but implementing reform has proved slow and contentious. The UK has responded by seeking to go it alone and has outlined a digital services tax (DST) to be introduced from April 2020. The proposal is that a 2 per cent tax will apply to the revenues above £25 million of certain digital businesses to reflect the value they derive from the participation of UK users, pending introduction of an international solution. Between now and 2020 the UK government will consult on the detail of the legislation in the Finance Act 2020.

**XI OUTLOOK AND CONCLUSIONS**

Until the outcome of Brexit becomes clearer it is hard to predict what lies ahead for the UK in the next few years. Recent surveys suggest that the UK is still seen as a business-friendly location but there is a danger that upheaval ahead will erode the benefit of the tax changes of recent years that helped to create this business-friendly environment.

However, whatever happens, the process of implementing the BEPS project is likely to continue irrespective of Brexit and any political changes, bringing with it an increasingly heavy and complex compliance and disclosure burden.
I INTRODUCTION

Foreign persons investing in the United States have great flexibility in determining the form and taxation of their investments. However, foreign investors should note that an investment in the United States may be subject to administrative, filing and tax requirements at the state and federal levels. At the federal level, US tax can be imposed on a ‘net’ basis on US business income (using available deductions, etc.) and on a ‘gross’ withholding basis on investment income.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

Foreign persons have several options with respect to the organisational form through which they conduct business in the United States (e.g., corporation formed under state law, general or limited partnership, or limited liability company). A foreign person can conduct business in the United States through either a US entity or foreign entity. However, from a tax perspective, regardless of the form chosen, the vehicle used generally will be considered either a corporation taxed at the entity level, with additional potential tax to the entity’s owner when funds are distributed; or a flow-through entity (e.g., partnerships) not subject to an entity-level tax, but with tax imposed directly at the owner (partner) level. Flow-through entities also can include entities treated as ‘branches’ for US tax purposes. The United States has far-reaching entity classification rules, the ‘check-the-box’ rules, which provide the ability in many cases to elect entity status as a corporation, partnership, etc.2

i Corporate

As a matter of corporate law, non-US investors may choose to invest in the United States either through a ‘regular’ corporation (a body corporate for state law purposes), or through a limited liability company or other entity, such as a partnership. For US federal income tax purposes, a regular corporation is subject to US tax at the corporate level. A special class of corporation that provides for ‘flow-through’ treatment (no entity-level tax) to investors, the ‘S’ corporation, is not available to non-US investors. With respect to other forms, such as LLCs, US tax rules generally permit the entity to elect to be taxed as a corporation or a

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1 Hal Hicks and Moshe Spinowitz are partners and Robert C Stevenson is an associate at Skadden, Arps, Slate, Meagher & Flom LLP.
2 Treasury Regulation, Section 301.7701-3.
flow-through entity. Other special types of investment entities, such as real estate investment trusts, generally have the status of a regular corporation and are subject to tax at the corporate level to the extent their earnings are not distributed.

Inbound businesses are often operated through a regular domestic corporation, or an entity formed in the United States that has elected to be taxed as a corporation. Operating through a domestic corporation offers a relatively simplified filing regime, in which the corporation files its tax return on IRS Form 1120, just like a domestic-owned corporation. If a single non-US investor owns 25 per cent of the voting power or value of the domestic corporation, certain additional filing requirements apply. In general, however, many investors prefer the relative anonymity and simplicity that this filing regime provides, as opposed to the filing requirements that apply if a US trade or business is conducted directly through a branch or flow-through entity. Operations through a domestic corporation also insulate a foreign corporate investor from the complex ‘branch profits’ tax (discussed below) applicable to non-corporate forms of business. In addition, only domestic corporations are eligible for certain deductions, such as a deduction for a portion of the corporation’s foreign-derived intangible income (FDII). There can, however, be US withholding on dividend distributions by the corporation. Further, whether operating through a domestic corporation or a branch or flow-through entity, certain inbound businesses are subject to a minimum tax on deductible payments to, and depreciation and amortisation of property purchased from, foreign related parties under the newly enacted Base Erosion and Anti-Abuse Tax (BEAT) discussed in more detail below.

ii Non-corporate

A non-US person wishing to invest in or operate a business in the United States may choose to do so through a pass-through entity (i.e., an entity not taxed at the entity level) that flows through the results of its operations to its owners. Generally, an entity with a single owner can be treated as ‘disregarded’ from its owner (that is, treated as a branch or division of its owner) or as a corporation, and an entity with multiple owners can be treated as a partnership or as a corporation. Regulations set forth general default classifications of single owner and multiple owner entities, with additional rules that generally permit the entity to adopt or change its classification, subject to certain limitations.3

Non-US partners that engage in a US trade or business through an entity treated as a partnership are treated as if they engage in a US trade or business directly, and generally are subject to US tax on their share of partnership income (regardless of whether distributed) at the same rates applicable to US partners. Generally, the partnership is obliged to withhold and pay over tax on the non-US partner’s distributive share of net business income at the maximum tax rate applicable to such person, and the non-US partner must file a tax return in the United States reporting such income and claiming credit for such withheld tax.4 Gain on the sale of an interest in a partnership that conducts a US trade or business is also subject to US tax and the proceeds from such sale can be subject to US withholding.5 This is one of the few areas where a US withholding tax is imposed on US business income (as opposed to US investment income, as discussed below).

3 Ibid.
4 Section 1446.
5 Sections 864(c)(8) and 1446(f).
Certain industries, such as the banking industry, typically operate directly in the United States through a branch. The United States taxes the branch on all income that is effectively connected with its US trade or business, and, in certain cases, applies special rules in computing the tax base. Transfers of ‘dividend equivalent amounts’ from the US branch back to the non-US home office trigger a 30 per cent branch profits tax, which may be reduced by treaty. The policy of the branch profits tax is to establish ‘branch–subsidiary parity’. The notion is that the United States should tax outbound remittances equally, whether they emanate from a US branch (including a partnership’s US operations) or a US corporation. Private equity investments will often be made through a pass-through entity such as a partnership, with non-US investors owning their partnership investment through a foreign or US corporate ‘blocker’ to avoid these complex rules.

In choosing between different forms of investment, non-US investors should also take into account whether the entity is likely to retain a significant portion of its earnings and whether the business might qualify for the new deduction for qualified pass-through business income under Section 199A. Because of the disparity between corporate and individual income tax rates, these considerations in addition to those listed above may make one form of investment more advantageous than the other.

III DIRECT TAXATION OF BUSINESSES
i Tax on profits

Determination of taxable profit

The United States imposes tax on ‘taxable income’, which is defined as ‘gross income’ less allowable deductions. Gross income is defined as gross revenues (receipts) less cost of goods sold. Allowable deductions include those for expenses that are ordinary and necessary to the conduct of the trade or business, such as salary and rental expenses of the business. Other expenses that may be deducted, subject to certain limitations, include interest expenses, depreciation and amortisation, state and local income taxes and real estate taxes, certain losses and worthless bad debts. A non-US person engaged in business in the United States is generally entitled to the same wide range of deductions as a US person, with a notable exception for the deduction for FDII.

Among the expenses that are non-deductible are certain excessive employee remuneration, ‘golden parachute payments’ made to executives in connection with a corporate change in control and expenses related to the production of tax-exempt income. In addition, the interest expense deduction to which certain businesses would otherwise be entitled is subject to limitations (discussed further below).

Taxable income is not based on accounting profits, but instead on the method required by the US Tax Code and applicable Treasury regulations. US corporations with assets above a certain threshold are required to reconcile their book and tax income on a separate schedule attached to their tax return.

6 Section 882.
7 Section 884.
8 Sections 11 and 63.
9 Section 162.
10 Sections 163 to 166.
11 Sections 162(m), 280G, 265.
Generally, taxpayers must compute their taxable income using the method of accounting that the taxpayer uses to compute book income. These methods could include the cash receipts method, the accrual method or any other permitted method. If the US Internal Revenue Service (IRS) successfully determines that the taxpayer’s method does not ‘clearly reflect’ its actual income, it may require the taxpayer to use another method. Once a taxpayer adopts a method of accounting, it generally must obtain the consent of the IRS to change its method.

US citizens and residents are taxed on worldwide income, while US corporations are taxed on a modified territorial basis. Previous law allowed deferral for certain active income earned abroad by a non-US corporate subsidiary until distributed as a dividend to a US corporation. The Tax Cuts and Jobs Act (TCJA), signed into law on 22 December 2017, moved away from this system of taxation by establishing a participation exemption for certain foreign income, a one-time ‘transition tax’ on certain past accumulated foreign earnings, and a current inclusion in income with regard to certain global intangible low-taxed income (GILTI) of such non-US subsidiaries. GILTI is generally defined as all income of non-US subsidiaries that is in excess of a fixed return on such subsidiaries’ tangible assets. Although the United States generally grants a ‘credit’ for certain non-US income taxes incurred by US taxpayers (foreign tax credit), no such credit is allowed for any taxes paid with respect to income that qualifies for the participation exemption.

Non-US taxpayers are generally taxed only on income that is effectively connected with a US trade or business (which generally includes US-sourced income and very limited types of foreign-source income), and on US-sourced income that is passive income, such as interest, dividends, rents and royalties. Non-US persons also may generally claim a foreign tax credit for non-US income taxes paid on income that is considered effectively connected with a US trade or business (other than taxes paid to their country of residence).

**Capital and income**

In general, for US corporate taxpayers there is no difference in the rate of tax applied to ordinary business income as opposed to capital gains. As discussed below, non-US persons generally are not subject to US tax on capital gains (the main exceptions being gains related to certain US real property, including gains realised on an interest in certain domestic corporations that hold US real property, and gains realised in connection with a US trade or business, including gains realised on an interest in a partnership conducting a US trade or business).

**Losses**

A US net operating loss (NOL) generally cannot be carried back but can generally be carried forward indefinitely (with special rules for insurance companies and for farming losses), subject to a limitation that the NOL used in a particular subsequent year cannot exceed 80 per cent of taxable income for such year. The deduction of losses is limited following certain types of ownership changes. An ownership change is generally deemed to occur

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12 Section 446.
13 Sections 27, 901, and 245A(d).
14 Section 906.
15 Section 172.
16 Section 382.
if there is a change in the stock ownership of a corporation aggregating to more than 50 percentage points over a three-year period. In such a case, the amount of ‘pre-change’ NOLs that may be deducted in each future year is generally limited to an amount of income each year equal to the value of the target corporation immediately before the ownership change multiplied by the long-term tax-exempt rate of interest published by the IRS for the month of the ownership change.

A capital loss can only offset capital gains. A capital loss can only offset capital gains. Excess capital losses may be carried back three years and forward five years. Because of the shorter carry-forward period for capital losses, taxpayers may seek to accelerate a capital gain to ensure that the capital loss does not expire unused.

Non-US corporations conducting a trade or business in the United States through a branch or other fiscally transparent entity must file an appropriate and timely tax return in the United States reporting any deductions or losses to preserve their ability to use any deductions or losses in future years.

Rates

Under previous law, corporations were subject to graduated rates and an alternative minimum tax (AMT) to the extent that tax exceeded the regular corporate tax. The TCJA reduced the federal corporate rate and repealed the AMT such that for tax years beginning after 2017, the corporate tax rate is a flat 21 per cent rate.

The TCJA also introduced the Base Erosion and Anti-Abuse Tax (BEAT), a minimum tax imposed in addition to any other income tax. The BEAT imposes a tax equal to the excess of 10 per cent of the taxpayer’s ‘modified taxable income’, less the taxpayer’s regular tax liability and certain specified tax credits (but without reduction for any foreign tax credit). Modified taxable income is taxable income computed without regard to base erosion tax benefits (i.e., deductions for payments to related foreign parties or depreciation or amortisation deductions on property purchased from related foreign parties). The BEAT only applies to (1) large corporations, other than RICs, REITs, or S corporations; (2) with annual gross receipts of at least $500 million for the three-tax year period ending with the preceding tax year; and (3) a base erosion percentage of 2–3 per cent. With certain limited exceptions, tax credits, including foreign tax credits, cannot be used to reduce the minimum tax due pursuant to the BEAT regime.

The rate of US withholding tax for outbound payments of US-sourced passive ‘investment’ income such as dividends, interest, rents and royalties is generally 30 per cent. This rate is subject to reduction or elimination pursuant to an income tax treaty between the United States and the recipient’s country of residence. If withholding does not properly occur, the foreign recipient of the payment must file a US tax return and pay the appropriate tax. Similarly, as discussed above, branch profits tax, if applicable, is also imposed at a rate of 30 per cent, and is subject to reduction or elimination by treaty.

17 Section 1211.
18 Section 1212.
19 Section 882(c). A similar rule also applies to non-corporate persons, Section 874(a).
20 Section 55(e) repealed by the TCJA.
21 Section 11 as amended by the TCJA.
Administration

A US corporation must generally file its income tax return on or before the 15th day of the fourth month following the end of its taxable year, although an automatic six-month extension is available and typically taken.\(^2\) As a result, a calendar year corporation usually files its returns by the following 15 October. A foreign corporation required to file a US income tax return with respect to its conduct of, for example, a US trade or business is required to file its income tax return on or before the 15th day of the sixth month following the end of its taxable year, although an automatic six-month extension is available.\(^3\) The tax owed for the year must be paid on or before the due date of the tax return (without extensions). Further, corporations must make estimated tax payments on a quarterly basis during the year, generally in an amount each equal to 25 per cent of the required annual payment.\(^4\) Special provisions apply to corporations with assets of $1 billion or more. The total quarterly payments must equal at least the lesser of (1) 100 per cent of the tax shown on the final return for the current year or (2) 100 per cent of the tax shown on the final return for the immediately preceding taxable year. Penalties apply if the estimated tax payments are less than these safe harbour amounts. For corporations with taxable income of at least $1 million during any of the three preceding taxable years, the required annual payment must equal 100 per cent of the current year’s tax liability; that is, the preceding year’s safe harbour in point (2) above cannot be used.

The most significant taxing authority for non-US taxpayers is the IRS, a division of the US Treasury Department.\(^5\) States and local jurisdictions, such as counties and cities, may impose additional taxes.

In general, there is no regular audit cycle. Special audit regimes may apply. For example, certain eligible taxpayers may be part of the compliance assurance process (CAP), which allows compliant taxpayers to resolve certain issues on an expedited basis, with the taxpayer and the IRS agreeing to the treatment of items by the time the tax return is filed, or shortly thereafter. The IRS expanded the CAP programme in 2011 to include pre-CAP (readying taxpayers to enter the CAP programme) and post-CAP (a maintenance stage for taxpayers with a low-compliance risk and low controversy rate) stages of the process. Certain large corporations may also be under continuous audit. Although no specific length of time is used for audit cycles, US corporations, for example, are typically audited for two to four taxable years at any one time.

Before a transaction is undertaken, taxpayers may seek private letter rulings from the IRS when there is uncertainty regarding the treatment of a transaction or an item of income. Each year, the IRS publishes a revenue procedure that details the steps to be taken in requesting a private letter ruling; the revenue procedure also describes those areas in which the IRS normally will not issue a private letter ruling. This general guidance is set forth in the first revenue procedure for the year.\(^6\) In addition, the seventh revenue procedure of each year\(^7\) discusses certain international issues regarding which the IRS will not, or ordinarily will not, issue a private letter ruling. Other forms of administrative filings for rulings are available. Among the most noteworthy are the ‘pre-filing agreement’ with the IRS and an

\(^2\) Sections 6072(b) and 6081.
\(^3\) Section 6072(c).
\(^4\) Section 6655.
\(^5\) Section 7803.
\(^6\) For example, Revenue Procedure 2018-1.
\(^7\) For example, Revenue Procedure 2018-7.
'advance pricing agreement' (APA) for transfer pricing issues with the ‘advance pricing and mutual agreement’ programme, which was formed from the recent combination of the APA Office and certain functions of the US competent authority.

If a taxpayer wishes to challenge a published IRS position on the treatment of an item, the taxpayer can minimise penalties (in the event that it ultimately fails in its challenge) by disclosing on its tax return that it is taking a position contrary to IRS guidance. If the IRS specifically challenges a taxpayer’s position on a tax return, the taxpayer generally has the opportunity to make an administrative appeal of the IRS determination. If the taxpayer does not succeed in its appeal, it may either file a petition in Tax Court (which does not require the taxpayer to pay the asserted deficiency), or it may pay the asserted deficiency and file a suit for refund in either a US federal district court or with the US Court of Federal Claims.

In addition, in certain cases where the IRS has proposed adjustments that result in a taxpayer being subject to double taxation or that should appropriately give rise to a correlative adjustment for a related person in a foreign country, the taxpayer may invoke the mutual agreement procedure of an applicable US tax treaty to attempt to resolve the issue.

**Tax grouping**

An affiliated group of US corporations may elect to file a consolidated income tax return. Non-US corporations generally are not ‘includible members’ in an affiliated group (with exceptions for certain Canadian and Mexican corporations), and therefore are not included in the consolidated group. The stock ownership requirements for an affiliated group are that the common parent must directly own at least 80 per cent of the stock (by vote and value) of at least one subsidiary in the group, and each other subsidiary in the group must be at least 80 per cent directly owned (by vote and value) by one or more of the other members of the group. An election made by the common parent to file a consolidated return applies to all corporations for which the ownership requirements are met.

Under the theory that a consolidated group is a unified entity, assets, losses, dividends and interest can generally move within a group without current tax cost. The consolidated group rules focus, however, on an item of income’s location, and therefore intercompany transactions will ultimately trigger tax when the item is no longer capable of being reflected in the consolidated group. Income and losses of a group member generally give rise to adjustments in the stock of that member held by other members.

In general, a consolidated group determines its income tax liability by computing the separate taxable income of each member as if it were filing a separate return, but excluding income and deductions that are determined on a group basis, and computing income and deductions on a group basis, such as the NOL deduction. Credits, determined on a group basis, may be available to offset the consolidated income tax liability. Each member of the group is jointly and severally liable for the total tax liability of the entire group.

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28 Treasury Regulation, Sections 1.6662-3 and -4; IRS Forms 8275 and 8275-R.
29 Section 1501.
30 Sections 1504(b) and 1504(d).
31 Treasury Regulation, Section 1.1502-77.
32 Treasury Regulation, Section 1.1502-13.
33 Treasury Regulation, Section 1.1502-32.
34 Treasury Regulation, Section 1.1502-11.
35 Treasury Regulation, Section 1.1502-6.
Losses incurred by a corporation while it is a member of the group are available to offset another member’s income. Losses incurred before a corporation joins a consolidated group are subject to ‘separate return limitation year’ rules, generally permitting use of such losses only to the extent of the corporation’s contribution to the consolidated group’s positive net income. Special limitations also apply to ‘dual consolidated losses’, generally defined as an NOL of a domestic corporation (or component thereof) that is also subject to tax in a foreign country. Thus, for example, a US corporation tax resident in the United Kingdom generally cannot offset its NOL against another member’s income unless it elects to use the loss only in the United States. If such an election is made, the loss could be used in the United Kingdom after five years, provided that UK law permits the loss to be claimed.

ii Other relevant taxes
The United States does not impose value added tax (VAT) or sales tax at the federal level, although many states, counties and cities do impose a sales tax on the sale of goods. The United States also does not impose stamp duty, capital duties, registration taxes or net wealth taxes. US employers have payroll tax obligations, including paying obligations for US social security and Medicare taxes and withholding from employee wages. The United States has considered a federal VAT (or similar tax) from time to time, either as an additional tax or as a replacement for income tax. So far, however, no such tax has been enacted.

IV TAX RESIDENCE AND FISCAL DOMICILE
i Corporate residence
The United States does not generally employ the concept of corporate ‘residency’ based on the seat of management. Instead, how a corporation is taxed is generally based on its place of incorporation, and not where it is managed or controlled. In some circumstances, a non-US corporation can elect to be treated as a US corporation, or in some cases generally designed to prevent a perceived abuse, a foreign corporation may be deemed to be a US corporation.

