MOORE STEPHENS

Volume 7 Issue 3 – November 2017

European Tax Brief

Tax

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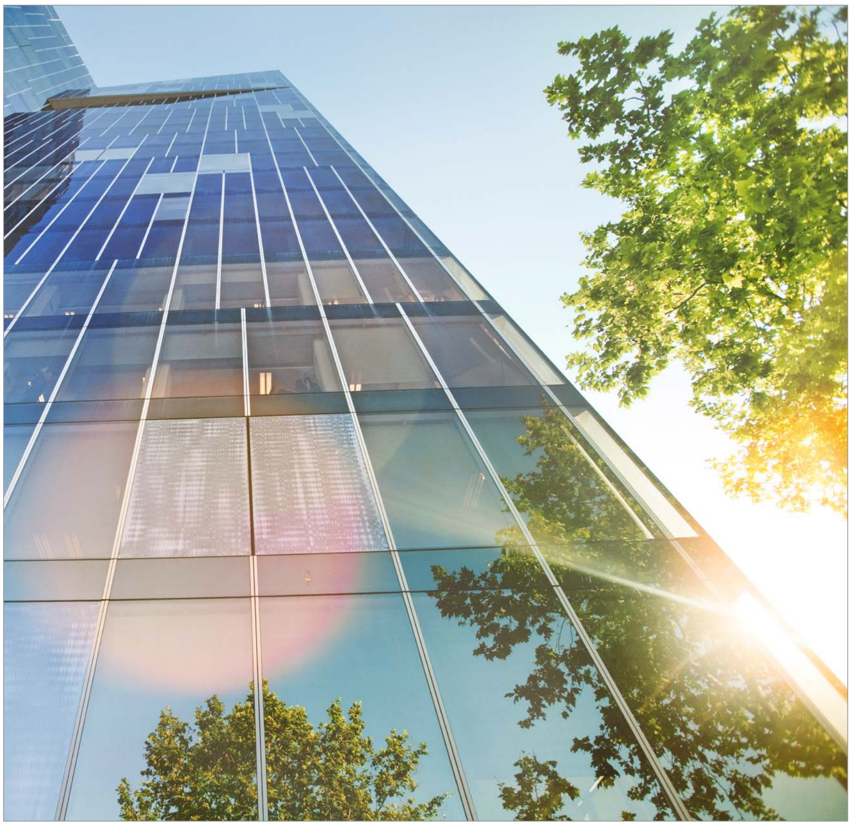
Editorial

Welcome to the latest issue of Moore Stephens *European Tax Brief*. This newsletter summarises important recent tax developments of international interest taking place in Europe and in other countries within the Moore Stephens European Region. If you would like more information on any of the items featured, or would like to discuss their implications for you or your business, please contact the person named under the item(s). The material discussed in this newsletter is meant to provide general information only and should not be acted upon without first obtaining professional advice tailored to your particular needs. *European Tax Brief* is published by Moore Stephens Europe Ltd in Brussels. If you have any comments or suggestions concerning *European Tax Brief*, please contact the Editor, Zigurds Kronbergs, at the MSEL Office by e-mail at zigurds.kronbergs@moorestephens-europe.com or by telephone on +32 (0)2 627 1832.



Inside

Belgium

Major corporate tax reform

Introduction
On 26 July 2017, the parties composing Belgium's centre-right Government came to an agreement on the reform of corporation tax, featuring a significant reduction in the tax rate. Other measures resulting from this agreement are the tax on securities accounts, the expansion of flexible jobs, the option to make the rental of property subject to VAT and the reform of the tax on savings, with the emphasis on encouraging investments in shares. The overhaul is to take place in two stages, with the first series of measures taking effect in 2018 and the second phase scheduled for 2020.

At present it remains a political agreement, and the actual impact and timing of the various fiscal measures will only become clear once the technical details have been hammered out and translated into legislation. Below, however, we set out an overview of the major changes to the tax rules, based on information publicly available at the present time.

Corporation tax measures
The measure that has received the most publicity is the reduction of the effective corporate tax rate from 34% to 25% (and down to 20% for SMEs for the first EUR 100 000 bracket). The reduction is set to be performed in two phases, with a cut to 29% in 2018. Meanwhile the 'crisis contribution' of 3% will also be abolished over two phases.