In recent years, certain members of Congress have periodically proposed legislation that would define a corporation’s residency for US tax purposes based on where it is managed and controlled. This legislation, if ever enacted, would represent a significant change in the US tax treatment of both US and non-US corporations. In addition, the prior Obama administration enacted and the current Trump administration finalised changes to the corporate residence rules that significantly expanded the scope of existing anti-abuse provisions, which potentially cause non-US-incorporated entities to be treated as US corporations for tax purposes, in particular when such non-US-incorporated entities have engaged in cross-border business combination transactions with US corporations.

ii Branch or permanent establishment
If a non-US person conducts sufficient activities in the United States, it will be ‘engaged in a US trade or business’, and income that is ‘effectively connected’ to such business generally

36 Section 1503(d).
37 Sections 3102, 3111 and 3301.
38 See, e.g., Sections 953(d), 897(i), 1504(d).
39 See, e.g., Sections 269B and 7874.
is subject to net basis tax. The threshold of activities needed to constitute a US trade or business is not precisely defined, but factors derived from case law include whether there are ‘regular and continuous’ activities within the United States, including through employees or agents. To secure greater tax parity between a US subsidiary and a US branch, a 30 per cent ‘branch profits’ tax may apply when the US branch makes distributions (or is deemed to make distributions) to its home office. This is the same rate of US withholding tax that applies to dividend distributions by US corporations. Just as US tax treaties may reduce withholding tax on corporate distributions, so do they provide for a common, reduced rate of withholding that applies to branch remittances. Some US treaties even provide for the complete elimination of branch profits tax. The United States no longer imposes a ‘secondary’ withholding tax on dividends paid by a non-US corporation.

If the non-US entity is a resident of a jurisdiction with which the United States has an income tax treaty, the entity will generally become subject to tax on its ‘business profits’ that are attributable to a US permanent establishment (PE) maintained by the non-US entity. The PE standard generally requires a non-US entity to have a greater nexus with the United States than is required to be considered ‘engaged in a US trade or business’. The relevant treaty and domestic law provide rules regarding the definition of a PE and, if a PE exists, the amount of income and expenses that are attributable to that PE and subject to US tax. The rules for attributing income and capital to a PE are generally based on OECD standards, and may result in differing amounts of income and deduction than under the US rules that apply in determining the non-US entity’s effectively connected income. US tax treaties generally require a non-US entity to consistently apply either the PE rules or the US effectively connected rules in determining its income subject to US tax.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes

Prior to the passage of the TCJA, potential double taxation was generally addressed with respect to non-US income paid to a US person or branch of a non-US corporation through the US foreign tax credit regime and the relief from double taxation articles of US tax treaties. Recently, however, to encourage US corporations to repatriate earnings, the United States enacted a provision under the TCJA which exempts certain foreign earnings from taxation. This new ‘participation exemption’ system allows certain US corporations a 100 per cent dividends received deduction (DRD) for the ‘foreign-source portion’ of dividends received from a ‘specified 10 per cent owned foreign corporation.’ Because, as of the time of writing, the IRS has yet to issue regulations or publish guidance under the directive of Section 245A(g), it is uncertain how, or whether, the DRD would apply to a domestic corporation that indirectly owns shares in a foreign corporation through its interest in a partnership. The GILTI regime, discussed further below, significantly reduces the otherwise expansive scope of the DRD by making a significant portion of a non-US subsidiary’s earnings subject to current US taxation at a reduced rate.

40 See, e.g., Section 882.
41 Section 884.
42 Section 245A(a) and (c).
Importantly, unlike some other countries, the United States does not generally impose any tax on the sale of capital assets (such as stock) by non-US persons. One key exception to the general rule relates to the sale of certain ‘US real property interests’ (USRPI), which may require the purchaser to withhold 10 per cent of the consideration paid for the property. No withholding is required if the non-US person transfers stock in a non-US corporation that holds the USRPI. Other important exceptions relate to deferred payments for property or services, and the sale of assets that are used (or within the prior 10 years were used) in a US trade or business (e.g., depreciable assets). Generally, the US taxation of such income or gain from such payments or sales is determined based on the facts existing when the property or service was provided, without regard to whether the non-US entity is engaged in a US trade or business in the taxable year the income or gain is received. The United States does not impose a withholding tax on ‘portfolio interest’, discussed further below.

### ii IP regimes

Research and development (R&D) expenses paid or incurred in tax years before 2022 may be deducted in the year incurred or amortised over five years. Beginning in 2022, R&D expenses must be capitalised and amortised over five (or 15) years. The United States also provides a 20 per cent R&D credit for expenses that exceed a base amount determined by reference to a percentage of the taxpayer’s average annual gross receipts for the preceding four taxable years.

### iii FDII

The TCJA also adopted a new regime that generally allows domestic corporations to deduct 37.5 per cent of its foreign derived intangible income (FDII) for tax years beginning 2017, decreased to 21.875 per cent of FDII for tax years beginning after 2025. Very generally, a domestic corporation’s FDII is equal to the excess of income earned selling certain goods and services or licensing or leasing property to non-US persons for use outside the United States over the corporation’s deemed return on investments in tangible assets.

### iv General

Certain tax credits (particularly for renewable energy) and accelerated depreciation deductions can reduce the tax cost of running a US business. The TCJA made extensive changes to the depreciation (and expensing) rules, including changes to Section 168(k) which provide a 100 per cent first-year depreciation deduction for certain ‘qualified property’. Additionally, states and local jurisdictions may have investment incentives.

The relatively extensive advance pricing and mutual agreement programme (discussed further below), which can include ‘bilateral’ agreements with other taxing jurisdictions, may

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43 Section 897.
44 Section 1445.
45 Section 864(c)(6) and (c)(7).
46 Section 174 repealed by the TCJA.
47 Section 174(a) as amended by the TCJA.
48 Sections 38 and 41 as amended by the TCJA.
49 Section 250.
50 Sections 48 and 168 as amended by the TCJA.
help minimise tax controversy for an inbound investor. Investors also benefit from the fact that the United States does not generally impose any tax on the sale of capital assets by non-US persons, unless the asset is a ‘US real property interest’.\(^51\)

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)

A US person must generally withhold 30 per cent of the gross amount of certain US ‘investment’ income paid to non-US persons, such as dividends, interest and royalties, and certain dividend equivalent amounts.\(^52\) This statutory rate, however, can be reduced (and up until 2018 could be eliminated) by an applicable bilateral treaty. Many US bilateral treaties reduce the withholding tax rates on interest or royalties to zero, but as discussed in detail above, for certain taxpayers, the BEAT functionally disallows deductions with regard to deductible payments to related foreign persons below a minimum percentage.\(^53\) A recent treaty trend has been to reduce the withholding tax on certain dividend distributions to zero if certain ownership and holding period requirements are met. In certain cases, the US tax rules treat certain payments or distributions by foreign persons (e.g., a foreign partnership) as US-sourced income subject to withholding.\(^54\)

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

A portfolio interest exception applies to eliminate US withholding tax on certain interest payments to non-US corporations and individuals.\(^55\) This exception is fairly broad and operates as a matter of domestic US tax law, regardless of the application of any bilateral treaty. The interest recipient must establish its ability to claim the exception by providing documentation to the payor. The exception does not apply to:

- a interest paid to a 10 per cent shareholder of the payor and certain other related persons;
- b interest paid to a controlled foreign corporation (CFC) that is a related person;
- c payments to certain foreign banks;
- d payments on non-registered instruments (i.e., bearer bonds); and
- e contingent interest (i.e., dependent on metrics related to sales, profits, etc.).

In limited circumstances, a foreign person receiving an interest or dividend payment may be exempt from withholding when it receives the payment from a domestic corporation with a significant portion of its gross income from non-US sources.\(^56\) A recent statutory change eliminated these rules in most cases.

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51 Section 897.
52 Sections 871(m), 1441 and 1442. Further, amounts paid by US corporations or non-corporate US residents for guarantees issued after 27 September 2010 are treated as US-sourced payments subject to withholding, Section 861(a)(9).
53 Section 59A.
54 Sections 861(a)(1)(B).
55 Sections 871(h) and 881(c).
56 Sections 861(a)(1)(A) and 871(i)(2)(B).
Outside of the treaty context, or unless the recipient is a non-US sovereign, the United States does not have exemptions from withholding on outbound dividend or royalty payments. Certain income of non-US sovereigns is exempt from US federal income tax, including income received from investments in the United States of stocks and bonds or other US securities, and income from financial investments held in the execution of governmental, financial or monetary policy. The exemption does not apply to income derived from a commercial activity, any income received by or from a controlled commercial entity, or income from the disposition of an interest in such entity.

### iii Double tax treaties

The United States has approximately 60 income tax treaties covering 68 countries. The treaty network is most extensive in Europe, is expanding in Asia (e.g., negotiations are ongoing with Vietnam), and is limited in South America and Africa. Generally, these income tax treaties reduce the US withholding tax on dividends, interest and royalty payments to residents of a treaty country, provided that the beneficial owner is a resident of the treaty country and meets the anti-treaty shopping provision (i.e., the limitation on benefits (LOB) provision) of the applicable treaty. The current negotiating position of the United States is reflected in its 2016 model income tax convention, which contains certain significant changes from the prior 2006 model income tax convention. The changes generally deny treaty benefits on payments by expatriated entities (generally, US companies that have engaged in an ‘inversion’ transaction), where income is subject to a special tax regime in the country of receipt and where a country reduces its tax rates below a certain threshold. The United States typically uses its own US model treaty rather than, for example, the OECD model, as the starting point for negotiations.

With respect to dividends, the US position is generally to provide for a maximum of 5 per cent withholding if the shareholder holds 10 per cent or more of the US resident corporation, and 15 per cent in all other cases. In an increasing number of US treaties, the United States has agreed to forgo withholding on dividends if the shareholder holds 80 per cent or more of the US tax-resident corporation. This elimination of US dividend withholding tax typically requires updated LOB and exchange of information provisions.

With respect to interest and royalty payments, the general US position is to eliminate withholding.

The table at Appendix I, below, summarises the withholding rates applicable to dividend, interest and royalty payments under the double taxation treaties concluded by the United States.

### iv Taxation on receipt

The United States permits US corporations to credit foreign income taxes (or taxes imposed in lieu of a foreign income tax) against the US tax liability on non-US dividends and other income flows. In general, many non-US withholding taxes are creditable in the United States provided that certain requirements (such as a minimum holding period) are met. Under prior law, if a US corporation owned at least 10 per cent of the total voting power of a foreign

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57 Section 892(a)(1).
58 Section 892(a)(2).
59 Sections 27 and 901.
corporation’s stock, the US corporation could claim a ‘deemed paid’ credit for foreign taxes that the foreign corporation actually paid on its income, once the US corporation received a dividend (or was deemed to receive a distribution under the US anti-deferral regime) from the foreign corporation.\textsuperscript{60} If a US corporation claimed a deemed paid credit, it also had to increase its income in the year the dividend was received by the amount of the foreign taxes deemed paid, whether or not the US corporation, after application of various limitation provisions, was able to use the credit to reduce its US tax liability.\textsuperscript{61}

The TCJA repealed the deemed-paid credit with respect to dividends received by a US corporation that owns 10 per cent of the total voting power of a foreign corporation’s stock. Instead, earnings of foreign corporations can generally be repatriated free of tax under the participation exemption system of taxation discussed above and subject to the GILTI regime discussed below. The deemed-paid credit regime generally remains in place for the portion of a foreign corporation’s foreign income taxes that are properly attributable to the Subpart F income or GILTI of that corporation.\textsuperscript{62}

\textbf{v} \hspace{1em} \textbf{Foreign Account Tax Compliance Act (FATCA)}

FATCA is a complex reporting regime intended to encourage US persons to report ownership of offshore accounts; however, the provisions affect, \textit{inter alia}, non-US entities and financial institutions receiving payments from US sources, directly or indirectly. Under FATCA, withholding at a rate of 30 per cent would apply to certain payments to (or through) certain financial institutions (including investment funds), unless such institution:

\begin{itemize}
\item[a] enters into, and complies with, an agreement with the IRS to report, on an annual basis, information with respect to interests in, and accounts maintained by, the institution that are owned by certain US persons or by certain non-US entities that are wholly or partially owned by US persons and to withhold on certain payments;
\item[b] if required under an intergovernmental agreement between the United States and an applicable foreign country, reports such information to its local tax authority, which will exchange such information with the US authorities; or
\item[c] otherwise qualifies for an exemption.
\end{itemize}

Similarly, certain amounts payable to a non-financial non-US entity generally will be subject to withholding at a rate of 30 per cent, unless such entity certifies that it does not have any ‘substantial United States owners’, provides certain information regarding the entity’s ‘substantial United States owners’ or otherwise qualifies for an exemption. The Treasury Department has entered into agreements for the implementation of FATCA with the competent authorities of other countries, including Canada, France, Germany, Italy, Japan, Spain, Switzerland and the United Kingdom, which agreements modify certain of these provisions.

\textbf{VII} \hspace{1em} \textbf{TAXATION OF FUNDING STRUCTURES}

Entities may be funded with capital contributions or with debt funding, but there must be some member with an equity interest in the entity. The US tax rules generally permit a

\begin{footnotes}
\item[60] Sections 902 repealed by the TCJA and 960 before amendment by the TCJA.
\item[61] Section 78.
\item[62] Section 960 as amended by the TCJA.
\end{footnotes}
deduction for interest payments made on indebtedness, but do not permit a deduction (or deem a deduction) on capital infused in an entity in exchange for equity. Regardless of the entity’s form, contributions of cash or property when forming an entity are generally tax-free for the contributor and the receiving entity.

i Characterisation of funding as debt or equity
The characterisation of an instrument as debt or equity for US federal income tax purposes generally depends on all the surrounding facts and circumstances. Because the US Tax Code does not contain a single defined set of standards for purposes of distinguishing between debt and equity, taxpayers generally rely on case law and certain published pronouncements of the IRS to guide them in making general debt–equity determinations. Courts and the IRS have articulated certain factors that are relevant in determining whether an investment, analysed in terms of its economic characteristics, constitutes risk capital largely subject to the performance of the issuer’s business (thus making the investment more like equity) or, alternatively, exhibits the characteristics of a bona fide loan that is expected, or may be compelled, to be repaid in full (thus making the instrument more like debt).

In an effort to discourage ‘earnings stripping’ out of the United States, on 13 October 2016 the US Treasury Department and the IRS issued final and temporary Treasury regulations under Section 385 of the Internal Revenue Code that materially impact the treatment of certain related-party debt issued by issuers that are domestic corporations (including disregarded entities and certain partnerships owned by domestic corporations). These new regulations generally operate to convert certain instruments that are otherwise classified as indebtedness for US federal income tax purposes into equity (and thus convert interest and principal payments on such debt as distributions on equity). The new regulations generally apply to convert into equity debt instruments issued by domestic corporations (including disregarded entities and certain partnerships owned by domestic corporations) to certain related parties (such as a non-US parent corporation or a non-US finance entity that is directly or indirectly owned by the same parent corporation that owns the domestic issuer) if:

a such instruments are issued without satisfying certain documentation requirements;
b such instruments are issued in certain prohibited transactions, such as a distribution of the instrument to a related party; or
c if the issuer of such instrument engages in certain prohibited transactions, such as a distribution of property to a related person that is funded by or occurs within three years before or after the issuance of such instrument.

The US Treasury Department and the IRS have proposed to eliminate the documentation requirements that would otherwise come into effect in 2019.

ii Thin capitalisation
Under the new ‘business interest deduction limitation’ passed as part of the TCJA, the interest deduction to which certain taxpayers would otherwise be entitled (after application

63 Section 163.
64 See TD 9790.
of other statutory limitations) is generally limited to the sum of (1) 30 per cent of the taxpayer’s ‘adjusted taxable income’ (roughly equivalent to earnings before interest, taxes, depreciation and amortisation for tax years beginning before 1 January 2022) and (2) any interest includible in the taxpayer’s income for the taxable year.\textsuperscript{66} If a taxpayer has interest disallowed for a tax year as a result of this new provision, such interest may be carried over to the following tax years indefinitely, subject to restrictions applicable to certain partnerships;\textsuperscript{67} any excess limitation, however, is not able to be carried forward. In late 2018, the IRS issued several packages of proposed regulations under the TCJA, including regulations addressing the interaction between this new business interest deduction limitation and the BEAT as well as other regulations.

### iii Deduction of finance costs

Interest deductions may be limited if the interest is:

\textit{a} paid with respect to certain acquisition indebtedness that is subordinated and convertible into equity, and the issuer’s debt-to-equity ratio exceeds two-to-one, or projected earnings do not exceed three times the interest on the acquisition debt;\textsuperscript{68}

\textit{b} paid on certain high-yield obligations;\textsuperscript{69}

\textit{c} payable either in cash or equity of the issuer (or a related party);\textsuperscript{70}

\textit{d} paid or accrued by or to a hybrid entity or pursuant to a hybrid instrument;\textsuperscript{71} or

\textit{e} related to tax-exempt income (e.g., debt incurred to acquire tax-exempt securities).\textsuperscript{72}

Finance costs may generally be deducted by a US debtor, although certain rules may require that these costs be capitalised if related to inventory property or deducted over the term of the financing.

### iv Restrictions on payments

The ability to pay dividends is governed by state, not US federal, law. Many states, such as Delaware, do not impose burdensome restrictions on the ability to pay dividends. In general, a corporation needs either ‘surplus’ or net profits from the fiscal year in which the dividend is paid (in the latter case, provided that capital represented by outstanding stock of classes having a preference upon the distribution of assets is not impaired).\textsuperscript{73} It is important to note, however, that the definitions of ‘dividend’ for state law and US federal income tax law are not coterminous. For example, a distribution could constitute a dividend under state law because it is paid out of ‘surplus’, while it may not constitute a taxable dividend for US federal income tax purposes because the corporation has no ‘earnings and profits’ (a tax concept that roughly corresponds with taxable income, plus adjustments).\textsuperscript{74}

\begin{itemize}
\item \textsuperscript{66} Section 163(j) as amended by the TCJA.
\item \textsuperscript{67} Section 163(j)(2) and (j)(4)(B)(i)(I).
\item \textsuperscript{68} Section 279.
\item \textsuperscript{69} Section 163(e)(5).
\item \textsuperscript{70} Section 163(l).
\item \textsuperscript{71} Section 267A.
\item \textsuperscript{72} Section 265.
\item \textsuperscript{73} 8 Del C, Section 170.
\item \textsuperscript{74} Sections 312 and 316.
\end{itemize}
v Return of capital
Distributions are treated first as taxable ‘dividends’ to the extent the distributing corporation has ‘earnings and profits’; distributions beyond this amount are tax-free ‘return of capital’ distributions; any distribution amounts greater than a taxpayer’s capital are treated as capital gain (generally not taxable for a non-US person).75

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition
Taxable acquisitions of US corporations are frequently structured as cash mergers, whereby a non-US acquiring corporation funds a transitory US merger subsidiary with equity and debt, after which the merger subsidiary merges with and into the US target corporation, with the latter surviving. The acquisition debt resides with the US target corporation after the transaction, providing a means to reduce the US tax base.

Generally, there is no US withholding tax when a non-US corporation acquires a US corporation. However, if the US corporation is a ‘US real property holding corporation’, then the acquiring corporation generally would be obliged to withhold 10 per cent of the consideration paid to any non-US sellers.76

ii Reorganisation
The United States has very flexible rules that permit merging and demerging (or ‘spinning off’) corporations on a tax-free basis.77 Mergers, stock combinations or asset acquisitions generally can be implemented on a tax-free basis within the United States. If a non-US entity acquires the stock or assets of a US corporation, there are several requirements that must be satisfied. These rules are focused on preventing an ‘inversion’, whereby a US corporation moves to a non-US jurisdiction with substantial continuity of its existing shareholder base, and, somewhat related, the loss of US taxing jurisdiction over corporate assets. If a transaction violates anti-inversion rules, the US shareholders or the US target could be subject to tax or, in certain cases, the non-US acquiring corporation could actually be treated as a US corporation for all US federal income tax purposes.78 Generally, foreign-to-foreign reorganisations do not give rise to US tax, except in certain cases where there is significant (i.e., controlling) US ownership of the acquired or target foreign corporation before but not after the transaction.79

iii Exit
Under prior law, relocating outside the United States was an issue of great interest to many US taxpayers, given the relatively high US corporate tax rates and broad tax base. Although less attractive after the TCJA’s reduction of US corporate income tax rates, a US corporation may nevertheless wish to exit the United States. In order to do so, either its stock or assets must be transferred to a non-US corporation. Two different sets of rules limit a US corporation’s ability to ‘invert’ to a non-US jurisdiction.

75 Section 301(c).
76 Section 1445.
77 Sections 368 and 355.
78 Treasury Regulation, Section 1.367(a)-3(c); Section 7874(b); Section 367(a)(5).
79 Treasury Regulation, Section 1.367(b)-4.
The Section 367 Internal Revenue Code rules tax US shareholders on gain in stock of a US corporation that is transferred to a foreign corporation, unless several requirements are met. These requirements include that the foreign acquiring corporation be at least as valuable as the US target corporation, and conduct an active foreign trade or business. Further, a US parent corporation generally will recognise gain on assets that it transfers to a foreign acquiring corporation even if the transaction otherwise qualifies as a non-taxable asset reorganisation. For this reason, it generally is necessary to transfer the stock, rather than assets, of a US corporation that wishes to exit the US.