	Now	2018	2020
Standard rate	33%	29%	25%
SMEs (first €100,000)	–	20%	20%
Crisis contribution	3%	2%	0%

In the future more companies will most likely also be able to benefit from the SME rate, with the scope of which companies are defined as an SME set to be expanded in this context. It will not just be the companies that fulfil the traditional criteria according to the Income Tax Code 1992 (which is purely profit-based, but excludes certain types of company) that will benefit; the reduced rate will apply to all small companies within the meaning of company law (these are companies that have not exceeded more than one of the following criteria in the previous year: average employees 50 or more; turnover EUR 9 million; total assets EUR 4.5 million). Companies must exceed at least one of these criteria for two consecutive financial years before they cease to be considered as small.

In addition, unless a company pays remuneration of at least EUR 45 000 per year to a managing director, it will face a special tax assessment of 10% of that sum (or of the difference between EUR 45 000 and the effective lower remuneration). The EUR 45 000 sum will also be the new minimum remuneration that a company must pay to its managing director if it wishes to retain SME status (previously EUR 36 000). The sum only has to be paid to one managing director. Start-ups are still to be exempt from this requirement for the first four years after incorporation.

Introduction of a minimum tax rate
As a further quid pro quo for the reduced tax rate, it seems that a minimum tax rate of 7.5% is set to be introduced indirectly, by limiting the total deductions that may be set against taxable income.

This will apparently work as follows. Firstly, the deduction of losses brought forward from previous periods is to be considerably limited. Previous losses, together with the notional interest deduction, any unused 95% deduction for dividends received qualifying for the participation exemption ('the DTI deduction') brought forward and the brought-forward 'patent-box' deduction will be placed together in a basket, the total amount of which that may be deducted in any taxable period will be limited to EUR 1 million plus 70% of the sum of the deductible items that exceed EUR 1 million. This means that 30% of the deductible sum in excess of EUR 1 million cannot be effectively deducted (but may still be carried over to the next and following years). The upshot of this is that this 30% then forms a minimum taxable base – the company is taxed on it, even though no actual taxable base remains because the previous losses (or other deductible elements) are greater than the profit. This explains the 'minimum tax rate' of 7.5% (25% – the minimum tax rate as of 2020 – of 30% is 7.5%, excluding the EUR 1 million base against which the full deduction may still be applied).

Limited notional-interest deduction

The notional-interest deduction is also to be limited to the average growth of the risk capital over the previous five years (on the basis of a weighted average), and the investment reserve (available to small and medium-sized companies, under which they may create a tax-free reserve of up to EUR 37 500 per year from which to finance investments) is to be gradually abolished. The ability to carry forward unused NID to subsequent years remains intact. Another notable measure is that the costs pertaining to activities or income for future years are only deductible in that year. In other words, the matching principle is extended here in a fiscal sense. This means, for example, that it will no longer be possible to claim a deduction for tax purposes for rent paid in advance in the year in which it is paid. Rather, the deduction may only be made in the year to which the rent refers.

Taxation of capital gains on shares

The taxation of capital gains from the disposals of shares under corporation tax is once again set to be amended. To date, large companies have been required to pay a minimum of 0.412% tax on capital gains on shares that were held for more than a year, but this will now be scrapped. As of 2018, capital gains on shares will be subject to corporation tax at a rate of 25%. Meanwhile, the exemption for capital gains on shares will be curtailed by subjecting them to the condition of participation that holds for the DTI deduction – aside from the other conditions for that DTI deduction. This means that a threshold participation of at least 10% or an acquisition cost of EUR 2.5 million is required, together with a minimum holding period of one year, so capital gains on a share participation of less than 10% (and with an acquisition cost of less than EUR 2.5 million) will in principle still be subject to a 25% rate of tax.

There will also be changes in respect of the deferment of tax on reinvested capital gains. If reinvestment relief has been claimed but tax later falls due because the reinvestment criteria are not met, the rate at which the gain will be taxed will be the rate applicable at the time of the original gain and not that applicable when the tax falls due. Companies will thus not be able to benefit from any tax reductions in the interim.

New and existing incentives

For SMEs and self-employed persons, the investment deduction is to be temporarily increased from 8% to 20%, and the exemption from paying salary withholding tax for academic research will be 'extended in phases' (for example, to bachelor degrees where it previously only applied to master's degrees).

Measures taking effect in 2020

A second and major package of measures will take effect in 2020.