The Section 7874 Internal Revenue Code rules apply at the entity level, and can treat a foreign acquiring corporation as a US corporation for all US federal income tax purposes if:

a. the foreign acquiring corporation acquires substantially all the assets (either directly or through a stock acquisition) of the US target corporation (or substantially all the properties constituting a trade or business of a US partnership);

b. at least 80 per cent of the stock of the foreign acquiring corporation is owned by former shareholders of the US target corporation (or US partnership) by reason of having owned the US target; and

c. the foreign acquiring corporation's expanded affiliated group lacks 'substantial business activities' in the jurisdiction in which the foreign parent corporation is incorporated. Treasury regulations finalised in 2015 require that at least 25 per cent of a foreign acquiring corporation's expanded affiliated group's employees, assets and income be located or derived from the relevant foreign jurisdiction for there to be substantial business activities in such foreign jurisdiction.80

Alternatively, if the above requirements are satisfied but the ownership continuity is at least 60 per cent (but less than 80 per cent), then the foreign acquiring corporation is respected as a foreign corporation; however, the US target will not be able to use any attributes (such as losses or foreign tax credits) against any gain that the US target corporation recognises (or royalty income it receives from affiliates) by reason of property transfers during the 10 years that follow the inversion. Under the TCJA's new recapture provision, a corporation that undergoes such a 60 per cent inversion during the 10 years after 22 December 2017 may also have to increase its tax by an amount equal to 35 per cent of its income exempted under the participation exemption regime.81 In addition, Treasury regulations generally make it more difficult to satisfy the above-mentioned ownership thresholds and restrict the ability of such multinational corporate groups that do successfully invert to efficiently access their global cash flow and integrate their non-US operations.82

A special excise tax may also apply to certain stock compensation of insiders or large shareholders of a US corporation that inverts to a foreign jurisdiction.83

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80 Treasury Regulation Section 1.7874-3. Regulations also require that the foreign parent's tax residence be located in the relevant foreign jurisdiction.

81 Section 965(l)(1) as amended by the TCJA.

82 Treasury Regulation Section 1.7874-5T et seq.

83 Section 4985.
A non-US person’s disposition of assets used in a US trade or business will be subject to US tax; however, a disposition of stock in a US or foreign corporation conducting a US business will generally not give rise to US tax unless, in the case of stock of a US corporation, the corporation is considered a US real property holding corporation.

Entities operating in partnership form are generally able to relocate their business to a foreign partnership without US tax.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

Anti-avoidance doctrines developed through common law (i.e., court decisions) include the ‘step transaction’ doctrine, the ‘business purpose’ requirement (imposed on reorganisations and spin-offs) and the ‘economic substance’ doctrine. In 2010, Congress codified the common law ‘economic substance’ doctrine with substantial penalties for transactions subject to the provision (discussed further below). This codification had been contemplated for some time and was controversial within the tax community. Anti-deferral rules discussed immediately below are generally aimed at income received in low-tax jurisdictions. The United States also seeks to police treaty shopping in low-tax jurisdictions by negotiating for a strict ‘limitation on benefits’ in its treaties.

ii Controlled foreign corporations (CFCs)

The US CFC regime is expansive and imposes current US tax on ‘subpart F income’, an umbrella term that comprises:

- passive income (foreign personal holding company income);
- income earned in a jurisdiction resulting from related party transactions where there may be little activity and value added in the foreign jurisdiction where the CFC is created or organised (sales and service income);
- certain insurance income; and
- certain other types of income.

With respect to foreign personal holding company income, a key exception is the ‘same country exception’ whereby certain payments of dividends, interest and royalties between corporations in the same jurisdiction do not give rise to current tax in the United States. Additional temporary exceptions are provided for payments received from related CFCs that are not attributable to subpart F income, and ‘qualified banking or financing income’.

84 Sections 882 and 864(c)(7).
85 Sections 897 and 1445.
86 Section 7701(o).
87 Section 952.
88 Section 954(c).
89 Section 954(d).
90 Section 953.
91 Section 953(a)(3), (4) and (5).
92 Section 954(c)(3).
93 Section 954(c)(6) and (h).
A foreign corporation generally is a CFC if more than 50 per cent of the vote or value of the foreign corporation is owned by ‘United States shareholders’, which are defined as US persons owning at least 10 per cent of the total vote or value of all classes of stock of the foreign corporation. The US has an extensive constructive ownership attribution regime. Under this regime, a shareholder that does not directly hold a 10 per cent interest may still be classified as a United States shareholder if the shareholder is attributed stock of other shareholders and, as a result, that shareholder indirectly holds a 10 per cent interest. Another anti-deferral regime applies, without regard to the level of US ownership, to a foreign corporation classified as a ‘passive foreign investment company’ (PFIC). A foreign corporation is classified as a PFIC with respect to any US shareholder if at least 75 per cent of its gross income is passive income or if at least 50 per cent of its assets are passive assets.

### iii Transfer pricing

The US transfer pricing regime is based upon the familiar tax principle that transactions between commonly controlled entities must be priced at ‘arm’s length’. There is no precise definition of what constitutes common control. Penalties of up to 40 per cent may apply if a taxpayer’s price deviates significantly from the ultimately determined arm’s-length price. Taxpayers can avoid penalties by preparing contemporaneous documentation of a reasonable choice of method to determine the appropriate price. Regulations also provide detailed descriptions of methods, and the taxpayer is required to use the ‘best method’ to determine the appropriate price. For sales of tangible property, these methods include:

- the comparable uncontrolled price method;
- the resale price method;
- the cost-plus method;
- the comparable profits method;
- the profit-split method; and
- the unspecified methods. 97

For transfers of intangible property, a fundamental principle is that the income received must be ‘commensurate with the income attributable to the intangible’. The methods include:

- the comparable uncontrolled transaction method;
- the comparable profits method;
- the profit-split method; and
- the unspecified methods. 98

Fairly recent guidance has also been provided regarding transfer pricing of controlled services transactions. 99 The methods include:

- the services-cost method;
- the comparable uncontrolled services price method;
- the gross services margin method;

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94 Section 957.
95 Section 951(b) as amended.
96 Sections 1291 to 1298.
97 Treasury Regulation, Section 1.482-3.
98 Treasury Regulation, Section 1.482-4.
99 Treasury Regulation, Section 1.482-9.
d the cost of services-plus method;
e the comparable profits method;
f the profit-split method; and
g the unspecified methods.

A very significant element of the transfer pricing regulations pertains to ‘cost sharing’, where parties develop and own IP based on their share of cost and risk, comparable to the terms unrelated parties would adopt. The major benefit of a qualified cost-sharing agreement is that the IRS is limited to adjusting the ‘inputs’ or allocated costs of the IP development, and cannot adjust the potentially much larger ‘outputs’ (i.e., income) attributable to the cost-shared IP.

As discussed in further detail below, many taxpayers find it advantageous to enter into an APA with the IRS, which generally precludes the IRS from challenging the relevant transfer pricing for a specified period contained in the agreement.

iv GILTI
A US shareholder of a CFC must include in gross income its share of each of its CFC’s GILTI using mechanics similar to other Subpart F income inclusions. GILTI is the sum of ‘net tested income’ (or losses) over the shareholder’s ‘net deemed tangible income return’. Net tested income (or losses) is generally equal to 10 per cent of a CFC’s basis in tangible depreciable property. Broadly, net tested income excludes ECI, Subpart F income, foreign oil and gas extraction income, certain related-party dividends, and non-economic transactions intended to affect tax attributes of US shareholders and their CFCs. Foreign tax credits are allowed for foreign income taxes paid with respect to GILTI, but are limited to 80 per cent of foreign income taxes paid and cannot be carried forward or back or used to offset any other income. In addition, while both corporate and non-corporate US shareholders must include their GILTI in income, generally only domestic corporations are entitled to a 50 per cent deduction on the gross income included GILTI (effectively cutting the applicable tax rate on GILTI in half for domestic corporations).

v Tax clearances and rulings
Taxpayers may seek private letter rulings when there is uncertainty regarding the treatment of a transaction or an item of income. Each year the IRS publishes a revenue procedure that details the steps to be taken in requesting a private letter ruling; the revenue procedure also describes those areas in which the IRS normally will not issue a private letter ruling. Tax clearances are not required for the acquisition of a US business.

The IRS will also enter into APAs with taxpayers to ensure that transfer pricing is not challenged. A taxpayer may also be able to enter into a pre-filing agreement, which ensures that the IRS will not challenge how a taxpayer reports certain positions on its return for a specified number of years. US tax treaties generally contain a provision that allows for a ‘competent authority agreement’, which grants the benefit of a treaty article the terms of which are not otherwise technically satisfied.

100 For recent guidance, see TD 9441.
101 Section 904(c).
102 Section 250.
X YEAR IN REVIEW

The TCJA, which was signed into law in late December 2017, introduced the most dramatic changes in US federal income taxation in the past three decades. In addition to the massive overhaul of the US outbound taxation regime, the TCJA made several significant changes relevant to inbound investors, such as the BEAT and expanded interest expense limitations. As a result of the changes, the clear focus of both tax administrators and taxpayers in 2018 has been on interpreting the provisions of this new tax regime. Numerous questions have been raised as to the proper interpretation of, and as to technical errors in, the TCJA, and the Treasury and the IRS have been working diligently to release guidance, particularly in those areas most critical to taxpayers. At the time of writing, only proposed regulations have been released with regard to the new provisions under the TCJA, with more expected.

XI OUTLOOK AND CONCLUSIONS

The Treasury and the IRS have been focused on drafting guidance relating to the TCJA, and several packages of proposed regulations have been issued, with final regulations expected in the coming year. In addition, Congress is expected to work towards certain technical corrections, and potentially even additional tax reform. There can be no certainty, however, as to what additional tax legislation, if any, Congress may pass in the coming year. In addition, because of the novelty of many of the tax reform provisions, such as the BEAT, FDII, GILTI, etc., there may be some uncertainty as to the long-term prospects for these and other provisions all remaining in their current form.
## Appendix I: Domestic and treaty rates for dividends, interest and royalties

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<th>Dividends</th>
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* Generally, the lower non-zero rate applies if the corporate shareholder owns at least 10 per cent of the voting stock of the US corporation. The text of the treaty should be consulted.
† The treaty concluded between the United States and the former USSR.
‡ The zero per cent rate generally applies if the corporate shareholder owns 80 per cent or more of the voting stock of the US corporation for a 12-month period and qualifies under certain provisions of the limitation on benefits article of the treaty. The text of the treaty should be consulted.
I  INTRODUCTION

The Venezuelan market has been less active than other Latin American markets, mainly because of its political and economic instability, high inflation rates and strict foreign exchange control. Investments in Venezuela mainly continue to involve infrastructure, energy projects and regional or worldwide M&A transactions, which include the purchase of subsidiaries in Venezuela and the purchase of companies by local or international investors willing to bear the high risks of doing business in Venezuela in exchange for potential significant rewards if the current situation improves.

The government has enacted changes to the foreign exchange regime, which continues to restrict the ability to convert bolivares into foreign currency; nevertheless it has adopted a more flexible scheme than previous years by repealing certain laws and regulations that established criminal sanctions for individuals or entities conducting exchange transactions outside the official exchange mechanisms.

The most recent tax measures include (1) a temporary regime of VAT and income tax advance weekly payments applicable to certain designated taxpayers; (2) the increase of the standard VAT rate from 12 per cent to 16 per cent; (3) an income tax exemption for income derived from hydrocarbons production activities for the fiscal year 2018; and (4) the increase of the financial transactions tax from 0.75 per cent to 2 per cent.

II  COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

The most commonly used forms of business organisations are:

a  the corporation (SA);

b  the partnership (SNC);

c  the limited liability partnership (SCS);

d  the limited stock partnership (SCA); and

e  the limited liability company (SRL).

i  Corporate

Investors generally prefer a corporate business form, and the SA is the most commonly used corporate form. The SA limits the liability of the shareholders to the subscribed capital.

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1 Alberto Benshimol and Humberto Romero-Muci are partners at D’Empaire.
The SA must have a stated or subscribed capital, which is the amount of capital that the shareholders of the corporation agree to subscribe. The SA's stated capital is represented by shares of stock in registered form (bearer shares are not permitted), with a par value. The shares must be subscribed by the shareholders. At least 20 per cent of the subscribed capital must be paid at the time of incorporation. In addition, under the Public Registry Law, the Commercial Registry Office may deny registration of the articles of incorporation in the event that it considers the capital insufficient for the purpose of the SA. Although there are no statutory minimum capital requirements applicable to the stated capital, each Venezuelan commercial registry sets out a minimum stated capital requirement on a case-by-case basis or depending on the purpose of the SA. The stated capital of the SA can be paid in cash or in kind. In the case of a payment in cash, at least 20 per cent of the stated capital must be paid by the shareholders at the time of the registration of the shareholders' meeting approving the incorporation of the SA or the corresponding capital increase (the amount of stated capital already paid by the shareholders is known as 'paid-in capital'). Payment in cash of the stated capital must be made by a deposit in bolivares in a bank account opened with a Venezuelan bank under the name of the SA. In the case of payment in kind, assets of a value equal to 100 per cent of the stated capital must be contributed to the SA.

The initial and any subsequent issuance of capital stock is subject to a tax of 1 per cent levied on the stated capital, plus other registration fees and expenses. Certain commercial registries of the Capital District apply a registration tax equal to 10 per cent of the stated capital. However, to mitigate the effects of this tax, shares may be subscribed at a premium. Although the SA must initially have at least two shareholders, it may subsequently become a wholly owned subsidiary of one shareholder.

The SA is a separate taxpaying entity. The SA's worldwide net income is levied with Venezuelan income tax at a corporate rate of up to 34 per cent. Dividends paid by an SA to either a resident or non-resident are subject to a dividends tax levied at a flat rate of 34 per cent to the extent that 'financial earnings' exceed 'net taxable earnings'. The transfer of an SA's shares by a legal entity is subject to 5 per cent Venezuelan income tax withholding, regardless of the legal entity's domicile. Sales of shares made by individuals are subject to a 34 per cent Venezuelan income tax withholding if the individual is not domiciled in Venezuela, or to a 3 per cent withholding if the individual is domiciled in Venezuela. Special tax treatment applies if shares are listed on a Venezuelan stock exchange.

The other corporate business form used in Venezuela is the SRL. The SRL is rarely used since its stated capital cannot currently exceed 2,000 bolivares. Like the shareholders of a corporation, members of the SRL enjoy limited liability. The capital of the SRL is represented by quotas. In the case of the transfer of a quota owned by a member, the other members have a preferential right to acquire such quota, and the transfer of the quota to third parties requires the approval of three-quarters of the SRL's capital. The process to incorporate an SRL is similar to that of setting up a corporation. Its by-laws may provide for mandatory cash contributions of the members, which will not be considered capital contributions. The SRL is subject to the same income tax treatment as the SA.

ii Non-corporate

The SNC, the SCS and the SCA are the most commonly used non-corporate entities in Venezuela. The SNC is the Venezuelan partnership. The partners of an SNC are personally, jointly and severally liable for the debts, obligations and liabilities of an SNC. The contributions of the partners in an SNC are not represented by shares. The initial and subsequent capital
contributions made by the partners to the SNC are subject to a 1 per cent tax. The SNC is fiscally transparent for income tax purposes. The SNC will report its taxable income in accordance with the Venezuelan Income Tax Law; however, it will not be taxed on such net income. The SNC’s partners will be subject to income tax on their portion of SNC’s taxable income and will have to report such income on an accrual basis. The assignment of the SNC’s interest to an entity is subject to a 5 per cent Venezuelan income tax withholding levied on the cash consideration paid.

An SCS is the Venezuelan limited liability partnership. The SCS must be organised by one or more general partners, plus one or more limited partners. The general partners of an SCS are jointly and severally liable for the debts, obligations and liabilities of the SCS, whereas the limited partners are not liable for such debts, obligations or liabilities. The liability of the limited partners is limited to the amount they agree to contribute to the SCS. The contributions of the limited and general partners in the SCS are not represented by shares. A 1 per cent tax is levied on capital contributed by the limited partners. The SCS is fiscally transparent and taxed like the SNC as described above. The assignment of the SCS’s interest by an entity is subject to a 5 per cent Venezuelan income tax withholding levied on the cash consideration paid.

The SCA must be organised by one or more general partners and one or more limited partners. The SCA is similar to the SCS, but the limited partners’ interests in the SCA are represented by shares, which may be transferred as the shares of an SA.

The assignment of shares of the SCA by an entity is subject to a 5 per cent Venezuelan income tax withholding levied on the cash consideration paid. The SCA is treated as an SA (corporation) for Venezuelan income tax purposes.

The fiscally transparent entities (SNCs and SCSs) are used to achieve tax consolidation through fiscal transparency, as Venezuelan income tax law does not contain tax consolidation rules.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

_Determination of taxable profit_

Venezuelan-resident entities are generally subject to Venezuelan tax on their worldwide income at rates of up to 34 per cent set out in the progressive schedule provided in the Venezuelan Income Tax Law.

In general, the income tax is levied on net taxable income, which is calculated by subtracting from the annual gross revenue costs and allowable deductions (e.g., salaries, interest, amortisation, depreciation, technical assistance, and any expense that is ‘normal and necessary’ to generate income).

Expenses that are ‘normal and necessary’ to produce income may be deducted. Expenses are ‘normal’ if the amount of the disbursement made is in accordance with amount of income produced and the amount of disbursements customarily made by other taxpayers in the same line of business for similar expenses. Expenses are ‘necessary’ if there is a reasonable relationship with the business of the taxpayer.

In general, any reasonable depreciation or amortisation charge for fixed assets located in Venezuela assigned to income-producing activities is admissible. In general, the units of production depreciation method and straight-line depreciation method are admissible, among others. The ‘exhaustion’ amortisation method of depletion is allowed.
Taxable income must be reported on an accrual basis, except for income from wages and salaries, which is taxed on a cash receipt basis.

Calculation of taxable income tax liability also entails ‘inflation adjustment’, which is calculated as follows. The nominal value of a corporation’s shareholders’ equity at the closing of its fiscal year is multiplied by the Caracas consumer price index (the CPI), as published by the Central Bank of Venezuela. This adjustment is deductible as a loss in the calculation of the corporation’s final tax liability. For example, if a company’s shareholders’ equity is 100 per cent and the CPI was 25 per cent, the company will be allowed to deduct 25 per cent in the calculation of its final income tax liability.

The nominal value of a corporation’s ‘non-monetary assets’ (e.g., buildings, machinery, equipment and foreign currency amounts) is also multiplied by the Caracas CPI. The adjustment becomes a taxable gain that must be included in the calculation of its final income tax liability.

Taxpayers designated as special taxpayers by the tax authorities, as well as banks, insurance and financial companies, may not apply the adjustment for inflation for income tax calculation purposes.

**Capital and income**

There is no distinction between capital gains and ordinary income.

**Losses**

Foreign and domestic losses may be carried forward for three years and offset up to 25 per cent of the taxpayer’s yearly taxable income. Losses may not be carried back. The losses can survive a change of ownership.

**Rates**

The schedule of income tax rates for corporate residents contains three rate-brackets:

- **a** 15 per cent on taxable income up to 2,000 tax units;
- **b** 22 per cent on additional taxable income up to 3,000 tax units; and
- **c** 34 per cent on taxable income above 3,000 tax units.

The tax unit is a value for measurement set by the tax administration (SENIAT) before 15 February every year, and published in the Official Gazette. The adjustments to the tax units are made upon the variations of the CPI, as published by the Central Bank of Venezuela. Each tax unit is currently equivalent to 300 bolivares.

**Administration**

Income tax returns must be filed within three months of the end of the tax year of the taxpayer. SENIAT administers income tax and other national taxes such as value added tax (VAT), and municipal tax agencies administer municipal taxes such as the business activities tax, real property tax and vehicles tax. There are no regular routine audit cycles. Rulings may be requested on uncertain tax issues. Tax assessments may be appealed before the tax administration or challenged before tax courts.

**Tax grouping**

There are no rules on consolidated tax grouping.
ii Other relevant taxes

VAT
VAT applies to sales of all goods and services throughout the chain of distribution, except certain exempted items such as food, medicine, telephones, domestic electricity and domestic natural gas. VAT is levied at a rate of 16 per cent. VAT taxpayers are charged VAT on all their purchases of goods and services (input credits). In turn, they have to charge and collect VAT in their sales of goods and services (output debits), effectively passing down the VAT to the end consumers. VAT liability (excess of output debits over input credits) is paid each week by VAT taxpayers to the Venezuela national tax administration.

Certain designated VAT taxpayers must (1) pay VAT advance payments on a weekly basis, based on the VAT payable the previous week, and (2) withhold 75 per cent of the VAT charged on all their purchases of goods and services, and pay the withheld amounts to the Venezuelan treasury on a weekly basis. Likewise, such designated VAT taxpayers are also subject to said VAT withholding on every sale of goods or services they make to other designated VAT taxpayers. This regime puts enormous pressure on such designated VAT taxpayers’ cash flows.

A municipal tax on business activities is levied by the local municipalities on gross revenue (i.e., no deductions are allowed). The applicable rates vary from municipality to municipality and according to the business activity in which the taxpayer is engaged. The rates range from 0.5 per cent, and may reach as high as 2 per cent (or more).

Financial Transactions Tax (FTT)
The FTT applies to legal persons (not individuals) appointed as special taxpayers who are: (1) making payment transactions through Venezuelan banks or financial accounts, and (2) paying debts outside the financial system by means of payments, novation, offsetting and forgiveness of debts.

The FTT also applies to legal persons legally related to special taxpayers and to legal persons or individuals making payments on behalf of special taxpayers. The FTT rate is 2 per cent, and its tax base is the amount of the transaction.

Contribution to the National Organisation against Drugs
Commercial or industrial businesses that employ 50 or more workers must pay a special contribution to the National Organisation Against Drugs equal to 1 per cent of their ‘business profits’, which are defined as net profits obtained from business transactions. This tax is calculated and paid annually.

Contribution to the National Fund of Science, Technology and Innovation
Both companies domiciled in Venezuela and non-domiciled companies that carry out activities in Venezuela generating gross revenues in excess of 100,000 tax units must pay a special contribution to the National Fund of Science, Technology and Innovation. This contribution ranges between 0.5 per cent and 2 per cent of their gross revenues, depending on the type of business activity carried out. This tax is calculated and paid annually.
**Contribution to the National Sports Fund**

Both companies domiciled in Venezuela and non-domiciled companies that carry out activities in Venezuela obtaining net profits of at least 20,000 tax units must pay a special contribution to the National Sports Fund equal to 1 per cent of their net profits. This tax is calculated and paid annually.

**Contribution to the Venezuelan Institute of Social Security**

Employees must pay a contribution to the Venezuelan Institute of Social Security (IVSS), equal to 9 per cent, 10 per cent or 11 per cent of the lower of each employee's salary or five times the minimum monthly urban salary, for each employee (the IVSS salary base). The applicable percentage (9, 10 or 11 per cent) depends on the level of risk of the business activities (the higher the risk, the higher the percentage). Employees must also pay a contribution to IVSS equal to 4 per cent of the IVSS salary base, such contribution being withheld by the employer and paid by the employer to IVSS. These contributions must be paid on a weekly basis.

**Contribution to the National Institute of Educational Cooperation**

Employers with five or more employees must pay a contribution to the National Institute of Educational Cooperation (INCES) equal to 2 per cent of total wages, salaries, daily payments and remuneration of any kind, but excluding occasional payments such as extra bonuses (normal salary). Employees must also pay a contribution to INCES equal to 0.5 per cent of any profit-sharing, such contribution being withheld by the employer and paid to INCES. These contributions must be paid by the employer within the first five days of each quarter.

**Contribution to the Housing Saving Fund**

Employers must pay a contribution to the Housing Saving Fund (FAOV) equal to 2 per cent of the monthly integral salary of each employee. Employees must also pay a contribution to FAOV equal to 1 per cent of their monthly integral salary, such contribution to be withheld or deducted by the employer and paid to the national housing bank, Banavih. These contributions must be paid on a monthly basis.

In a recent decision, the Constitutional Chamber of the Supreme Court of Justice stated that the mandatory contribution to FAOV shall not be considered a tax and shall not be subject to Venezuelan tax laws.

**Unemployment or lay-off contingency**

Employers must pay a contribution to IVSS for an unemployment or lay-off contingency equal to 1.7 per cent of the IVSS base salary, and employees must pay a similar contribution equal to 0.5 per cent of the IVSS base salary, such contribution being withheld or deducted by the employer and paid to IVSS. These contributions must be paid on a weekly basis.

**Gifts tax**

Donations or gifts of assets located in Venezuela are generally subject to the Venezuelan gift tax levied at the rates of up to 55 per cent set out in the progressive schedule applicable depending on the relationship between the beneficiaries of the gift and the donor.
IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence
An entity is considered a Venezuelan resident if it is organised in accordance with Venezuelan laws or domiciled in Venezuela.

A non-locally incorporated entity may not become resident in Venezuela because it has a local seat of management or due to other factors, but it may have a permanent establishment in Venezuela if its place of effective management is in Venezuela.

ii Branch or permanent establishment
Foreign entities may operate in Venezuela through a permanent establishment. A branch, a fixed place of business, place of effective management and an agent with authority to enter into contracts will be considered a permanent establishment. The threshold for a foreign entity to have a permanent establishment in Venezuela is lower under the income tax law in comparison with the tax treaties in effect in Venezuela. Therefore, foreign entities entitled to the benefits of a tax treaty may be protected in certain situations from having a permanent establishment in Venezuela.

The permanent establishment is taxed on income attributable to the permanent establishment’s activities. Income that the permanent establishment might be expected to make if it will be a separate and distinct entity will be attributable to the permanent establishment. Deductions of expenses incurred for the purpose of the permanent establishment are allowed, including executive and general administrative expenses. Interest, technical assistance fees or royalties payments made to the head office and its affiliates are not deductible, but interest, fees and royalties paid to other entities are deductible.

The Venezuelan branches of foreign legal entities are subject to a deemed dividend tax on their earnings. The deemed dividends tax is levied at a flat rate of 34 per cent on the excess amount of the branch’s ‘financial earnings’ over the branch’s ‘net taxable income’. The deemed dividends tax is exempted if the branch reinvests in Venezuela the amount subject to the deemed dividends tax and the investment is maintained in Venezuela for five years.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes
No special holding company regimes are available in Venezuela.

ii IP regimes
No special IP regimes are available in Venezuela.

iii State aid
The tax incentives for new investments were eliminated in the 2015 Income Tax Law amendment.

iv General
Venezuela has signed treaties for the avoidance of double taxation with Austria, Barbados, Belarus, Belgium, Brazil, Canada, China, Cuba, the Czech Republic, Denmark, France,
Germany, Indonesia, Iran, Italy, Korea, Kuwait, Malaysia, the Netherlands, Norway, Palestine, Portugal, Qatar, Russia, Spain, Sweden, Switzerland, Trinidad and Tobago, the United Arab Emirates, the United Kingdom, the United States and Vietnam. These agreements provide significant protection to investors against changes in tax legislation.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)
Dividends paid by a Venezuelan corporate entity to either a resident or non-resident are subject to a 34 per cent withholding levied on the distributed excess amount of the corporate entity’s ‘financial earnings’ over its ‘net taxable earnings’.

Interest payments made to non-resident entities are subject to a withholding levied at a progressive corporate rate of up to 34 per cent on 95 per cent of the payment. Interest payments made to qualified financial institutions domiciled outside Venezuela are subject to a withholding tax of 4.95 per cent.

Payments of royalties to a non-domiciled entity are subject to a withholding levied at the progressive corporate rate of up to 34 per cent on 90 per cent of the gross payment.

Payments of technical assistance fees to a non-domiciled entity are subject to a withholding levied at the progressive corporate rate of up to 34 per cent on 30 per cent of the gross payment.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments
Interest payments on bonds issued by Venezuela are exempted from withholding, whereas payments in kind are not.

iii Double tax treaties
The table in Appendix I summarises the withholding rates on dividends, interest and royalty payments under each of the tax treaties currently in effect in Venezuela.

iv Taxation on receipt
Dividends paid by a Venezuelan corporation to either a resident or non-resident are subject to a dividend tax levied at a flat rate of 34 per cent to the extent that the ‘financial earnings’ of the Venezuelan corporation exceed its ‘net taxable earnings’. Dividends paid by a Venezuelan corporation out of dividend distributions received from other Venezuelan corporations are not subject to the dividend tax.

There is no indirect credit for local or foreign underlying taxes. Therefore, dividends paid by a foreign corporation to Venezuelan residents out of dividend distributions received by such foreign corporation from Venezuelan corporations are subject to 34 per cent dividends tax.
VII TAXATION OF FUNDING STRUCTURES

i Thin capitalisation
Under the thin capitalisation rules, interest on related-party debt will be deductible for tax purposes provided the 1:1 debt-to-equity ratio is not exceeded. In calculating whether the amount of debt exceeds the taxpayer's net equity, the taxpayer's annual average net equity must be subtracted from the annual average related-party debt.

ii Deduction of finance costs
Finance costs are generally deductible. Interest expenses incurred in connection with income production should be deductible, provided that the interest paid is in accordance with the amount of income produced.

iii Restrictions on payments
Dividends must be distributed from liquid and collected earnings.

iv Return of capital
Equity capital can be repaid by a reduction or return of capital, and it is tax-neutral.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition
Non-local companies acquiring local businesses generally structure the transaction using a local entity. Buyers generally structure financing through loans, because interest payments under such loan will be deductible. It is common that the consideration for sellers is paid with negotiable instruments to avoid the income tax withholding applicable to cash considerations.

ii Reorganisation
Mergers are generally considered tax-neutral. There are no rules on demerging. A merger between a local and a non-local entity is not contemplated in the law, but could be implemented through the domestication of one of the entities in the jurisdiction of the other entity.

iii Exit
Entities may be deregistered in Venezuela and relocated in another jurisdiction. There are no applicable taxes on the relocation of a Venezuelan entity.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance
General anti-avoidance provisions grant the tax administration the power to disregard legal forms adopted by the taxpayer with the main intention of evading taxes. The isolated court decisions on abuse of legal forms in the tax context provide that legal forms with a prevailing ‘business purpose’ should not be disregarded by the Venezuelan tax administration.
ii Controlled foreign corporations

The Income Tax Law generally requires reporting of income, and imposes disclosure obligations on Venezuelan residents with direct or indirect controlled interests in foreign entities and other investments organised, located or resident in any of the jurisdictions considered as low-tax jurisdictions when a resident exercises management or control over such investments. Control over investments is defined as the ability to decide the timing of the distribution of profits, yields or dividends derived from the investment. The control requisite is presumed, but the taxpayer may rebut such presumption.

Venezuelan taxpayers are required to accrue into their Venezuelan taxable income the gross income derived from an investment in a low-tax jurisdiction (either directly or indirectly) without any deductions taken by the latter in computing net income. However, such amounts may be deducted in computing a Venezuelan resident’s taxable income if the accounting records of the investment in a low-tax jurisdiction are maintained in Venezuela, and made available to the Venezuelan tax authorities.

iii Transfer pricing

SENIAT has created a transfer-pricing department formed by professionals specialised in transfer-pricing issues. Since its creation, SENIAT has become very strict about and aware of transactions made by Venezuelan companies with related parties.

In fact, SENIAT has been auditing Venezuelan companies undertaking transactions with foreign related parties in order to verify if such transactions comply with the existing arm’s-length standards. Tax audits have been undertaken in order to verify if interests and royalties paid by a foreign company to its related company in Venezuela, or vice versa, were agreed at fair market value.

The transfer pricing methods that are currently in force in Venezuela are basically identical to those contained in the OECD Guidelines:

- the comparable uncontrolled price (CUP) method;
- the resale price method;
- the cost plus method;
- the profit-split method; and
- the transactional net margin method.

There is a preferred method rule that requires the taxpayer to document the rationale for its choice of methodology. The first method that must be evaluated for use by the taxpayer must be the CUP method.

iv Tax clearances and rulings

There are no tax clearances or rulings generally required to acquire a local business. Rulings may be requested on uncertain tax issues.

X YEAR IN REVIEW

Over the past year, the government has tried to implement measures to ease the exchange control regime and certain tax measures to increase revenue. However, high levels of inflation,
maxi-devaluation of the currency and estimations that gross domestic product will shrink about 18 per cent in 2018 (IMF) have led to a poor economic forecast for 2019. Therefore, the priority will be to maintain existing business activity.

XI OUTLOOK AND CONCLUSIONS

The tax burden of Venezuelan and foreign companies carrying on economic activities in Venezuela has significantly increased. Income obtained by the Venezuelan government has become insufficient to subsidise public expenses. By creating new special contributions and by increasing tax rates, the government aims to obtain more resources to meet public expenses and subsidise social projects.

Despite its economic setback, Venezuela continues to be a country with significant business opportunities for foreign investors willing to assume risks for a number of reasons:

a. Venezuela is one of the largest Latin American economies, given its status as one of the world’s largest oil producers and exporters;

b. Venezuela has the fifth-largest proven oil reserves in the world (and the largest in the western hemisphere) and the second-largest proven natural gas reserves in the western hemisphere;

c. the devaluation of the local currency has made Venezuela very competitive in terms of labour and other local costs if compared with other countries of the region;

d. the Venezuelan government has engaged in infrastructure and other strategic projects with foreign investors under contract, providing for payments in foreign currency and in certain cases for international arbitration to settle potential disputes; and

e. the level of M&A activity in Venezuela could increase owing to potential important oil and gas projects in the Orinoco Belt region during 2018, as the Venezuelan government will probably have to negotiate more advantageous conditions with the international oil companies to attract the badly needed foreign investment in the sector currently affected by low oil prices.

In light of this political and economic environment, doing business in Venezuela involves significant risk, but continues to provide opportunities for high returns.
## Appendix I: Treaty rates for dividends, interest and royalties

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<th>Country</th>
<th>Dividends</th>
<th>Interest</th>
<th>Royalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>5 per cent if the shareholder is an entity that directly controls at least 15 per cent of the capital of the distributing entity. 15 per cent in all other cases</td>
<td>4.95 per cent on interest paid to banks 10 per cent on other interest payments</td>
<td>5 per cent</td>
</tr>
<tr>
<td>Barbados</td>
<td>5 per cent if the shareholder directly controls at least 5 per cent of the capital of the distributing entity. 10 per cent in all other cases.</td>
<td>5 per cent on interest payments to banks 15 per cent other interest payments</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Belarus</td>
<td>5 per cent if the shareholder directly or indirectly owns at least 25 per cent of the capital of the distributing entity. 15 per cent in all other cases</td>
<td>5 per cent</td>
<td>5 per cent copyright and leases 10 per cent other royalties</td>
</tr>
<tr>
<td>Belgium</td>
<td>5 per cent if the shareholder directly or indirectly owns at least 25 per cent of the capital of the distributing entity. 15 per cent in all other cases</td>
<td>10 per cent</td>
<td>5 per cent</td>
</tr>
<tr>
<td>Brazil</td>
<td>10 per cent if the shareholder is a corporation that directly or indirectly controls at least 20 per cent of the capital of the distributing entity. 15 per cent in all other cases</td>
<td>15 per cent</td>
<td>15 per cent</td>
</tr>
<tr>
<td>Canada</td>
<td>10 per cent if the shareholder controls 25 per cent of the capital of the distributing entity. 15 per cent in all other cases</td>
<td>10 per cent</td>
<td>5 per cent copyright except on videos 10 per cent other royalties</td>
</tr>
<tr>
<td>China</td>
<td>5 per cent if the shareholder is a corporation that directly controls at least 10 per cent of the capital of the distributing entity. 10 per cent in all other cases</td>
<td>5 per cent on interest payments to banks 10 per cent other interest payments</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Cuba</td>
<td>10 per cent if the shareholder is a corporation that directly controls at least 25 per cent of the capital of the distributing entity. 15 per cent in all other cases</td>
<td>10 per cent</td>
<td>5 per cent</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>5 per cent if the shareholder is a corporation that directly controls at least 15 per cent of the capital of the distributing entity. 10 per cent in all other cases</td>
<td>10 per cent</td>
<td>12 per cent</td>
</tr>
<tr>
<td>Denmark</td>
<td>5 per cent if the shareholder controls 25 per cent of the capital of the distributing entity. 15 per cent in all other cases</td>
<td>5 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>France</td>
<td>5 per cent or exempted if the shareholder directly or indirectly owns at least 10 per cent of the capital of the distributing entity</td>
<td>5 per cent</td>
<td>5 per cent</td>
</tr>
<tr>
<td>Germany</td>
<td>5 per cent if the shareholder owns at least 15 per cent of the capital of the distributing entity. 15 per cent in all other cases</td>
<td>5 per cent</td>
<td>5 per cent</td>
</tr>
<tr>
<td>Indonesia</td>
<td>10 per cent if the shareholder directly controls at least 10 per cent of the capital of the distributing entity. 15 per cent in all other cases</td>
<td>10 per cent</td>
<td>20 per cent royalty payments 10 per cent technical assistance fees</td>
</tr>
<tr>
<td>Iran</td>
<td>5 per cent if the shareholder is a corporation that directly controls at least 15 per cent of the capital of the distributing entity. 10 per cent in all other cases</td>
<td>5 per cent</td>
<td>5 per cent</td>
</tr>
<tr>
<td>Italy</td>
<td>10 per cent</td>
<td>10 per cent</td>
<td>7 per cent copyright 10 per cent other royalties</td>
</tr>
<tr>
<td>Korea</td>
<td>5 per cent if the shareholder is a corporation that directly controls at least 10 per cent of the capital of the distributing entity. 10 per cent in all other cases</td>
<td>5 per cent on interest payments to banks 10 per cent on other interest payments</td>
<td>5 per cent lease payments 10 per cent on other distributions</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Country</th>
<th>Dividends</th>
<th>Interest</th>
<th>Royalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kuwait</td>
<td>5 per cent if the shareholder is a corporation that directly owns at least 10 per cent of the capital of the distributing entity. 10 per cent in all other cases</td>
<td>5 per cent</td>
<td>20 per cent</td>
</tr>
<tr>
<td>Malaysia</td>
<td>5 per cent if the shareholder is a corporation that directly controls at least 10 per cent of the capital of the distributing entity. 10 per cent in all other cases</td>
<td>15 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Netherlands</td>
<td>10 per cent or exempted if the shareholder controls at least 25 per cent of the capital of the distributing entity</td>
<td>5 per cent</td>
<td>5 per cent leases and other royalty payments 7 per cent trademarks 10 per cent copyright</td>
</tr>
<tr>
<td>Norway</td>
<td>5 per cent if the shareholder directly controls 10 per cent of the capital of the distributing entity. 10 per cent in all other cases</td>
<td>5 per cent interest paid to banks 15 per cent other interest payments</td>
<td>12 per cent royalties 9 per cent technical assistance fees</td>
</tr>
<tr>
<td>Palestine</td>
<td>10 per cent if the shareholder directly controls 10 per cent of the capital of the distributing entity. 15 per cent in all other cases</td>
<td>5 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Portugal</td>
<td>10 per cent</td>
<td>10 per cent</td>
<td>12 per cent royalties 10 per cent technical assistance fees</td>
</tr>
<tr>
<td>Qatar</td>
<td>5 per cent if the shareholder is a corporation that directly controls at least 10 per cent of the capital of the distributing entity. 10 per cent in all other cases</td>
<td>5 per cent</td>
<td>5 per cent</td>
</tr>
<tr>
<td>Russia</td>
<td>10 per cent if the shareholder is a corporation that directly controls at least 10 per cent of the capital of the distributing entity and invested at least US$100,000 in such entity. 15 per cent in all other cases</td>
<td>5 per cent on interest paid to banks and 10 per cent on other interest payments</td>
<td>15 per cent royalties 10 per cent technical assistance fees</td>
</tr>
<tr>
<td>Spain</td>
<td>10 per cent or exempted if the shareholder controls 25 per cent of the capital of the distributing entity</td>
<td>4.95 per cent on interest payments to financial institutions or 10 per cent other interest payments</td>
<td>5 per cent</td>
</tr>
<tr>
<td>Sweden</td>
<td>10 per cent or exempted if the shareholder controls at least 25 per cent of the capital of the distributing entity</td>
<td>10 per cent</td>
<td>10 per cent copyright 7 per cent other royalties</td>
</tr>
<tr>
<td>Switzerland</td>
<td>10 per cent or exempted if the shareholder controls at least 25 per cent of the capital of the distributing entity</td>
<td>5 per cent</td>
<td>5 per cent</td>
</tr>
<tr>
<td>Trinidad and Tobago</td>
<td>5 per cent of the gross amount of the dividends if the beneficial owner is a company that holds directly or indirectly at least 25 per cent of the capital of the company paying the dividends. 10 per cent in all other cases</td>
<td>15 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) that holds directly at least 10 per cent of the capital of the company paying the dividends. 10 per cent in all other cases</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>10 per cent or exempted if the shareholder directly or indirectly controls at least 10 per cent of the voting rights of the distributing company</td>
<td>5 per cent</td>
<td>7 per cent copyrights 5 per cent other royalties</td>
</tr>
<tr>
<td>United States</td>
<td>5 per cent if the shareholder owns at least 10 per cent of the voting shares of the distributing company. 15 per cent in all other cases</td>
<td>4.95 per cent on interest paid to financial or insurance institutions and 10 per cent on other interest payments</td>
<td>5 per cent lease payments 10 per cent other royalty payments</td>
</tr>
<tr>
<td>Vietnam</td>
<td>10 per cent if the shareholder is a corporation that directly controls at least 10 per cent of the capital of the distributing entity. 15 per cent in all other cases</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
</tbody>
</table>
Chapter 39

VIETNAM

Fred Burke and Nguyen Thanh Vinh

I INTRODUCTION

In the first nine months of 2018, GDP growth was 6.98 per cent, the highest growth in the past seven years, and the total amount of registered foreign investment reached US$25.37. Major investors include Korea, Japan, Singapore and China. Major inflow capital continues to concentrate in industrial manufacturing sectors. In addition, Vietnam has welcomed the investment in renewable energy.