These include:

- A two-year period for conversion of tax-free reserves into taxed reserves at a rate of 15% or 10%
- Interest expense (probably, net interest expense) will only be tax-deductible to a limited extent – amounting to 30% EBITDA. For loans dating from before 17 June 2016, a grandfathering clause will provide an exemption
- The option to depreciate assets through accelerated depreciation is to be scrapped, after which SMEs shall only be able to depreciate assets in the year in which they are acquired on a pro rata temporis (straight-line) basis
- There will be stricter restrictions on deductions for car-related expenses
- There will also be an 'economic interpretation' for countering the concept of permanent establishments for shifting international profits (a diverted profits tax)
- Belgium will also introduce CFC legislation, in accordance with the EU Directive of 12 July 2016, under which the income of a 'controlled foreign company' can still be taxed in Belgium
- As of 2020 a fiscal consolidation (tax grouping) system will also be introduced in Belgium, a country that to date has been one of the few where this was not possible. The losses and profits of various group companies will then be able to be set off against each other. This will only be applicable for profits and losses after that time (i.e. there can be no setting-off of profits from one company through the losses carried over from another group company dating from prior to 2020). We are curious as to how this will be worked out legislatively
- Finally, the deductibility of both the assessment on secret commissions and VAT penalties will be abolished and the benefits for additional staff will likewise be scrapped.

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Cyprus

New residence test for individuals

Cyprus has introduced a new, alternative test for individuals to determine their residence for tax purposes. The new test sits alongside the existing test, which is that an individual who spends more than 183 days in Cyprus during a tax year is resident in that year.

Under the new test, an individual who spends at least 60 days in Cyprus in a tax year will also be considered resident if he or she:

- is not resident for tax purposes in another state and does not spend more than 183 days of that tax year in another state
- carries on a business in Cyprus or is an employee or officer of a company that is resident in Cyprus at any time in the tax year and
- has a permanent residence (owned or rented) in Cyprus

If the individual's business, employment or office is terminated during the tax year, the individual ceases to be considered to be resident in Cyprus for tax purposes for that year.

The new test applies from 1 January 2017.

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European Union

Council agrees Directive on resolving double-taxation disputes

The European Council of Economic and Finance Ministers (ECOFIN) has formally adopted a Directive on a binding mechanism for resolving disputes over double taxation. The Directive will apply to complaints submitted by taxpayers after 30 June 2019 in relation to tax years starting after 31 December 2017. For an earlier stage in the Directive's journey, see *European Tax Brief*, Vol. 7 Issue 2, July 2017, under 'Agreement on double-taxation dispute resolution'.

Currently, disputes over the right to tax are usually resolved via the 'competent authority procedure' under bilateral tax treaties, whereas transfer-pricing disputes may be resolved under the EU Union Arbitration Convention (90/436/EEC).

The new Directive (2017/1852/EU) applies to tax disputes between Member States' tax authorities and requires dispute-resolution mechanisms to be mandatory and binding, with clear time limits and an obligation to reach results. It thereby sets out to secure a tax environment where compliance costs for businesses are reduced to a minimum.

The text allows for a mutual-agreement procedure to be initiated by the taxpayer, under which Member States must reach an agreement within two years. If the procedure fails, an arbitration procedure is launched to resolve the dispute within specified timelines. For this, an advisory panel of three to five independent arbitrators is to be appointed together with up to two representatives of each Member State. The panel ('advisory commission') issues an opinion for eliminating the double taxation in the disputed case, which is binding on the Member States involved unless they agree on an alternative solution.

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EU Fourth Anti-Money Laundering Directive in force

This Directive, intended to combat tax evasion and money laundering, came into force on 26 June.

The Fourth Anti-Money Laundering Directive reinforces the existing rules by introducing the following changes:

- Reinforcing the risk assessment obligation for banks, lawyers, and accountants
- Setting clear transparency requirements about beneficial ownership for companies. This information will be stored in a central register, such as commercial registers, and will be available to national authorities and obliged entities
- Facilitating cooperation and exchange of information between Financial Intelligence Units from different Member States to identify and follow suspicious transfers of money to prevent and detect crime or terrorist activities
- Establishing a coherent policy towards third countries that have deficient anti-money laundering and counter-terrorist financing rules
- Reinforcing the sanctioning powers of competent authorities.

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European Court acts as arbitrator on double taxation dispute

The Court of Justice of the European Union (CJEU) has delivered its first judgment as a court of arbitration in a double tax dispute between two Member States – a mechanism provided under Article 273 TFEU (Treaty on the Functioning of the European Union) but not hitherto invoked.

In Case C-648/15, the German and Austrian tax authorities were unable to settle a dispute concerning the double taxation treaty between their two countries and hence invoked Article 273. The dispute revolved around the interpretation of profit-participating loans in article 11 of the treaty (taxation of interest). Article 11(1) provides that interest may be taxed only by the home state of the beneficial owner of the interest payments, whereas article 11(2) provides that where the loan enables the lender to participate in the profits of the borrower, the source state may also tax the income.

The subject-matter was participation certificates that an Austrian bank acquired from a German bank. The certificates provided that interest would be paid at a fixed rate on their nominal value, but in the event that the payment would give rise to a loss for the German bank, the amount of interest payable would be reduced accordingly, with the right to receive the arrears in future years. The German authorities asserted that the certificates fell within article 11(2), so that Germany could exercise taxation rights, whereas the Austrian authorities maintained that there was no right to participate in profits, hence that article 11(1) applied and Austria had sole taxation rights.

The CJEU held that in everyday language and most commonly accepted accounting conventions, the concept of a profit-participating loan was one that conferred the right to share in the positive income of the borrower (i.e. in its profits). The terms on which the certificates were issued carried no right to share in profits, but merely required there to be sufficient profits for the interest payment to be made. Furthermore, every one of the examples of profit-participating loans listed under article 11(2) involved a share of the profits.

Accordingly, the CJEU found in favour of Austria, by holding that article 11(2) had to be interpreted so as to exclude participation certificates of the kind involved in the case.

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Commission takes Ireland to court over Apple

We have reported in previous issues of *European Tax Brief* that the European Commission considers Ireland to have granted unlawful State Aid to the technology giant, Apple, in its tax arrangements with that company. The Commission ruled that the tax unlawfully remitted by Ireland was EUR 13 000 million, and that Ireland should take steps to recover this amount, plus compound interest, immediately.

Both Ireland (on 9 November 2016) and Apple (on 19 December 2016) have appealed against this ruling. Although final resolution of the dispute may take several years, the fact of an appeal does not suspend the obligation to take effective steps to recover the amount at stake.

The Commission has concluded that Ireland has taken insufficient steps to collect the amount owing, and is therefore bringing a case against the Irish government to the CJEU. The Irish Ministry of Finance has called the decision 'extremely disappointing', has stressed that Ireland fully respects the rule of law in the European Union, and considers that it has acted with due expedition in face of the acknowledged difficulties.

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Commission rules against Luxembourg on Amazon tax arrangement

Under Competition Commissioner, Margarethe Vestager, the European Commission has issued a series of State Aid rulings against what Commission experts believe are unlawful tax arrangements a number of Member States, to date principally Ireland and Luxembourg, have made with multinational companies. The latest such ruling concerns Luxembourg and Amazon.

After a three-year investigation, the EU Competition Commissioner has ruled that Amazon benefited from illegal state aid from a tax arrangement with Luxembourg in 2003, and is demanding that Amazon pay Luxembourg back approximately EUR 250 million in tax.

Under the ruling granted to Amazon by the Luxembourg tax authorities, all Amazon's EU-wide retail revenues accrued to its Luxembourg-resident subsidiary, Amazon Luxembourg. However, Amazon Luxembourg paid about 75% of its revenues in the form of intra-group royalties to an intermediate holding structure, Amazon Europe Holding Technologies, which takes the form of a limited partnership and has no substance, but held the IP rights for Amazon in Europe under a cost-sharing agreement with its two US partner companies, to which it paid cost-sharing contributions towards IP development. The limited partnership is tax-transparent and therefore tax in Luxembourg is payable at the level of the individual partners. However, the partners are exclusively US-resident, and have so far deferred any tax liability.

The Commission's case is that given the lack of substance of the partnership, the level of the royalty paid by the sales company is excessive. Both the Luxembourg state and Amazon have defended the 2003 arrangement as compatible with State Aid regulations, and have argued that Amazon has been properly taxed in accordance with tax rules applicable at the relevant time. They will almost certainly appeal against the ruling.

The structure in question was changed in 2014.

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Car-leasing scheme was supply of services

The CJEU has given its judgment in the Mercedes Benz case (Case C-164/16), on whether the Agility car-leasing scheme operated by Mercedes Benz Financial Services in the United Kingdom involved a supply of services rather than a supply of goods.