Trade war between US and China not only poses a challenge but also creates an opportunity for Vietnam. However, the biggest challenges are the underlying problems for the economy such as low tech skills, exhausted lands and natural resources, low productivity and competition. To improve the business environment and attract investment, the government has focused on reforming the administration and reducing the obstacles to investment. The government plans to reduce 50 per cent of the business conditions. As of August 2018, all of the ministries had submitted draft decrees regarding the abolition of the business conditions. If these decrees take effect, the government can begin their plan to abolish from at least 50 per cent to over 60 per cent of the current business conditions.

On 12 November 2018 the Vietnam National Assembly officially ratified the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). To date, the agreement has already been ratified by Australia, Canada, Japan, Mexico, New Zealand and Singapore, and it entered into force on 30 December 2018 in those countries. The CPTPP shall enter into force for Vietnam 60 days after Vietnam officially notifies New Zealand, the official depository, in writing of Vietnam’s ratification. One of the largest trade pacts to date, the CPTPP will stimulate trade and investment among its parties by creating benefits and opportunities for businesses. It will be one of the key drivers for economic growth in Vietnam. Sometimes referred to as a ‘deep’ trade agreement or a ‘21st century’ trade agreement, the treaty goes well beyond the parameters of the traditional WTO rules-based trading system by expanding its scope to include investment, competition, e-commerce, regulatory coherence, labour, the environment and investor-state dispute settlement. This is a significant step because Vietnam will be one of the biggest winners of the CPTPP trade pact. The World Bank released a report in March 2018 indicating that there will be significant economic gains for Vietnam. Some of the reasons for this growth include reduction of tariffs

1 Fred Burke is the managing partner and Nguyen Thanh Vinh is a partner at Baker McKenzie Vietnam.
and non-tariff barriers to trade. Although there are approximately 22 suspended provisions in the CPTPP, what remains is one of the largest trade agreements, which will facilitate and open trade among the participating parties.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate
Inward investors may choose to establish a limited liability company (LLC) or a joint-stock company (JSC) for investment in Vietnam.

There are two different types of LLC: a single-member LLC (SMLLC) and a multi-member LLC (MMLLC). SMLLCs are owned by one organisation or an individual member (company owner) who is liable for the debts and liabilities of the company to the extent of the amount of the charter capital of the company. An MMLLC is an enterprise that has more than one but no more than 50 members, which may be organisations, individuals or a combination of both. MMLLCs have the same legal status as SMLLCs. However, in SMLLCs, the company owner has more autonomy with regard to decisions made about the company than those of MMLLCs. With MMLLCs, capital transfers are limited in the sense that capital may be sold to external investors only after all other members of the MMLLC have decided not to purchase such capital. The new Enterprise Law, which took effect on 1 July 2015, also limits the duration for capital contributions in LLCs to within 90 days of the issuance of the enterprise registration certificate. In the event of failing to meet the deadline, the enterprise is required to adjust its charter capital to be settled at the amount actually contributed.6

The corporate form of JSC is more flexible and does not have limitations for the number of shareholders. With the development of two stock exchanges (i.e., the Ho Chi Minh Stock Exchange and the Hanoi Stock Exchange) and over-the-counter markets, JSCs are the appropriate choice when there is a higher capacity of capital mobilisation, and tend to be the more popular option for foreign investors looking into M&A deals.

ii Non-corporate
A partnership is a form of enterprise set up by at least two partners, who are personally liable for its debts (partnership). Limited liability partners may also join in the partnership, and are only liable to the extent of their capital contribution. This form of business is not common for inward investment.

A private enterprise is established by an individual, who is the owner of the enterprise. Such individual is liable by all of his or her assets for the enterprise’s debt. However, in practice, inward investors are not able to establish private enterprises owing to complications with identifying foreign assets.

For these reasons, non-corporate entities are not commonly chosen for inward investment in Vietnam.

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III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

Enterprises established under Vietnamese law are subject to enterprise income tax (EIT) on their worldwide income. Such enterprises are allowed to deduct income tax paid overseas against the EIT payable in Vietnam in accordance with the provisions of the EIT Law.7

A permanent establishment (PE) of a foreign enterprise is subject to EIT on its income derived from Vietnam and on its income derived outside Vietnam related to the PE’s activities.

Foreign companies that are located abroad but are engaging in business activities in Vietnam or deriving income in Vietnam are also subject to EIT.

Taxable profit (or actual assessable income) is based on an accrual basis and is subject to adjustments of non-deductible expenses for the purposes of calculating the EIT payable, except for the deemed tax rates applicable to the income of business entities established under foreign laws or of enterprises established under Vietnamese law, which can determine revenue but cannot determine expenses and business profits. Taxable income is made up of the taxable turnover minus tax-deductible expenses plus other taxable incomes. Assessable income is equal to the taxable income minus the tax-exempt income and the losses carried forward. In addition, funds for scientific and technological development set up by enterprises can be deducted against the assessable income before multiplying the tax rate for calculating the EIT payable.

‘Tax-deductible expenses’ means expenses incurred for business purposes and supported by appropriate documents, invoices or payment vouchers proving that payments were made on a non-cash basis (non-cash payment is a requirement for tax deductibility with respect to payments from 20 million dong or more), except for certain expenses subject to limitations on deduction (e.g., depreciation expense subject to the statutory depreciation rates, contributions of voluntary pension funds, voluntary pension premiums for employees).

Enterprises can use the straight-line method in calculating the depreciation of tangible fixed assets and amortisation of intangible fixed assets. Accelerated depreciation can be applicable to enterprises in business sectors that require fast changes or rapid development.

Capital and income

To the extent that capital profits mean the profits gained from the transfer of capital or from the transfer of securities, generally capital profits will be considered as other taxable income of the enterprise, which will be included in the taxable income used as a base to calculate assessable income. However, with respect to enterprises eligible for EIT incentives, capital profits are not subject to tax incentives, but they are permitted to be offset against the losses from the business enjoying EIT incentives.

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7 Law No. 14/2008/QH12 dated 12 June 2008 of the National Assembly on Enterprise Income Tax, as amended by Law No. 32/2013/QH13 passed by the National Assembly on 19 June 2013 and Law No. 71/2014/QH13 passed by the National Assembly on 26 November 2014 (the EIT Law).
**Losses**

Enterprises can carry forward the loss from a fiscal year entirely and consecutively for a maximum of five years, and the loss carry-forward years must be counted consecutively. This means that the loss must be carried forward ‘entirely’ and ‘consecutively’ even when enterprises are in a period of enjoying a tax holiday or tax reduction.

In cases where an enterprise undergoes a conversion, merger or consolidation, losses that occurred prior to such conversion, merger or consolidation can be offset against the taxable income of the year when such conversion, merger or consolidation occurs, or the loss may be permitted to continue to carry forward in the following years, but not exceeding five years from the year when the loss arose.

**Rates**

The current standard rate is 20 per cent, applicable to corporate forms and non-corporate forms beginning 1 January 2016.8

Investment projects that meet incentive conditions regarding industry, location or large-scale investment capital may enjoy preferential tax rates of 10, 15 or 17 per cent.

**Administration**

There are three levels of tax authorities in Vietnam. The General Department of Taxation (GDT) is the central tax authority. The GDT implements tax laws and provides the Ministry of Finance (MOF) with feedback on enterprises and assists it in creating tax policy. The provincial-level tax department manages district-level sub-tax offices. The tax departments and the sub-tax offices are responsible for collecting all types of tax, except for duties and taxes relating to import and export, which are under the management of the customs authorities. Depending on the scale of its investments, an enterprise may either be administered by the tax department or the sub-tax office.

Enterprises must make provisional EIT payments on a quarterly basis, by the 30th day after the end of each quarter. Enterprises are also required to conduct annual EIT returns and pay any tax deficits by the 90th day after the end of the fiscal year. The fiscal year is usually the calendar year. If taxpayers choose a fiscal year different from the calendar year, the fiscal year must start on the first day of a quarter and must last for 12 months.

Tax authorities routinely conduct tax audits. A tax audit may be conducted at a tax authority if there are some unclear points in the tax documents submitted by an enterprise. Tax audits may be scheduled to be conducted at the enterprise’s premises, or may occur when such enterprise has a tax refund or is suspected of being in breach of tax regulations.

When enterprises have tax issues, they may seek guidance on such issues by coming to the tax authority in person or by sending a letter to the tax authority. In practice, it may take the tax authority one month to reply to an enterprise’s letter. However, there is no formal procedure provided by law regarding the responsibility of tax authorities to provide guidance or reply to enterprises.

Enterprises in Vietnam may challenge the tax authority’s assessment by appealing to the tax authority that issued the tax assessment. If the enterprise is not satisfied with the initial tax authority’s conclusion on the appeal, it may then appeal to the higher level of such tax

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8 Decree No. 218/2013/ND-CP dated 26 December 2013 of the government detailing and guiding the implementation of the Enterprise Income Tax Law and its amended decrees.
authority. Enterprises are also permitted to bring a case to court upon the receipt of the tax authority's assessment or after receiving the conclusions on the appeals of the tax authority that issued the tax assessment or of the higher level of such tax authority.

**Tax grouping**

A parent company is required to prepare and submit consolidated financial statements to the tax authorities in which the figures on assets, payable accounts, owner's equities, revenues, other incomes and costs stated in the consolidated financial statement reflect the amount added from the figures of the parent company and those stated in the financial statements of the subsidiaries. The names of the subsidiaries must be stated in the consolidated financial statement.  

There are no specific provisions regarding tax treatments applicable to a group comprising a parent company and its subsidiaries. However, in principle, a parent company and its subsidiaries are independent and equal in contracts, transactions and other interactions.

Each entity of a group is responsible for its own tax obligations and those of its shareholders.

**ii Other relevant taxes**

**Business fee/licence fee**

Enterprises and their branches, being business entities, are required to pay a business fee once a year. The annual business fee, as detailed below, will be applied based on the charter capital stated in the enterprise registration certificate or business registration certificate of the enterprise or branch.

<table>
<thead>
<tr>
<th>Charter capital</th>
<th>Annual business fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>More than 10 billion dong</td>
<td>3 million dong</td>
</tr>
<tr>
<td>From 10 billion dong or less</td>
<td>2 million dong</td>
</tr>
<tr>
<td>For branches, representative offices, business location, public service providers and other business organisations</td>
<td>1 million dong</td>
</tr>
</tbody>
</table>

If an enterprise has no charter capital, it will depend on the investment capital stated in the investment registration certificate.

Branches of enterprises that do not state their registered capital in their business registration certificate must pay a business fee of 1 million dong annually.

**Value added tax (VAT)**

VAT applies to the supply of goods and services that are deemed to be used ‘for production, business or other consumption in Vietnam’. A number of goods and services are exempt from VAT.

The VAT Law provides three rates of tax: zero, 5 and 10 per cent. The standard VAT rate is 10 per cent. Exported goods and services are zero-rated if goods or services are provided to customers overseas and consumed outside Vietnam or within tariff-free zones.

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9 Article 191 of the Enterprise Law.
10 Points 12 and 28 of Vietnamese Accounting Standard No. 25.
11 Article 190 of the Enterprise Law.
12 Decree No. 139/2016/ND-CP dated 4 October 2016 of the government regulating licensing fees.
Foreign companies located abroad and engaging in business activities in Vietnam or deriving income in Vietnam are also subject to VAT regardless of whether they have a PE in Vietnam or not.

**Special consumption tax (SCT)**

Enterprises that produce or import goods or provide services subject to SCT are required to declare and pay SCT in addition to VAT. SCT does not apply to subsequent stages in the distribution of goods. However, from 1 January 2016, imported goods, except for gasoline, are subject to SCT at the importation stage based on the import price (import SCT) and at the distribution stage based on the distribution price (distribution SCT). Import SCT can be offset against distribution SCT for the purpose of calculating the distribution SCT payable.\(^{13}\) As a result, the SCT amount payable for imported goods is higher from 2016, since SCT is eventually calculated based on the distribution price rather than on the import price. SCT rates of certain commodities, including cigarettes, cigars, alcohol and beer, will be adjusted upward annually until 2019.

- Goods and services subject to SCT include:
  - cigarettes and cigars;
  - spirits and beer;
  - automobiles with fewer than 24 seats, motorcycles with a capacity of over 125cc, aircraft and yachts (except those used for business in the transportation or tourism sector);
  - gasoline of all kinds;
  - air conditioners with a capacity of 90,000BTU or less;
  - playing cards and votive paper; and
  - the operation of dancehalls, massage lounges, karaoke parlours, casinos, electronic prize games, betting businesses, golf and lotteries.

**Land rental and non-agricultural land use tax**

Enterprises are subject to land rental for land areas leased from the state or from companies developing industrial zones and export processing zones. Enterprises can also be subject to non-agricultural land use tax when using non-agricultural land for business purposes, such as for industrial zoning, mining and commercial use.

**Registration fee**

Ownership of the following assets is subject to a registration fee:

- houses and land;
- ships;
- boats;
- aircraft;
- automobiles;
- motorcycles; and
- hunting and sporting rifles.

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\(^{13}\) Decree No. 108/2015/ND-CP dated 28 October 2015 of the government on 28 October 2015 detailing a number of articles of the Law on SCT and the amended Law on SCT and its amended Decree No. 100/2016/ND-CP.
**Personal income tax (PIT)**

PIT is imposed on the income of employees of enterprises. However, enterprises being income payers are required to withhold PIT on employment income and then declare and pay PIT to the tax authority on behalf of their employees.

Residents are subject to progressive tax rates ranging from 5 to 35 per cent on worldwide employment income. Non-residents are subject to a flat tax rate of 20 per cent on Vietnam-derived employment income.

**IV TAX RESIDENCE AND FISCAL DOMICILE**

**i Corporate residence**

The tax laws neither define the term ‘corporate residence’, nor provide the conditions under which a non-locally incorporated entity (or foreign enterprise) can be a resident in Vietnam. According to the current provisions of the EIT Law, it may be interpreted that an enterprise would be considered fiscally resident in Vietnam if it is established under Vietnamese law.

**ii Branch or permanent establishment**

PEs of foreign enterprises are determined in accordance with the EIT Law, which defines PEs as including the following:

- a branch, management office, factory, workshop or means of transportation;
- a mine, oil or gas well, or place of extraction of natural resources;
- a building site, construction, assembly or installation project;
- an establishment furnishing services, including consultancy services, through employees or other personnel;
- an agency of the offshore company; and
- a representative in Vietnam in the following instances: he or she has the authority to enter into contracts in the name of the offshore company; or he or she does not have the authority to enter into contracts in the name of the offshore company, but regularly carries out deliveries of goods or provision of services in Vietnam.

If foreign enterprises are residents of a country that Vietnam has an effective tax treaty with, PE assessment will be in accordance with the tax treaty. Foreign enterprises from those countries may seek exemption from EIT on business income in Vietnam in accordance with the relevant tax treaty provisions, subject to certain procedures, provided that the concerned activities do not constitute a PE.

Currently Vietnam's World Trade Organization commitments allow foreign enterprises in certain service areas to set up branches in Vietnam, while such allowance for other service areas may be later phased in (e.g., non-life insurance, securities, computer and related services, management consultant services, construction and franchising). However, as a matter of practice, the government has only allowed foreign law firms and banks to set up branches in Vietnam. Branches in Vietnam are dependent units of foreign companies that operate under an establishment certificate issued by the competent licensing authority.14

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Foreign contractors engaging in construction works in Vietnam can obtain contractor permits issued by the competent licensing authority and then can set up management offices in Vietnam.

Foreign enterprises having PEs in Vietnam, adopting the Vietnamese accounting system and having a tax code (i.e., branches, foreign contractors having contractor permits) issued by the tax authorities are subject to EIT at a rate of 20 per cent of the actual assessable income, which is the same rate for enterprises established under Vietnamese law. Otherwise, tax rates deemed at a rate of 1, 2 or 5 per cent will be imposed on a foreign enterprise’s revenue derived from Vietnam, and on its revenue derived outside Vietnam relating to the PE’s activities.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes
There is no particular tax incentive for holding company regimes. The general rule is that if a local holding company receives after-tax profits or dividends from its local subsidiaries, such after-tax profits or dividends will not be taxed again at the level of the holding company.15

ii IP regimes
Investment in R&D is entitled to special tax treatment. Particularly, revenues derived from new investment projects in the fields of scientific research and high technology development and application will enjoy an EIT rate of 10 per cent within the 15 years from the licensing date.

Venture investment in high technologies and high-tech start-ups is also entitled to this tax regime.

In addition, R&D income derived from scientific research and technology development of products under testing production, or products made from new technology applied in Vietnam for the first time, or technology transfer to individuals and entities in areas of special hardship, are tax-exempt.16

iii State aid
State aid is found mainly in the form of tax incentives to facilitate the development of certain sectors (e.g., R&D, infrastructure development, education, training and healthcare) or to develop geographically disadvantaged areas by granting special tax regimes to business entities established in such areas.

The government also provides financing aid to projects of special importance and social development projects. The Vietnam Development Bank (VDB), a non-profit state-owned institution, finances the industries of infrastructure, mechanical engineering and business development at a subsidised rate of interest.17

17 Circular No. 18/2010/TT-NHNN dated 16 September 2010 of the State Bank of Vietnam (SBV) detailing the provision of interest rate support for organisations and individuals borrowing medium or long-term loans from the Vietnam Development Bank.
By raising capital from Vietnamese and foreign sources, and through receiving funds from the state budget, the VDB is able to provide loans at a reduced rate thanks to certain special mechanisms, such as a compulsory reserve ratio of zero per cent, and its solvency being guaranteed by the government.

iv General
At the start of 2016, the EIT rate was reduced by 2 per cent to its current rate of 20 per cent.

Tax incentives with respect to new investment projects include preferential tax rates, tax exemption and tax reduction. Preferential tax rates of 10, 15 or 17 per cent may be granted if a new investment project meets incentive conditions regarding the investment sector, location and scale of the project. New investment projects may enjoy tax exemptions for two or four years, and 50 per cent tax reductions for four, five or nine years.

Investment sectors entitled to tax incentives will be limited to high-tech industries, scientific research and technological development, infrastructure development, software product production, education and training, medical services, sports and cultural activities, and environmental activities.

Tax incentives are also granted to enterprises established in industrial zones (except industrial zones located in geographical areas with advantageous socioeconomic conditions), economic zones, high-tech zones, geographical areas with difficult socioeconomic conditions and geographical areas with especially difficult socioeconomic conditions.

Since 1 January 2014, under the amended EIT Law, tax incentives are granted to large-scale manufacturing projects (except for production of goods subject to special consumption tax and exploitation of mineral resources) with investment capital at least 6 trillion dong.

No tax incentives are applicable to capital gains, interest income, foreign currency trading, recovered bad debts, income from business activities outside Vietnam, precious mineral resources, oil and gas exploration and exploitation, or electronic games of chance and betting.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)
Interest payable to foreign companies is subject to a withholding EIT rate of 5 per cent.

Royalties paid to foreign companies for transfer of ownership of intellectual property are subject to a withholding EIT rate of 10 per cent. There will be additional 5 per cent withholding VAT levied in case of a licensing arrangement (i.e., transfer of use right).

Dividend payments to offshore investors other than individual investors are not subject to any further withholding tax. From 2009, individual investors are subject to a 5 per cent PIT on distributed profits or dividends.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments
There is no particular domestic law exclusion or exemption from withholding on outward-bound payments except for dividend payments as mentioned above.

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iii  Double tax treaties
Vietnam has tax treaties with 71 countries currently in force. In addition, eight tax treaties have been signed but are not yet in force, including the tax treaty between Vietnam and the United States, which was officially concluded in July 2015. Except for the tax treaty with the United States, which is based on a US model from 2006, all other tax treaties are based on OECD and UN Model Conventions.

The current domestic withholding tax rate is lower than or equivalent to those of most treaties.

<table>
<thead>
<tr>
<th>Domestic standard tax rate</th>
<th>Dividend</th>
<th>Interest</th>
<th>Royalty</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Zero per cent (foreign companies)</td>
<td>5 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td></td>
<td>5 per cent (individuals)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>10 per cent</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Canada</td>
<td>5 to 15 per cent</td>
<td>10 per cent</td>
<td>7.5 to 10 per cent</td>
</tr>
<tr>
<td>China</td>
<td>10 per cent</td>
<td>10 per cent</td>
<td>10 per cent</td>
</tr>
</tbody>
</table>

iv  Taxation on receipt
A local holding company will not be subject to tax on receipt of local after-tax profits or dividends.

Foreign tax credit is allowed subject to supporting documents. The tax credit may not exceed the amount of the Vietnamese tax (before application of the credit) that is attributable to the income derived from the foreign country.

VII  TAXATION OF FUNDING STRUCTURES
i  Thin capitalisation
There is currently no restriction on debt-to-equity ratios. However, there are restrictions applicable to specific sectors, such as the wind power sector, where the law requires that equity be equal to at least 20 per cent of the total investment capital. In addition, there is a minimum charter capital (i.e., equity) requirement in certain sectors, such as securities, banking and multi-level sales. In practice, the licensing authority, at its discretion, may question the feasibility of the project if the equity is deemed too low. In addition, total interest expenses allowed to be deductible for EIT purposes must not exceed 20 per cent of earnings before interest, tax, depreciation and amortisation (EBITDA). This 20 per cent cap on interest is supposed to apply to interest expenses incurred from loans from related parties only, but according to the current controversial interpretation by the tax authorities, the cap is applicable to any interest expense if the taxpayer has related-party transactions.

ii  Deduction of finance costs
Interest expenses incurred to fund contributions to charter capital (if any) are not deductible for tax purposes. Interest expenses incurred with respect to debt capital (i.e., the difference between the investment capital and the charter capital as stated in the investment certificate) are fully deductible if the investors have contributed the registered charter capital in

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18 Decree No. 20/2017/ND-CP dated 24 February 2017 of the government providing guidelines on the tax management of enterprise with related party transaction, Article 8.3.
compliance with the agreed schedule, and the loan agreements are properly supported and offshore medium or long-term loans are properly registered with the SBV. For interest to be tax deductible, the interest rates charged by lenders other than credit institutions and corporate lenders (i.e., the rates charged by individual lenders) must not be more than 1.5 times the basic interest rate announced by the SBV at the time the borrower obtains the loan.

### iii Restrictions on payments

Payment of dividends of a foreign-owned company can be done based on the year-end profit after the company has fulfilled its statutory tax and financial obligations.

If the company has accumulated loss according to its annual audited financial statements, then payment of dividends is not allowed.

### iv Return of capital

Equity capital may be reduced by means of return of registered capital. In principle, a return of charter capital can be done only after more than two years of consecutive operation from the date of incorporation, and the company must ensure that it can pay the outstanding liabilities even after such return of capital.

### VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

#### i Acquisition

Acquisition is usually effected either at the onshore level (by using a local or non-local entity as a buyer) or at the offshore level (by using a special vehicle to acquire shares of an offshore company directly or indirectly holding shares or capital in a company incorporated in Vietnam).

Capital gains tax is summarised in the table below:

<table>
<thead>
<tr>
<th>Transferor</th>
<th>Transferee</th>
<th>LLC (capital contribution)</th>
<th>Private JSC (shares)</th>
<th>Public company (shares)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resident legal entity</td>
<td>Resident/non-resident</td>
<td>20 per cent of net gain Transferor to declare and pay tax</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-resident legal entity</td>
<td>Resident</td>
<td>20 per cent of net gain Transferor to withhold tax</td>
<td>0.1 per cent of proceeds Securities company/bank/ transferee to withhold tax</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Non-resident</td>
<td>20 per cent of net gain Target to declare and pay tax</td>
<td>0.1 per cent of proceeds Securities company/bank/ target to withhold tax</td>
<td></td>
</tr>
</tbody>
</table>

Until the introduction of Decree 12/2015/ND-CP with effect from 1 January 2015 (Decree No. 12), Vietnamese tax law did not address capital gains tax on indirect transfers. According to Decree No. 12, taxable incomes (or gains) derived in Vietnam by a foreign or offshore company (regardless of whether it has a PE in Vietnam and its location of doing business) are any incomes (or gains) derived from certain M&A activities, including transfers of contributed capital, investment projects, the right to contribute capital and the right to participate in investment projects. However, Decree No. 12 and other relevant tax regulations do not specifically address how the taxable gain would be calculated and which party would be liable for tax declaration and payment in the context of indirect transfers. This gives rise to uncertainty in its implementation.
ii Reorganisation
Mergers, demergers, separations and consolidations are allowed and stipulated under the Enterprise Law, but such reorganisation occurs between locally established entities. There is no particular tax treatment for these types of reorganisation. Generally, if any party derives gains under such reorganisation, capital gains tax would be triggered on such party.

iii Exit
A foreign investor can exit from its investment in Vietnam by transferring its shareholding in its Vietnamese subsidiary or liquidating such subsidiary. The transfer of capital or shares is subject to capital gains tax as mentioned in Section VIII.i. The transfer of assets for liquidation purposes is subject to VAT (at the standard rate of 10 per cent) and EIT on the difference between the transfer price and the net book value of the assets.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION
i General anti-avoidance
Vietnam does not have comprehensive general anti-avoidance rules. However, it addresses the issue through other separate tax rules, such as transfer pricing rules and beneficial ownership requirements for the purposes of claiming a tax treaty benefit.

ii Controlled foreign corporations
Vietnamese law does not yet have any rules for controlled foreign corporations.

iii Transfer pricing
Transfer pricing issues have attracted more attention from Vietnamese policymakers in recent years. In an effort to strengthen existing transfer pricing rules and enforcement, the government issued Decree No. 20/2017/ND-CP (Decree No. 20) regulating tax administration with respect to enterprises having transactions with related parties. Decree No. 20 took effect on 1 May 2017 and creates a new legal framework for related-party transactions in Vietnam, and also provides certain changes to the current transfer pricing rules toward a more consistent approach with OECD BEPS Action Plan. Decree No. 20 provides detailed guidance on the determination of arm's-length pricing of related-party transactions, rights and obligations of taxpayers, tax authorities and other relevant authorities. Prices in related-party transactions are determined through comparability analysis, which requires the elimination of significant differences by evaluating criteria comprising product characteristics, asset and operation functions, business risk, contractual terms of the transaction and economic conditions of the transaction.

In principle, Decree No. 20 continues to maintain five methods of determining market prices, including comparable uncontrolled price, resale price method, cost plus method, profit comparable method and profit-split method. There is no hierarchy among the methods. The most appropriate method will be adopted based on the conditions of the transaction, information and data for a comparability analysis. Furthermore, Decree No. 20 also introduces the substance over form principle, which relies on data and actual transactions of related parties for comparison with independent transactions under similar conditions.
regardless of the form of transactions presented in the agreements of related parties. The tax authorities’ power to scrutinise related party transactions from a transfer pricing perspective will, therefore, go beyond the form of contracts and agreements.

Decree No. 20 adds more reporting and documentation obligations in addition to the existing ones, which require intensive information and documentation from taxpayers, which must be submitted together with the annual enterprise income tax finalisation return. For ultimate parent company taxpayers in Vietnam, further documentation and report are required when the consolidated global revenue during the tax period is 18 trillion dong or more. For taxpayers having the ultimate parent company in a foreign country, taxpayers are required to provide a copy of the declaration on transnational profit of the ultimate parent company in the event the ultimate parent company is required to submit this declaration to the tax authority where it is incorporated. If taxpayers cannot provide this declaration, taxpayers must explain in writing the reason, legal basis and regulations of the foreign country that do not allow taxpayers to provide this declaration.

Taxpayers are partly or fully exempt from preparing and maintaining transfer pricing reports or transfer pricing documentation in the following cases:

- related-party transactions between local taxpayers that apply the same income tax rate and do not enjoy income tax incentives;
- the total revenue in a tax period is lower than 50 billion dong and the total value of related-party transactions in a tax period is lower than 30 billion dong;
- the taxpayers signed an advanced pricing agreement (APA); and
- the taxpayers perform business with simple functions with revenue of lower than 200 billion dong without generating revenue or incurring expenses related to the exploitation and usage of intangible assets and apply a net profit margin before interest and income tax over revenue as follows:
  - distribution: 5 per cent or more;
  - production: 10 per cent or more; and
  - toll manufacturing: 15 per cent or more

The Amended Tax Administration Law effective from July 2013 provided for the concept of the APA for the first time. Enterprise income taxpayers are allowed to initiate the five-step APA procedure:

- a taxpayer must file a request on consulting to the GDT as to whether an APA is principally an appropriate solution for the transfer pricing issues of the transactions in question;
- after securing approval of the GDT, a formal application can be submitted to the GDT;
- evaluation of the application will follow;
- the tax authorities and taxpayer will negotiate the terms of the APA; and
- if the GDT agrees to the terms discussed and negotiated with the transaction parties, the final draft will be concluded with a duration of at least five years and can be extended for no more than five years.

The procedure is under the supervision of the MOF and subject to its approval. The GDT will be responsible for receiving the application, conducting the negotiation, concluding the APA and monitoring the implementation, and the respective local tax authorities may also be involved in the negotiation and implementation of the APA.
iv  **Tax clearances and rulings**

Advance tax rulings are not specifically provided under the law. However, as a matter of practice, taxpayers can write to the tax authorities to request confirmation or clarification on particular tax issues. The tax authorities’ response may not be always helpful or address the issue, but in certain cases it is helpful to gain more clarity and confirmation.

A taxpayer can also request the tax authority to confirm the status of the tax payment (i.e., no tax debt). However, such confirmation or clearance is based on the records available to the tax authority, and the tax authority takes the position that it can retroactively assess additional tax if violations are found later. The statute of limitations for tax assessment and imposing interest is 10 years from the date when the violation is detected.

X  **YEAR IN REVIEW**

Transfer pricing continues to be one of the hot topics of the year. With the participation in the BEPS inclusive framework as an official member, Vietnam will continue its effort to address the BEPS minimum standards in its legislation. Capital gains tax with respect to offshore indirect share transfer still remains a controversial issue in the absence of a thorough technical and legal basis. The increasing volumes of e-commerce and online transactions continue to pose challenges regarding the tax regulatory framework for tax authorities and tax compliance for businesses.

XI  **OUTLOOK AND CONCLUSIONS**

Pressure for further reform will continue as a key element for changes in the taxation environment. Phase-ins of free trade deals will lead to stricter management in tax compliance and an increase in indirect taxes.

The MOF has the following draft tax laws in the pipeline.

i  **Draft Special Consumption Tax Law**

This is proposed to take effect on 1 January 2020. Sugary drinks including carbonated and non-carbonated soft drinks, energy drinks and packaged instant tea and coffee are proposed to be subject to a special consumption tax at the rate of 10 per cent.

ii  **Draft Tax Administration Law**

This draft has been updated recently and is expected to be adopted by the National Assembly in May 2019 and take effect from July 2020. The Draft Tax Administration Law aims to address various tax administration issues including, inter alia, taxation of e-commerce, electronic invoice, BEPS, enforcement, etc.
ADEFOLAKE ADEWUSI
ÆLEX
Adewusi is a senior associate at ÆLEX. She is part of the dispute resolution and the corporate/commercial team with a focus on taxation. She regularly provides advice on a broad range of tax, oil and gas, corporate governance and compliance issues. She has professional certifications in taxation and corporate governance, and represents international oil companies in tax litigation at the tax appeal tribunal and superior courts of records.

BIJAL AJINKYA
Khaitan & Co
Bijal is a partner in the tax, private client and investment funds practice in Mumbai. With over 18 years of experience on the tax side, Bijal primarily focuses on structuring of inbound and outbound investments, M&A tax negotiations, writing opinions on complex tax issues of GAAR, POEM, PE, etc. On the tax litigation front, she has immense experience in providing advice on unique litigation strategies and has been a lead adviser in many successful and groundbreaking tax litigations in India. She has also served as an expert witness on Indian tax matters in an international arbitration.

On private client matters she has varied experience in advising individuals and family businesses both from a legal, regulatory and tax perspective, on succession planning and asset protection. She has pioneered tax structures for investment funds and managers and has been nominated by the IFA, India as the India country reporter in the global IFA Congress to provide a report in the International Cahiers Edition, 2019 on the topic of investment funds.

THOMAS E ALNÆS
Grette AS
Thomas E Alnæs is a partner in Grette and he has more than 15 years’ experience in the field of national and international corporate tax, both with the Norwegian tax authorities and as a tax lawyer. He has unique experience in combining tax expertise with corporate and M&A work, and his practice mainly involves inbound investments and national tax planning, cross-border and national (public and private) M&A transactions, including management incentive schemes and company buyouts. He also has experience in petroleum transaction and Norwegian petroleum tax.
JAKOB SKAADSTRUP ANDERSEN
Gorrissen Federspiel
Jakob Skaadstrup Andersen is head of tax at Gorrissen Federspiel, where he has been a partner since 2003. He studied law at the University of Copenhagen (1992), was admitted to the Danish Bar in 1996 and gained the right of audience before the Danish High Court in 1998.

Mr Andersen is an expert in international tax matters, and his focus is multinationals involved in tax controversies with the Danish tax authorities, in particular transfer pricing matters.

Over the years he has assisted a number of international clients establishing themselves in Denmark, and has also assisted foreign and Danish clients with the acquisition of Danish and foreign entities by providing structural and due diligence advice.

Mr Andersen holds rankings from, inter alia, Chambers Global, Chambers Europe and The Legal 500.

ALBERTO J E AÑESES NEGRÓN
Casillas, Santiago & Torres, LLC
Mr Añeses Negrón is an associate at Casillas, Santiago & Torres, LLC, where he is a member of the corporate and taxation practice group. His practice focuses on local, federal and international taxation, intellectual property and bankruptcy. He also provides assistance in commercial and civil litigation. Prior to joining the firm, he worked at one of Puerto Rico’s largest full-service law firms where he was an associate in the litigation department. He is the author of several law reviews pertaining to the Puerto Rico tax system. Alberto is the holder of a BSIB, summa cum laude, from Bryant University, a JD, magna cum laude, from the University of Puerto Rico School of Law, and an LLM with a certification in international taxation from the University of Miami School of Law. He is also a certified global business professional. He is admitted to practise in all the courts of the Commonwealth of Puerto Rico, the US District Court for the District of Puerto Rico, the US Court of Appeals for the First Circuit, the US Tax Court and the US Court of International Trade.

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DLA Piper Nederland NV
Rhys Bane advises clients on Dutch and international (corporate) taxation aspects of international tax planning, corporate restructurings and M&A. He also focuses on tax policy and legislation in the area of Dutch, European and international (corporate) taxation. He received his LLM in tax law cum laude from Leiden University in 2018, his thesis is titled ‘Mandatory and Binding Arbitration in the MLI: An Improvement of Taxpayers’ Legal Status in International Tax Law?’ and was awarded a grade of 9.0.

EDUARDO BARRÓN
Deloitte Impuestos y Servicios Legales, SC (Deloitte México)
Eduardo Barrón has a CPA degree from the Universidad Anahuac, and a postgraduate degree in international taxation by the Universidad Panamericana and the International Fiscal Association, Grupo Mexicano, AC. He has over 17 years’ experience in corporate tax, transfer pricing and international taxation. He currently leads the international tax practice.
for Deloitte in Mexico and is part of the Latin American international tax group. In this role, he actively participates in the design and implementation of international tax solutions involving Mexico from inbound and outbound perspectives, including efficient investment and debt structures, and advice on structuring and restructuring operations for multinational enterprises.

ALBERTO BENSHEMOL
D’Empaire
Alberto Benshimol received his law degree summa cum laude from Universidad Católica Andres Bello (1996). He has a master of laws degree (LLM) in international taxation from New York University (1997). He is a professor of finance law at UCAB (since 2002). Alberto was a member of the Venezuelan team that conducted and completed the negotiations of the US–Venezuela tax treaty (1998). Alberto is admitted to practise law in Venezuela and in the state of New York. Alberto has been a tax partner at D’Empaire since 2005.

JAROSŁAW BIEROŃSKI
Soltyński Kawecki & Szlezak
Jarosław Bieroński has provided counselling services to a number of Polish businesses, including within the Warsaw office of Ernst & Young, where he specialised in tax and foreign exchange law. He joined SK&S in 1993 and has been a partner at the firm since 2000. He established the firm's tax, customs and foreign exchange practice, and has been coordinating it ever since. He is a highly regarded specialist in international tax law, and has extensive experience in representing clients in tax disputes before tax authorities and administrative courts, in tax planning and implementation – M&A, real estate, business restructuring, tax audits, transfer pricing documentation and wealth tax management. Apart from tax law, he deals with customs and foreign exchange law, company transformation and debt restructuring. In the ranking of tax firms and tax advisers, published by the daily newspaper Dziennik Gazeta Prawna, in 2010–2016 he was placed second and first in Poland in the category of the ‘best tax adviser’ in M&A transactions and in international taxation. He provides advice to international and local clients, such as General Electric, Lone Star Funds, Goodyear, Gillette, Autodesk, Philips, Toyota, Sony Computer Entertainment, Viacom Global, Bakoma, Bank BPH, BlackRock Investment Management, MassMutual, SallieMae, ING Bank Śląski SA, ING Bank Hipoteczny SA, Carlo Tassara and Alior Bank SA.

Mr Bieroński graduated with a law degree from Poznań University Law School in 1990. He is admitted to practise as a legal and tax adviser. He is also a member of the International Fiscal Association and other international tax organisations.

CAMERON BLACKWOOD
Greenwoods & Herbert Smith Freehills
Cameron Blackwood has almost 15 years' transactional tax experience, having joined Greenwoods & Herbert Smith Freehills as a graduate in 2004. He has broad industry knowledge, including the mining, real estate and financial services sectors, and specialises in advising clients in relation to mergers, acquisitions and restructures, including capital management and cross-border issues, and all aspects of employee share schemes. Cameron has also been involved in undertaking tax due diligence for insurers providing warranty and
indemnity insurance in M&A transactions. In addition to his advisory practice, Cameron takes an active role in Australian Taxation Office and Treasury consultation on capital management, cross-border and employee share scheme issues.

In 2018 Cameron acted for clients in some of Australia’s key M&A transactions, including Unibail-Rodamco SE’s A$32.7 billion acquisition of Westfield Corporation, Australia’s largest ever M&A transaction; BHP Billiton’s US$5.4 billion off-market buy-back; and the spin-off by Wesfarmers of the Coles supermarket business.

Cameron is named as a recommended tax lawyer in New South Wales by both Doyle’s Guide and the AFR’s Best Lawyers.

JUANITA BROCKDORFF
KPMG Malta
Juanita, a lawyer, read her master’s in tax law at the University of Leiden, the Netherlands. She provides advice and assistance to multinationals, typically household names and major global brands, with a presence in Malta with international corporate tax and cross-border tax planning in both direct and indirect taxation. A member of the International Fiscal Association (IFA), the International Bar Association (IBA) and the Malta Institute of Taxation, and an honorary member of the Malta Institute of Management, she serves on the Council of the Institute of Financial Services Practitioners (IFSP) and chairs the IFSP’s Tax Committee making representations to the Executive directly, including suggestions on the tax treatment of distributed ledger technology transactions, blockchain and cryptocurrencies. Juanita has almost two decades of experience in providing advice to financial services clients, notably asset managers and insurance and reinsurance underwriters, in connection with their obligations at law for tax and commercial law matters. She has been involved in M&A transactions, drafting the legal bibles of documentation supporting such transactions and advising her clients on their positions. Juanita is frequently invited to speak at international tax conferences, such as the American Bar Association (ABA)’s annual US and Europe conference, and the STEP (Society for Trust and Estate Practitioners) annual international conference. Her work has been published in international journals. She also advises the government on legislation, in particular in EU-related matters.

FRED BURKE
Baker McKenzie Vietnam
Mr Fred Burke is managing partner of the Baker McKenzie offices in Vietnam. Recognised as one of Vietnam’s most prominent lawyers, Mr Burke has extensive experience in international trade; WTO and customs; M&A, foreign investment and securities; banking and finance; international employment; real estate; construction/projects; taxation; and dispute resolution.

Having served in the firm’s offices in New York, Shanghai and Hong Kong, Mr Burke came to Vietnam in 1991, where he became the first American to study at the University of Ho Chi Minh City after 1975. He helped found the American Chamber of Commerce in Vietnam, and has served as chairman and board member of its Ho Chi Minh City chapter for many years. He serves on the Prime Minister’s Advisory Council on Administrative Reform, chairs the Manufacturing & Distribution Working Group of the Vietnam Business Forum and has been recognised by the Ministry of Justice for his ‘Outstanding contributions in the field of international legal cooperation’.