Although the CJEU held that it was ultimately for the UK courts to determine whether the Agility agreement constitutes a supply of services or a supply of goods, it would appear that, on the basis of the CJEU's reasoning, the Agility agreement may be interpreted as a supply of services, although it remains to be seen what the final decision will be. The distinction matters because it affects when VAT is to be charged and paid. On a supply of goods, VAT is chargeable immediately on the handing-over of the goods on the full price of the supply. By contrast, on a supply of services over an extended period of time, VAT is chargeable on each instalment payment or on the earlier issue of an invoice.

Under Agility, which is a variant of a hire-purchase (HP) agreement, customers make monthly payments over a term of 36 months and have an option to purchase at the end of the agreement. However, the amount of the monthly payments is less than it would be under a standard HP agreement, with the result that the optional purchase price is about 40% of the initial price of the car, compared to the purely nominal final payment under a standard HP agreement. About 50% of Agility customers exercised the option to purchase.

Over the course of time, European case law has established that lease agreements should normally be treated as supplies of services, whereas most HP agreements constitute a supply of goods, since article 14(2)(b) of the VAT Directive (2006/112/EC) states that a supply of goods includes 'the actual handing over of goods pursuant to a contract for the hire of goods for a certain period, or for the sale of goods on deferred terms, which provides that in the normal course of events ownership is to pass upon payment of the final instalment'.

Mercedes Benz treated Agility contracts as a supply of services but the UK tax authority, HMRC, maintained it was a supply of goods within the UK transposition of article 14(2)(b). When the case before the Court of Appeal in England and Wales, that court referred the question to the CJEU.

According to the CJEU, a supply will fall within article 14(2)(b) only if (a) the contract includes a clause expressly relating to the transfer of the property *and* (b) objectively assessed at the time of concluding the contract, the intention is that ownership of the goods passes automatically to the lessee through the normal performance of the contract. With regard to the second limb of the test, the CJEU has in essence stated that this is likely to be the case where the option to purchase would be the only economically rational choice for the lessee. In other words, if the total amount paid over the lease term was more or less equivalent to the market price of the goods plus the cost of financing, transfer of ownership with or without payment of a token fee, would be the only economically rational option for the lessee and the test would be satisfied, i.e. there would be a supply of goods. If, however, transfer of ownership is only one of two or more options for the lessee and purchasing the vehicle is not the only economically rational option for the lessee, then this test fails. It was for the UK court to determine the outcome based on these principles.

The judgment has been welcomed by the UK's automotive sector, for which it has potentially wide ramifications. Although it is principally of interest to the United Kingdom, this interpretation of article 14(2)(b) could have significance in other Member States also.

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Commission announces investigation into UK CFC rules

The European Commission has announced that it is opening a formal State Aid investigation into the financing-income exemption in the United Kingdom's CFC rules.

The CFC rules recharacterise certain income of foreign subsidiaries located in low-tax jurisdictions and controlled by one or more UK-resident persons as income of UK-resident companies that control them. The European Union's Anti-Tax Avoidance Directive (2016/1164/EU) requires, inter alia, all Member States to adopt CFC provisions. The United Kingdom has had CFC legislation since 1984, but the law was comprehensively reformed in 2012 and the new legislation took effect on 1 January 2013, as Part 9A of the Taxation (International and Other Provisions) Act 2010. Under Chapter 9 of that Act, a 75% or 100% exemption from the CFC charge is available in certain circumstances for certain finance income, including that of so-called group treasury companies.

The European Commission believes that this exemption confers tax benefits that are not available to other comparable taxpayers, as it allows the group to provide financing to a foreign company via an offshore subsidiary while suffering a reduced level of tax on the profits from those transactions, and the Commission doubts whether this exemption is consistent with the overall objective of the CFC rules.

The United Kingdom and other interested parties now have the opportunity to submit comments. A spokesperson for HM Treasury is understood to have said that the UK Government does not believe the rules are incompatible with European law but will cooperate fully with the investigation.

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France

French dividend surtax ruled unconstitutional

The French Constitutional Court has held that the 3% surtax on dividends, which has been in force since 2012, is in violation of the constitution in its entirety.

The surtax is levied on most profit distributions by French companies, including French permanent establishments of foreign companies. Following infringement action against France by the European Commission on the grounds that the burden of taxation on intra-EU dividend redistributions exceeded what was permissible under the Parent Subsidiary Directive, the European Court upheld the Commission's position.

However, the exemptions introduced after the European Court's judgment and an earlier French Constitutional Court judgment now result in reverse discrimination against redistributions of dividends from a French subsidiary, and it was this situation that brought about a second reference to the Constitutional Court.

Taxpayers with outstanding appeals that have not yet been finally determined may invoke the decision.

The Finance Bill for 2018 contains a measure abolishing the tax (see also 'Corporate income tax rates set to fall substantially'.

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Wealth tax to be abolished

The Macron government's first Finance Bill, introduced into the French Parliament on 2 October (see also 'Corporate income tax rates set to fall substantially' and 'French dividend surtax ruled unconstitutional'), contains measures abolishing the wealth tax (*impôt de solidarité sur la fortune*) and replacing it by an immovable property tax (*impôt sur la fortune immobilière*).

The new tax will be charged on French immovable property not related to the business (if any) held directly by the taxpayer or by means of property companies (on the proportion of the company's value represented by immovable property). Property held through special vehicles, such as an SCPI (*société civile de placement immobilier* – property investment company) or an OCPI (*organisme commun de placement immobilier* – collective property investment fund), is not exempt. Homeowners will continue to benefit from the 30% deduction for their main residence and loans charged on property will be deductible, but deductions will be capped where the value of the property exceeds EUR 5 million). Otherwise, the new tax will keep the rates, valuation rules and reporting requirements of the existing wealth tax, so that property with a total value of no more than EUR 1.3 million will be exempt, but property above that value will be taxed at progressive rates, beginning with 0% on the first EUR 800 000 and rising to 1.5% on that part of the value exceeding EUR 10 million. The current overall cap of 75% of taxable income for combined income and wealth tax is also to be maintained.

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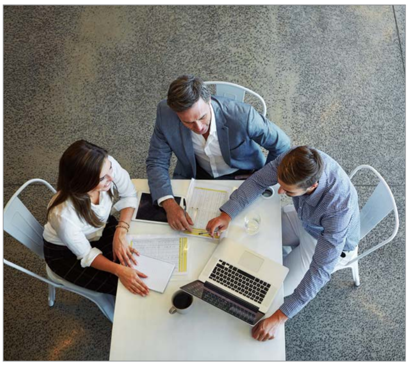

Corporate income tax rates set to fall substantially

Another element of the 2018 Finance Bill is a further phased reduction of the rate of corporate tax, which is currently 33.33%.

- In 2018, the rates as set by the previous government will apply, i.e. 28% on the first EUR 500 000 of profits and 33.33% on the remainder.
- In 2019, the 33.33% rate is to be reduced to 31%.
- In 2020, the rate on all taxable profits will fall to 28%; then further to 26.5% in 2021 and 25% in 2022.

As has been noted, the 3% dividend surtax is to be abolished, as from 1 January 2018.

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Germany

New limit on deductions for royalties paid to low-taxed foreign related parties

With effect from 2018, German taxpayers will no longer be able to claim a full deduction for royalties paid to foreign related parties benefiting from non-OECD-compliant patent box and other preferential intellectual property (IP) regimes, even where the royalties are set at commercial, arm's length rates. Non-arm's length royalties are already subject to transfer-pricing adjustments.

The new restriction aims to protect the German tax base via a new section in the German Personal Income Tax Act (section 4j *Einkommensteuergesetz – EStG*), which applies both to permanent establishments of non-resident taxpayers in Germany (including participations in German tax-transparent entities like limited partnerships) and to German-resident taxpayers (e.g. German companies such as GmbHs).

Under the new section, the tax-deductibility of expenses resulting from agreements for the use of, or the right to use, IP rights, in particular copyright and industrial-property rights, or information concerning industrial, commercial or scientific and similar experience, know-how and skill (for example plans, secret formulas or processes) with related parties is to be denied to the extent that the corresponding income is taxable in the hands of non-resident recipients at a rate below 25%.

As with other recent German tax measures against so-called hybrid mismatches, in particular as regards hybrid financing, the law is based on the principle of corresponding taxation, so that the percentage of expenses that is deductible by the German payer is dependent on the portion of income that is not subject to taxation abroad at below 25%.