CÉSAR CASTRO SALINAS

CMS Grau

César Castro Salinas graduated in law from the Pontificia Universidad Católica del Perú in 1977. He joined the firm in 1984 and became partner in 1989. He has led the private investment and taxation area since 1994.

He has developed an extensive practice on tax aspects of foreign investment as well as tax stability agreements with the state. His expertise was enhanced as tax adviser to the Minister of Economy and Finance in 1992, the year in which major changes were introduced into the entire Peruvian tax regime. Between 1996 and 1999, he was heavily involved in the design and proposal for the tax and legal framework required for ‘mega-projects’ in hydrocarbons and mining, as well as drafting the regulations to make the required financing for these projects feasible. Currently, he is actively involved in structuring tax-efficient foreign investment schemes.

He has published articles in specialised magazines regarding tax issues and investment in natural resources, and has been invited to give lectures on the tax framework, investment, mining closure programmes and tax, and treaties to avoid double taxation at the Canadian Chamber of Commerce, the British Chamber of Commerce, the Rocky Mountain Mineral Law Foundation and the Peruvian Tax Law Institute, among others.

Mr Castro was a member of the tax committee of the Lima Bar Association in 2002 to 2003, and a board member of the Peruvian Tax Law Institute between 1999 and 2002.

WENWEN CHAI

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Wenwen is an associate of the tax group at Baker McKenzie Hong Kong. Her practice areas include Hong Kong and Asian regional contentious and advisory tax work, as well as trust and private client matters. She received her bachelor of laws/economics double degree from the Australian National University, and is also admitted as a lawyer in New South Wales, Australia.

CHRISTIAN CHÉRUY

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Christian Chéruy is a member of Loyens & Loeff’s general tax practice group in Brussels. He is the former head of tax and partner.

Mr Chéruy’s practice covers a broad range of international and domestic corporate tax issues. These issues include inward investments, holding and financing structures (including the notional interest deduction), corporate restructurings (including cross-border reorganisations), transfer pricing and thin capitalisation rules, withholding tax requirements, double tax treaty matters, corporate and structured finance projects, mergers and acquisitions, real estate and private equity partnerships. He advises on the taxation of intellectual property and the availability of tax relief in respect of R&D. He also advises individuals on wealth optimisation techniques.

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Mr Chéruy also heads the Belgian tax controversy and litigation team. He provides assistance at every stage of the resolution process from audit examination to tax appeals and, where necessary, tax litigation. He frequently acts on behalf of taxpayers in negotiations with the Belgian revenue services, and particularly with the special Tax Investigation Brigade. He also has considerable experience in handling alternative dispute resolution processes (i.e., ruling requests and advance pricing agreements).

He is consistently ranked as one of the leading tax lawyers in Belgium by Chambers Europe and The Legal 500.

Mr Chéruy is a regular speaker at conferences on a wide range of (international) tax issues and the author of a leading treatise analysing the legal, accounting and tax aspects of Belgian holding companies.

He is a member of the Brussels Bar.

JOSÉ PEDROSO DE MELO
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José Pedroso de Melo is a former manager of an international audit firm and two of the largest law firms in Portugal. He has solid experience in the tax area, advising in domestic and international tax law, banking and insurance, restructuring of corporate and high net worth individuals' assets, merger and acquisition operations, compliance procedures and tax litigation. Mr de Melo is recognised as a tax expert by the Portuguese Bar Association, and is recommended as a tax lawyer by the international legal directories The Legal 500 and Chambers and Partners.

PHILIPPE DEROUIN
Philippe Derouin

Prior to reviving his own law firm, Philippe Derouin had been a partner with multinational law firms, namely Skadden, Arps, Slate, Meagher & Flom LLP, Linklaters LLP and Gide for 30 years. He has vast experience in business, civil, corporate, administrative and international law. He focuses on taxation, particularly in relation to mergers and acquisitions, corporate reorganisations, financial instruments, structured finance, and project and asset financing, both domestic and international.

Mr Derouin is also active in litigation, including assisting in tax audits and litigation before courts in France and Monaco, the Court of Justice of the European Union and the European Court of Human Rights, especially in important tax cases relating to domestic and international tax issues (transfer pricing, double taxation treaties, European law). He gives expert advice in foreign tax credit cases before the US courts and other tax matters in international investment arbitration. He also handles contract and civil liability cases relating to taxation.

He is consistently ranked among the leading professionals in his field. A member of the Paris Bar for more than 40 years, he chaired the French branch of the International Fiscal Association in 2016–2017.
MARC DHAENE
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Marc Dhaene is a member of Loyens & Loeff’s general tax practice group in Belgium.

His practice covers a broad range of international and domestic corporate tax issues such as inward investments, holding and financing structures, corporate restructuring (including cross-border reorganisations), transfer pricing, tax treaty issues, withholding tax requirements, corporate and structured finance projects, and mergers and acquisitions.

Mr Dhaene is also a member of the Belgian tax controversy and litigation team. He provides assistance at every stage of the resolution process from audit examination to tax appeals and, if necessary, tax litigation. Mr Dhaene acts frequently on behalf of the taxpayer in negotiations with the Belgian revenue services, and especially with the special Tax Investigation Brigade. He also has considerable experience in handling alternative dispute resolution processes (i.e., ruling requests and advance pricing agreements).

Mr Dhaene has written extensively on tax-related subjects, and has given several lectures and seminars on various aspects of corporate tax law such as the Belgian holding regime, transfer pricing, anti-abuse provisions, undervaluation of assets, tax treatment of partnership structures and tax treatment of mergers.

Mr Dhaene is a member of the Brussels Bar since 1998.

JON EICHELBERGER
*Baker McKenzie*

Jon Eichelberger practises in the area of taxation involving China, where he lived and worked for more than 29 years. Mr Eichelberger currently works from the firm’s San Francisco office. He is consistently recognised as a leading practitioner in his field by *Chambers Asia Pacific*, *The Legal 500 Asia Pacific*, *PLC Which Lawyer?* and *Asialaw Leading Lawyers* directory. Mr Eichelberger is admitted to practise in New York.

HACHEM EL HOUSSEINI
*Abou Jaoude & Associates Law Firm*

Hachem El Housseini is a senior associate at Abou Jaoude & Associates Law Firm practising in the areas of corporate and contractual law, international trade and commerce, banking, and oil and gas.

He has extensive legal multidisciplinary know-how, and throughout his career he has advised major companies with respect to various aspects of their activities, including with regard to their corporate and tax structures. He regularly represents investors and targets on the tax and regulatory aspects of a wide range of inward investments.

Mr El Housseini holds a JD in private law from the Lebanese University – Filière Francophone, and an MBA from ESA/ESCP (École Supérieure des Affaires/Ecole Supérieure de Commerce de Paris). He is a lecturer at the American University of Beirut.

He is admitted to the Beirut Bar Association and the International Bar Association, and he is an associate member of the Chartered Institute of Arbitrators, London. He is fluent in Arabic, French and English.
THEOPHILUS I EMUWA

ÆLEX

Theophilus I Emuwa is a partner at ÆLEX and head of the firm’s tax practice. He studied engineering at Imperial College London before qualifying as a barrister in England and then qualifying to practise in Nigeria and in Ghana. He has more than 25 years of corporate and commercial law experience, and is widely recognised as one of Nigeria’s leading tax practitioners. His practice extends to advising on direct as well as indirect taxes, including personal income tax, companies’ income tax and petroleum profits tax issues as well as VAT, capital gains tax, customs duty and stamp duty. His practice also covers tax appeals.

He is a fellow of the Chartered Institute of Taxation of Nigeria (CITN) and served as the vice chair of the Tax Law Review Committee of the Institute. He contributed the chapter on international taxation in the CITN Nigerian Tax Guide and Statutes. He was formerly the deputy editor of Nigerian Tax Notes.

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Sergei Eremin is a Russian-qualified lawyer specialising in national and cross-border corporate and individual taxation. Sergei’s experience includes tax advice, tax litigation, international tax structuring and advice on FATCA matters. Sergei has significant experience in anti-corruption and anti-bribery matters, including FCPA and Bribery Act compliance and investigations. Also, Sergei has been involved in a number of high-profile aviation projects and frequently advises on sanctions matters.

Sergei graduated from the Moscow State Academy of Law. Before joining the firm in 2007 he worked at another international law firm and a leading Russian law firm. Sergei has been practising law for over 14 years.

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Sumanti Disca Ferli is an associate at Mochtar Karuwin Komar, Jakarta, Indonesia, and joined the firm in 2011. She specialises in tax litigation and other dispute resolution matters, and advises on various legal issues, including corporate matters, financing and international trade. In cooperation with tax advisers from tax consulting firms, she has handled and represented companies in tax disputes at the level of the Supreme Court on various cases. She obtained her bachelor’s degree in law with cum laude predicate from the Faculty of Law of the University of Indonesia, majoring in litigation, in 2008, and her master’s degree with cum laude predicate from the same university, majoring in business law, in 2010. She also obtained an LLM from the University College London, majoring in international commercial law, in 2016.

ELENA FERRER-SAMA SERVER

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Elena is the director at the tax group practice at Roca Junyent’s Madrid office. She has a wide experience in advising companies from multinational groups, reorganisations, tax audits, transfer pricing and, generally speaking, in providing corporate income tax advice.

Before joining our Roca Junyent, she developed her career as a senior associate at Baker McKenzie and PwC.
RODRIGO FLORES BENAVIDES
CMS Grau

Rodrigo Flores Benavides is a senior associate with the tax practice group of CMS Grau. He graduated in 2005 from the Pontificia Universidad Católica del Peru Law Faculty.

Mr Flores’s tax advisory experience is focused on international tax matters, double tax treaties, cross-border transactions and tax planning. His work also comprises legal support to domestic and foreign companies for the conclusion of stability agreements with the government and the application of special tax regimes, as well as general tax consultancy, supervision processes and tax proceedings with different tax agencies. Before joining CMS Grau, he was an attorney in the tax area at Ernst & Young Peru and a tax analyst at IBM Peru.

Mr Flores was admitted to the Lima Bar Association in 2008, to the Peruvian Tax Law Institute in 2012 and to the International Fiscal Association (IFA) – Peruvian Branch in 2017. In 2013, he received an advanced LLM degree in international tax law from the International Tax Center of the University of Leiden, the Netherlands, where he was a teaching assistant on the tax treaties course during the 2013/2014 academic year. He remains affiliated to the International Tax Center Leiden, at which he has given lectures on international taxation and tax treaties in different countries such as Malaysia, Mexico and Panama.

PAOLO GIACOMETTI
Chiomenti

Paolo Giacometti is a tax partner at Chiomenti; he was former head of the tax practice, and is currently one of the managing partners of the firm. His areas of specialisation are domestic and international tax planning, cross-border transactions, corporate reorganisations and restructurings, and taxation of financial products. He also has extensive experience in tax litigation connected to the above areas.

Mr Giacometti joined Chiomenti in 1998 and worked from 2003 to 2005 in Chiomenti’s New York office. He was educated at Bocconi University of Milan and is a qualified chartered accountant. He is a frequent lecturer on fiscal matters in several postgraduate courses and seminars, and is the author of various publications on Italian and international law reviews.

GIUSEPPE ANDREA GIANNANTONIO
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Giuseppe Andrea Giannantonio graduated in economics cum laude from La Sapienza University in Rome in 1992 and was admitted to practise before the tax courts in 1993. He joined the tax department of Chiomenti in 1997 and became a partner in 2003. His areas of specific expertise are real estate, sophisticated structured finance, international taxation, structured and cross-border M&A, private equity funds and financial products.

He is the author of a large number of publications on tax matters, and a frequent speaker at conferences and lectures.

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Sirirasi Gوبpradit has practised in the corporate, commercial and tax areas since 2007. She has assisted many clients in various industries in dealing with business structure planning,
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**RICHARD HENDRIKS**  
*Greenwoods & Herbert Smith Freehills*

Richard Hendriks is head of corporate and M&A at Greenwoods. He has over 25 years’ experience in tax advisory in Australia and the UK.

Richard specialises in public markets mergers and acquisitions, demergers, capital management, and corporate restructures, including equity and debt raisings. He has also been involved in the private equity industry for many years, acting for large private equity funds in respect of management buyout transactions, loan-to-own restructures, and expansion capital investments. Richard has acted for many of Australia’s largest companies for a number of years in relation to their public markets transactions and interactions with the Australian Taxation Office.

**HAL HICKS**  
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Hal Hicks is a partner in the Washington, DC office and the global chair of Skadden’s international tax practice, and he has been advising clients on international tax issues for over 20 years. He is the former international tax counsel at the US Treasury Department and former associate chief counsel (international) of the IRS National Office.

**KOHEI KAJIWARA**  
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Kohei Kajiwara advises on various areas of law, including international and domestic tax; general and tax litigation; corporate and commercial law; M&A transactions; capital markets; structured finance; and customs duties.

He gained a bachelor of economics from the University of Tokyo (2010) and a JD from the University of Tokyo School of Law (2013), and attended the Legal Training and Research Institute of the Supreme Court of Japan (2013–2014).

He was admitted to the Japan Bar in 2014.

**FUMIAKI KAWAZOE**  
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Fumiaki Kawazoe advises on various areas of law, including tax regulations and tax litigation; international and domestic tax; M&A transactions; finance; labour and employment; and energy.

He gained a bachelor of commerce from Keio University (2010) and a JD from Hitotsubashi University Law School (2012), attended the Legal Training and Research Institute of the Supreme Court of Japan (2012–2013) and gained an LLM from Leiden University, International Tax Center Leiden (2018).

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MARIA KILATOU

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Maria is a tax lawyer, advising companies and individuals on tax planning and structuring, direct and indirect taxes, filing requirements and regulatory compliance. She advises on income tax, VAT and stamp duty liability for companies and individuals, as well as the taxes arising from the purchase, sale, transfer and ownership of real estate and movable assets. Maria has experience in the area of transfer pricing, as well as the application of European and international tax legislation to Greek nationals and residents. She also represents high net worth individuals on tax-related disputes and in cases of audits by the tax authorities.

OLEG KONNOV

_Herbert Smith Freehills CIS LLP_

Oleg Konnov has been practising law since 1993 and has developed a reputation as one of the best tax advisers in Russia. Oleg has been consistently ranked in the 1st tier by _Chambers Europe_ for tax in Russia. He advises on national and cross-border corporate and individual taxation, and represents clients in all stages of disputes with tax authorities, including tax audits, and administrative and court appeals against tax inspection decisions.

Oleg frequently writes about international and domestic taxation matters for the leading publications. He is a member of the International Fiscal Association and lectures on international tax law and tax law of foreign countries at the Moscow State University.

In addition, Oleg has considerable experience in corporate matters. His corporate practice focuses on M&A and joint ventures in a variety of sectors including oil and gas, metals and mining, telecommunications and infrastructure.

Oleg graduated from the international law department of the Moscow State Institute of International Relations and received a Candidate of Sciences from the Institute of State and Law at the Russian Academy of Sciences. He joined the firm in 2007 as a partner. Prior to that, he worked at another international law firm and at a major consultancy firm.

JIAN-CHENG KU

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Jian-Cheng Ku advises on international tax law and transfer pricing with a particular focus on international tax planning, M&A and private equity transactions, corporate reorganisations and planning and design of transfer pricing policies. His clients include multinational companies, financial institutions and private equity firms. He has (co-)authored several articles on aspects of international taxation and Dutch taxation.

DENNIS LEE

_Baker McKenzie_

Dennis Lee specialises in structuring Taiwan operations and transactions, including representative offices, branches and subsidiaries of foreign enterprises. He provides clients with valuable tax advice in relation to pre-acquisition modelling and post-acquisition restructuring.
He is also an expert on intercompany transfer pricing and tax incentives offered to encourage investment and transfer of technology, and also provides advice on value added tax issues.

In addition to advising various private equity funds and strategic corporate buyers on tax issues related to pre-acquisition modelling and post-acquisition restructuring, he advises various multinational companies on value added taxes and treaty protection as well as on tax dispute matters (e.g., withholding tax and tax assessment).

He is named a ‘recommended individual’ by The Legal 500 Asia-Pacific (2014).

MEIR LINZEN
Herzog Fox & Neeman

Meir Linzen is the head of the tax department and the managing partner of Herzog Fox & Neeman. He has been a partner in the firm since 1987.

Mr Linzen graduated with honours from Tel Aviv University's Faculty of Law, and has lectured in tax law at several forums, including the universities of Tel Aviv, Bar Ilan and Ben Gurion.

Mr Linzen is the chairman of STEP Israel (Society of Trust and Estate Practitioners), and is the chairman of the Tax Forum of the Israeli Bar Association. In addition, Mr Linzen served as a public representative on several committees appointed by the Israeli Tax Authority, including committees for the taxation of trusts and taxation of high-tech businesses, and also served as a member of the board of governors of the International Association of Jewish Lawyers and Jurists. In 2017, Mr Linzen received an honorary doctorate from Tel Aviv University.

Mr Linzen is ranked as a leading tax lawyer in leading international law directories such as Chambers Global and The Legal 500. He specialises in advising banks and other multinationals on their activities in Israel and advising individuals in cross-border activities, including the taxation of trusts and international estate planning.

ZIAD MAATOUK
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Ziad Maatouk is an associate at Abou Jaoude & Associates Law Firm practising in the areas of corporate and contractual law.

He regularly counsels clients on their corporate structures and on tax compliance matters in the context of various transactions involving the transfer of real estate and tangible assets. He has broad experience advising on controversies, audits and litigation involving tax authorities. His experience also includes representing foreign clients in establishing businesses in Lebanon, and obtaining all required permits and approvals from the public authorities.

He received his JD in private law from Saint Joseph University in Beirut. He is admitted to the Beirut Bar Association, and is fluent in Arabic, French and English.

SOURAYA MACHNOUK
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Souraya Machnouk is a partner at Abou Jaoude & Associates Law Firm, and lends her specialised knowledge and experience to several practice groups including corporate law, mergers and acquisitions, and banking and finance.
Relying on in-depth specialisation and a sharp understanding of the financial aspects of deals, she provides strategic tax planning advice and representation on a variety of complex local and cross-border transactions, such as acquisitions, equity offerings, joint ventures and tax-advantaged investments.

She advises diverse forms of entities and corporations on tax-efficient structures, and assists individuals and closely held companies in their corporatisation endeavours.

Ms Machnouk has considerable experience advising multinational companies in the reduction of overall tax costs inherent in operating in multiple jurisdictions, and in developing tax-efficient investment and operating structures.

She holds a JD with a double major in private and public law from Saint Joseph University, Beirut, a master's degree (DEA) in banking and financial markets law from Saint Joseph University in partnership with the University of Paris II-Assas in Paris and a joint master's of law degree (LLM) from Georgetown and George Washington Universities.

Ms Machnouk is recognised by The Legal 500 and Chambers and Partners as a leading practitioner in Lebanon.

She is admitted to the Beirut Bar Association and the International Bar Association, and is fluent in Arabic, French and English.

PETER MAHER
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Peter Maher is a partner with A&L Goodbody, and is the former head of the firm’s tax department. He represents clients in every aspect of tax work, with a particular emphasis on inbound investment, cross-border financings and structuring, capital market transactions and US multinational tax planning and business restructurings.

Mr Maher is ranked as one of the 10 ‘most highly regarded’ individuals globally in corporate tax by Who’s Who Legal: Corporate Tax. In 2013 and 2015 he was named ‘Global Corporate Tax Lawyer of the Year’ at the Who’s Who Legal Awards. He is also regularly listed as a leading adviser in Euromoney’s Guide to the World’s Leading Tax Lawyers, The Legal 500, Chambers Global and PLC Which Lawyer?. ‘Top tier expert Peter Maher’ (The Legal 500 2015) ‘retains a strong reputation among market sources’.

He is a former co-chair of the taxes committee of the International Bar Association and of the Irish Chapter of the International Fiscal Association. He lectures regularly, including at various IBA, IFA and ABA tax conferences, and has written extensively, including contributing chapters for The Inward Investment and International Taxation Review published by Law Business Research, The International Comparative Legal Guide to Corporate Tax published by Global Legal Group and Tax Treatment of Islamic Finance Products, a Comparative Survey published by IBFD. He has also written articles for Tax Management Financial Products Report, World Securities Law Report and Finance, and the Treasury weekly report. He is also one of the contributing editors of Getting the Deal Through – Tax on Inbound Investment published by Law Business Research and one of the two Irish contributors to the Tax Management International Forum.

ASPASIA MALLIOU
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Aspasia has over 25 years of specialisation in advising on tax law and representing clients before the administrative courts and the Council of State. She has vast experience in
advising on income, inheritance, donation and capital gains tax imposed on individuals and companies, the tax arising from a broad range of transactions and indirect taxation. She studied economics at the University of Athens, so she is business-minded.

She has taken part in committees set up to examine tax legislation in the context of public consultations at the Ministry of the Economy and working groups at the Hellenic Federation of Enterprises for the improvement of the taxation system. Aspasia is secretary of the Greek Association of Tax Law and Fiscal Studies, in which capacity she has organised and participated in numerous seminars, lectures, conferences and working groups on the interpretation of tax legislation. Aspasia has taught courses on tax law at ALBA Graduate Business School, and taught seminars at the Ministry of Finance and the Athens Law Society on developments in tax. She has been widely published in newspapers and periodicals and conducts research for tax law publications. Since 2011, Aspasia has been editor of the Tax Law Bulletin, a leading Greek publication she has contributed to as a director for the past 25 years.

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GREGORY J MAYEW
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Gregory J Mayew is a partner in Afridi & Angell’s Abu Dhabi office. Mr Mayew joined the firm in 2004, and is primarily involved in the firm’s corporate, commercial and regulatory compliance practices. A considerable portion of his practice relates to advising foreign companies on their inward investments in the UAE. He also represents local businesses in connection with their dealings with foreign companies, as well as other corporate and
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commercial matters. Prior to joining the firm, Mr Mayew was an associate for five years with the law firm Dewey Ballantine in New York and London.

KA SIOBHAN MONAGHAN

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KA Siobhan Monaghan is a senior partner at KPMG Law LLP and a partner with KPMG Canada. She has more than 30 years’ experience practising tax with an emphasis on corporate reorganisations, mergers and acquisitions, and financings. She is a member of the Law Societies of Upper Canada and Alberta, the Canadian Tax Foundation (CTF) and the International Fiscal Association. She is the past co-chair of the Chartered Professional Accountants of Canada–Canadian Bar Association joint committee on taxation, a member of the board of governors of the CTF and past chair of the national tax section of the Canadian Bar Association. She has spoken and written frequently about various income tax topics, and is co-author of Taxation of Corporate Reorganizations (Carswell, 2012) and a contributing author to Tax Policy in Canada (Canadian Tax Foundation, 2012). She is an adjunct lecturer for Osgoode Hall Law School’s professional LLM programme.

Ms Monaghan graduated from Memorial University of Newfoundland with a BComm (1981), and from Osgoode Hall Law School with an LLB (1984, Gold Medallist) and an LLM (1994).

MULYANA

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Frédéric Neukomm is a certified tax expert in the Geneva office. His main areas of work are company tax law and tax law for high net worth individuals. He also works in the fields of banking and finance.

Enjoying a ‘strong experience of transactional tax matters’, Frédéric Neukomm is praised by clients for being ‘very collegial – truly a team player’, ‘his experience is extremely extensive’ (Chambers, 2017). Sources highlight his ‘positive attitude and drive for successful outcomes’ (Chambers, 2018).
NGUYEN THANH VINH

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Mr Nguyen Thanh Vinh is a partner based in the Ho Chi Minh City office. His practice areas include tax and customs, corporate work and general commercial matters. Prior to joining Baker McKenzie's Ho Chi Minh City office in 2004, he practised tax advisory work for two international accounting firms for eight years and worked in the compliance function of an international insurance company. He has written a number of articles on Vietnamese tax issues and is co-author of the Bloomberg/BNA tax management portfolio *Business Operations in Vietnam*.

CHIOMA OKONKWO

*ÆLEX*

Chioma Okonkwo is an associate at ÆLEX. She is a member of the corporate/commercial practice group with emphasis on corporate taxation. She has a deep understanding of Nigeria's tax and corporate regulatory framework and regularly provides advice on a broad range of corporate tax issues.

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Nilanshu is a chartered accountant and an associate with the direct tax practice of Khaitan & Co. In his area of practice, he has extensively worked with a wide array of clients on several matters involving deals/transaction structuring (including the acquisition of potential targets under the Insolvency and Bankruptcy Code regime), corporate restructuring and due diligences.

FLORAN PONCE

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Floran Ponce is a lawyer and certified tax expert. He advises Swiss and foreign banks, investment funds and corporations on a broad range of domestic and international tax as well as commercial law matters. He advises them on matters relating to mergers, acquisitions, divestitures, financing transactions and restructurings, as well as on the management of tax affairs and controversies before Swiss tax authorities. He also assists private clients on complex tax matters.

Floran Ponce is a member of various professional tax law associations. He also teaches specialised tax courses for master’s degree programmes at the University of Geneva and the University of Lausanne as well as in the specialised training for the federal tax expert diploma.

ALEJANDRO PONCE MARTÍNEZ

*Quevedo & Ponce*

Alejandro Ponce Martínez, a senior partner at Quevedo & Ponce (established in 1941), where he has worked since 1963, is a doctor of jurisprudence from the Catholic University of Ecuador (1970) and a master of comparative jurisprudence from New York University (1973). He has practised in all branches of the law, including taxation, in most of the courts of Ecuador and in two international tribunals, as well as in arbitration both domestically and
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INTERNATIONALLY. He has presided over an average of 10 to 12 arbitration cases per year. He has been a law professor at the Catholic University of Ecuador, Universidad Central del Ecuador, Catholic University of Santiago de Guayaquil, Universidad del Azuay and Universidad Andina Simón Bolívar. He has written a wide range of legal articles and legal textbooks, and was chief legal adviser to the president of Ecuador, León Febres Cordero (1985 to 1987) and associate judge of the Superior Court of Quito (1988 to 1992 and 2000 to 2004), as well as of the Administrative Tribunal (2011 to 2012). He a member of the Ecuadorian Group of the Permanent Court of Arbitration, an ICSID arbitrator and a WIPO arbitrator, as well as a correspondent of UNCITRAL. Since August 2008, he has been the director of the section on juridical sciences of the Casa de la Cultura Ecuatoriana Benjamín Carrión. Together with important jurists from South America, he founded the Sociedad Internacional de Derecho Comunitario e Integración. He is also part of the arbitration section of the International Bar Association. He is a member of the Academy of Lawyers of the Quito Bar Association.

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Silvia A Pretorius is a senior associate in Afridi & Angell’s Abu Dhabi Office. Prior to joining the firm, she was a senior member in the English law department of the law offices of Gebran Majdalany in Doha, Qatar, where she advised on project finance, oil and gas purchase, offtake and supply agreements, facility construction and sharing arrangements, finance and corporate mergers and reorganisations. Ms Pretorius is involved in the firm’s corporate, commercial, telecommunications, banking and financial services practices. Ms Pretorius has spent a significant portion of her career as an attorney in South Africa, working on litigation for major financial institutions and telecoms issues.

HUMBERTO ROMERO-MUCI
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Dr Romero-Muci received his law degree summa cum laude from Universidad Católica Andres Bello in 1985, a master’s degree in law (LLM) and a diploma in international taxation from Harvard Law School in 1986 and a PhD in law from Universidad Central de Venezuela in 2003. Dr Romero-Muci has been named as one of the most distinguished tax specialists in Venezuela by Chambers and Partners and the International Tax Review. He is chair professor of tax law at Andres Bello Catholic University and the Central University of Venezuela. He is also a member of the Venezuelan Academy of Jurisprudence and was an alternate Supreme Court of Justice between 1996 and 2000. Before joining D’Empaire Reyna Abogados, Dr Romero-Muci was head of legal tax at Deloitte. He is fluent in Spanish and English. Humberto Romero-Muci has been a tax partner at D’Empaire since 2012.

RAÚL SALAS LÚCIA
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Raúl is the tax partner leading Roca Junyent’s Madrid tax practice. With over 20 years of experience, he has participated in some of the most relevant M&A and real estate operations in the Spanish and European market. Raúl has advised several large international groups when litigating with the Spanish tax authorities and the tax authorities from other European countries. His areas of specialisation
include, besides M&A, tax advice for financial institutions, energy and infrastructure companies.

Raúl has been recognised as one of the leading tax lawyers in Spain by independent directories such as *Chambers and Partners* and *The Legal 500*, and Euromoney has recognised him as a leading tax lawyer in Spain.

Before joining Roca Junyent he was the leading partner of Baker McKenzie’s corporate tax practice, which was awarded ‘Spanish Transfer Pricing Firm of The Year’ by *International Tax Review* in 2011, 2013, 2014 and 2017.

He has published numerous articles in specialist magazines, as well as in financial newspapers, has contributed to various publications, and has been a guest speaker in seminars and courses on tax issues.

**TIM SANDERS**

Tim Sanders is an English-qualified solicitor and fellow of the Chartered Institute of Taxation. After 35 years working in private practice, he retired as head of the European tax practice of Skadden, Arps, Slate, Meagher & Flom LLP and currently works as an in-house international tax adviser to an NYSE-listed company. He continues to work on a wide range of corporate and finance taxation matters.

**MIGUEL A SANTIAGO RIVERA**

*Casillas, Santiago & Torres, LLC*

Mr Santiago Rivera is a capital member at Casillas, Santiago & Torres, LLC (CST). He is a member of the corporate and taxation practice group. He advises clients in all aspects of corporate, tax, employee benefits, employment and real estate law. Prior to founding CST, he tenured at one of Puerto Rico’s largest full-service law firms, where he was a partner. Before such tenure, he was a senior tax consultant at Ernst & Young, LLP. A graduate of the University of Puerto Rico School of Law, Mr Santiago Rivera advises companies in the retail, insurance, wholesale goods, professional services, healthcare, transportation, manufacturing, banking and financial services industries as well as non-profit organisations.

**KEI SASAKI**

*Anderson Mōri & Tomotsune*

Kei Sasaki advises on a wide range of areas, including international and domestic tax; banking, structured finance and project finance; financial regulation; energy and resources; and customs duties. Mr Sasaki has also successfully represented a client at the Supreme Court of Japan in a landmark case regarding an investment scheme using the Cayman exempted limited partnership structure.

He gained a bachelor of laws from the University of Tokyo (2004), attended the Legal Training and Research Institute of the Supreme Court of Japan (2004–2005) and gained an LLM in international taxation from the New York University School of Law (2012).

During his career at Anderson Mōri & Tomotsune starting in 2005, he was associated with Herbert Smith Freehills in Sydney and Singapore (2012–2013).

He was admitted to the Japan Bar in 2005 and the New York Bar in 2014.
NIKLAS JRM SCHMIDT
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Dr Niklas JRM Schmidt, TEP, is a partner at Wolf Theiss, the largest Austrian law firm. He has been admitted as a lawyer and as a tax adviser. His areas of specialisation include tax law and private clients. Mr Schmidt is frequently engaged as a speaker at tax conferences and has been a visiting lecturer at various universities. Currently, he is a member of the examination commission for the certified financial planner exam in Austria, and he sits on the editorial board of the SteuerExpress magazine. Furthermore, Mr Schmidt is a member of the International Fiscal Association, the International Bar Association, the International Tax Planning Association and the Society of Trust and Estate Practitioners. He has been named one of Austria’s top 10 tax lawyers in the Austrian magazine TREND and is ranked in tier 1 by many international legal directories.

STEVEN SIEKER
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Steven has written and contributed to a number of publications in Hong Kong, Canada and internationally. He is a past member of the Hong Kong Inland Revenue Department Board of Review, and has been a part-time instructor in tax and revenue law at the Hong Kong University and City University of Hong Kong. He is a member of the Society of Trust and Estate Practitioners (STEP), and is a former executive director of STEP and the Canadian Chamber of Commerce in Hong Kong. Steven is the chairman of the Revenue Committee of the Law Society of Hong Kong and a member of the Joint Liaison Committee on Taxation. He is also a former clerk to the Supreme Court of Canada.

Steven’s practice focuses on Hong Kong and Asian regional tax advisory work, estate planning and tax litigation. He frequently represents clients in tax disputes with the Inland Revenue Department in Hong Kong. Steven is ranked as a leading individual for tax in Hong Kong by Chambers Asia, Citywealth Leaders List, Guide to the World’s Leading Tax Advisers, Benchmark Asia-Pacific and Who’s Who Legal.

Steven heads the tax group of Baker McKenzie in the Asia-Pacific region.

PANYA SITTISAKONSIN
Baker McKenzie

Panya Sittisakonsin has practised in the areas of international tax and international trade since 2002. With the benefit of over 16 years’ experience, he now provides tax, customs and excise tax advice from both a planning and a compliance perspective. During time spent in the tax practice group of Baker McKenzie’s Sydney office, and the trade practice group of the Washington, DC office, he gained extensive experience in international tax planning and US customs valuations.

Mr Sittisakonsin has assisted many clients from various industries in dealing with tax planning, compliance and audits, particularly regarding offshore and onshore investments, general tax advice, tax privileges, indirect taxes and tax and customs audits. He is part of a team that has successfully litigated several cases of tax planning, transfer pricing, customs valuation, excise tax and investment privileges.
MARIUS SOLLUND
Grette AS
Marius Sollund is partner and head of Grette’s Tax and VAT department, and he assists clients within all business sectors, including asset management, real estate, industry IT and telecoms, petroleum and renewable energy. He advises clients on tax matters in relation to M&A and other transactions and reorganisations, cross-border and international tax issues, and general tax advice. In addition, he assists clients with administrative procedures against the tax authorities, and he also litigates tax cases before the courts.

MOSHE SPINOWITZ
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Moshe Spinowitz is a partner in the Boston, MA office and a former Supreme Court clerk who has significant experience in international cross-border mergers and acquisitions.

EVA STADLER
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Dr Eva Stadler is a counsel with Wolf Theiss, having been with the firm since 2010. She specialises in taxation of private clients, international tax law, taxation of financial instruments and tax planning of international groups. Further, she regularly publishes articles in international and national tax journals and acts as a speaker at international tax conferences. Eva is in particular involved in the tax activities of AIJA, the International Association of Young Lawyers.

MÉLANIE STAES
Loyens & Loeff
Mélanie Staes is an international tax adviser and associate at Loyens & Loeff in Luxembourg, and was based in the New York office of the firm from 2016 to 2018. She specifically focuses on the North-American region and specialises in international tax law, focusing on group restructurings, mergers and acquisitions and investment funds. She advises multinational clients, pension funds, private equity firms, as well as other corporates and investment managers, on all aspects of Luxembourg tax law. Ms Staes regularly publishes in legal literature and is a member of International Fiscal Association (IFA), the American Bar Association (ABA) and the Canadian Tax Foundation (CTF), as well as the Luxembourg Bar.

PIETER STALMAN
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Pieter Stalman is an international tax adviser, partner and member of the executive committee of Loyens & Loeff Luxembourg. He has worked for the Amsterdam and Geneva offices, headed the Tokyo office from 1998 to 2005 and headed the Eindhoven office from 2005 to mid 2007. He specialises in advising multinational clients on cross-border transactions and group restructurings, with particular focus on the Benelux countries, Japan, China and Switzerland. Mr Stalman is a member of the International Fiscal Association and the Inter-Pacific Bar Association.
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Robert Stevenson is an associate in the Washington, DC office who has an LLM in taxation from Georgetown University, and whose practice focuses on international cross-border mergers and acquisitions.

MICHAEL TEGOS
KPMG Malta

Michail, a lawyer, read his master’s in tax law at the University of Leiden, the Netherlands. Following graduation from his master’s degree, he was handpicked and asked to stay on as the academic coordinator for the next two-and-a-half years, and he still lectures on the taxation of shipping and air transport. He is involved in the provision of tax advice to a broad range of international businesses, including a number of multinationals, in respect of a diverse range of projects including tax structuring, group restructuring and financing, and in the provision of advice on international tax issues as regards investments made into, out of or through Malta. Since arriving in Malta, he has lectured on EU law on the harmonisation of direct taxes, state aid, non-discrimination, double taxation relief and Malta’s double tax agreements for the course leading to the advanced diploma in international taxation conferred by the UK Chartered Institute of Taxation. He assists in providing feedback to the tax authorities as a member of the Institute of Financial Services Practitioners on various issues.

SILVANIA TOGNETTI
Tognetti Advocacia

Silvania Tognetti’s tax practice specialises in tax consulting for foreign investments in Brazil and Brazilian investments abroad, including infrastructure projects.

Mrs Tognetti opened her own private practice on July 2016 and has been actively working on tax and corporate issues ever since.

Mrs Tognetti has worked in the past at Veirano Advogados, as result of the integration of activities of some partners of Xavier Bragança Advogados, where she had been a tax partner since June 2012. Prior to this, she was a partner at Barbosa, Müssnich & Aragão (1999 to 2010), and also at Brasil, Pereira Neto, Galdino, Macedo Advogados – BPGM (2010 to 2012). She served as state’s attorney in Rio de Janeiro, exercising the functions of the Treasury representative on the Board of State Taxpayers, Assistant Attorney of the Tax Attorney General and Adviser to the Secretary of the Treasury of State (1996 to 1999). She also gained previous experience at Banco da Bahia (BBM) (1995 to 1996) and PricewaterhouseCoopers (1993 to 1995).

Since 2006, Mrs Tognetti has been recommended as a tax lawyer by Chambers Global. She attended the Federal University of Rio de Janeiro (JD, 1993), and the graduate programme (1994), and holds a master’s degree (2001), both from Universidade Cândido Mendes in Rio de Janeiro. She also has a PhD from the University of São Paulo (2009). Her professional memberships include ABDF, IFA, IBA, ABA and IBDT.
CARL-MAGNUS UGGLA

*Bird & Bird Advokat KB*

Carl-Magnus Uggla has 19 years of experience as an adviser on corporate tax. He has primarily focused on transactions and structuring, but also continuously worked with tax litigation and day-to-day tax advice.

*Chambers HNW* ranks him in Band 1 and states ‘He is a very skilful individual, and a brilliant tax lawyer’ (2018). *Chambers Europe* states that ‘sources value him for his knowledge and client focus’ (2018), that he ‘gives that little bit extra for his clients [and] is good at understanding complicated structures, seeing the problems and finding ways to handle them with the counterparty’ (2017), that he ‘can definitely be recommended’ (2016) and that he is an ‘increasingly prominent Swedish tax lawyer, who advises on complex restructuring and transactional mandates for Swedish and international clients’ (2015). *The Legal 500* ranks him as a leading individual and notes that ‘he has vast experience in tax issues associated with M&A… and he also undertakes tax litigation’ and that he is ‘highly experienced’ (2015). He has been featured in *ITR/World Tax* every year since 2013, when they stated that he has ‘experience in corporate taxation, focusing on M&A, restructurings, and international/EU taxation’ and that ‘he is also an experienced tax litigator, and of course is one of Sweden’s leading real estate experts’. He has also been recommended by Who’s Who Legal in *The International Who’s Who of Corporate Tax Lawyers* (2010, 2011).


Carl-Magnus holds an LLM from Lund University. He also studied, *inter alia*, business economics, economics, political science and business law at Lund University, University of Gothenburg and Suffolk University Law School.

CHINYERUGO UGOJI

*ÆLEX*

Chinyerugo Ugoji is a partner at ÆLEX. His practice focus is corporate and commercial law with an emphasis on tax. He has also advised extensively on fiscal regimes in Nigeria’s oil and gas sector. He regularly advises clients operating in diverse economic sectors on a broad range of Nigerian tax issues. He has provided tax structuring advice in relation to several cross-border and domestic M&A transactions. He has also advised extensively on fiscal regimes in Nigeria’s oil and gas sector, and has considerable experience with tax-related production-sharing contract disputes.

MICHAEL WONG

*Baker McKenzie*

Michael Wong is a leading authority on legal, regulatory and taxation issues involving major cross-border commercial transactions. He is head of the tax, mergers and acquisitions and private equity practice groups in the Taipei office of Baker McKenzie. His unrivalled depth and scope of experience covers a diverse spectrum of handling complex multi-jurisdictional acquisitions, joint ventures, infrastructure projects as well as technology, media and telecoms matters.
He assists financial institutions and independent trustees on cross-border tax and legal compliance issues; structures Taiwan operations and transactions, including representative offices, branches and subsidiaries of foreign enterprises; and prepares requests for tax rulings and assists high net worth families on private wealth management and cross-border legal and tax issues, including the use of trust and foundations, wills and private holding companies.

In addition to assisting several major US Fortune 100 companies in contentious tax matters with Taiwan’s tax authorities and providing advice and implementation on corporate restructuring, he also advises Taiwan’s Ministry of Finance as part of the prestigious panel of industry advisers for Taiwan tax reforms.

He is named a Band 1 Lawyer by *Chambers Asia-Pacific* (2014), a ‘leading individual’ by *The Legal 500 Asia-Pacific* (2018) and a ‘leading lawyer’ by *IFLR1000* (2019).
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