The law addresses in particular so-called IP, Licence and Patent-Box Regimes outside Germany where these do not require a certain level of commercial business activity, e.g. research and development, in the jurisdiction in which they are based (the so-called nexus approach). The new rules are motivated by action point 5 of the BEPS Project, in which the participating states have agreed on the abolition of preferential tax regimes not compliant with the nexus approach by 30 June 2021.

The new German rule applies to expenses accruing from 2018 onwards, irrespective of the taxpayer's business year and irrespective of whether or not the low tax in the recipient's jurisdiction is due to the existence of a specific preferential IP regime.

The rule should be seen in the context of Germany's obligations under the EU Interest and Royalties Directive and its own double tax treaties to reduce or eliminate withholding tax on outbound royalties in applicable cases. Existing anti-avoidance rules requiring claimants for the reduced or zero rates to prove that Germany's rules against treaty and Directive shopping are not applicable are currently under challenge in the European Court (see 'Anti-Treaty (and anti-Directive) shopping rules on inbound investments challenged' in *European Tax Brief*, Volume 6 Issue 3, December 2016).

The wording of the new law is not totally clear in every aspect and leaves room for interpretation so that taxpayers should seek advice based on thorough analysis of their individual circumstances.

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Greece

Greece broadens application of VAT reverse charge

Greece has introduced the VAT reverse-charge mechanism on supplies of mobile phones, games consoles, tablet PCs (personal computers) and laptops.

Under the reverse charge, it is the customer and not the supplier who must account for the VAT on the goods. The supplier does not charge VAT on the invoice. The reverse charge only applies where the customer is himself a taxable person.

Article 199a of the EU VAT Directive permits Member States to impose the reverse charge on supplies of goods particularly susceptible to fraud.

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Ireland

Commission takes Ireland to court over Apple

See under European Union.

Italy

VAT rate increases deferred

Both the scheduled increase in Italy's standard rate of VAT and the increase in the reduced rate have been deferred, due to improvements in Italy's fiscal position.

The standard rate was set to increase from 22% to 25% from 1 January 2018, but will now increase to 24.2% from 1 January 2019.

Also from 1 January 2018, the reduced VAT rate of 10% was to have been raised to 11.14% on 1 January 2018, with a further increase to 12% on 1 January 2019. Instead, it will remain at 10% for 2018 but increase to 11.5% on 1 January 2019.

The reduced rate applies to supplies such as certain foodstuffs, passenger transport (where not exempt), admission to cultural events and hotel accommodation.

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Latvia

Latvia set for zero tax on retained corporate income

A set of comprehensive tax reform measures was approved by Latvia's parliament, the *Saeima*, in August. Among the measures is abolition of the current corporate income tax of 15%, replacing it with a 0% rate on retained profits and a 20% rate on actual and deemed distributions. Distributions taxed at 20% will be free of income tax for the recipients. For the first time, most partnerships will cease to be tax-transparent and become liable to corporate tax, with partners' drawings assimilated to dividends. Latvia is thus set to emulate its northern neighbour Estonia, alone in the European Union thus far, which has had a similar system for many years.

Deemed distributions include most loans to connected persons, non-business expenditure (expenditure on luxury cars, expenditure on employee leisure, sporting and catering facilities (subject to a de minimis exemption)), excessive interest, transfer-pricing adjustments, certain bad-debt write-offs and a reduction in share capital at the expense of post 31 December 2017 earnings.

Dividends paid out of pre-1 January 2018 retained earnings will be exempt, but debt write-offs and accounting losses going forward will be applied to reduce the pool of these earnings.

Excessive interest is of two types. The first is interest on loans exceeding the 4:1 debt-equity ratio and the second is a new restriction on interest expense exceeding 30% of EBITDA. This will apply solely to the amount of interest expense exceeding EUR 3 million.

Several existing reliefs are retained, however, and may be deducted from the taxable base (whether from taxable dividends alone or from taxable deemed distributions also) or in some cases, as a tax credit. These include the 80% tax reduction for investment in Latvia's two free ports or three Special Economic Zones and the tax credit for approved significant investment of over EUR 10 million.

Tonnage tax also remains in force.

Additionally, both domestic and foreign dividends received may be deducted in computing taxable dividends, provided that the distributing company is subject to Latvian corporate tax or corporate income tax in its home jurisdiction or where the dividend is received after deduction of foreign withholding tax, unless the distributing company has obtained a deduction for the dividend in its home jurisdiction or is established in a tax-free or low-tax jurisdiction.

As a transitional measure, companies will be able to deduct unrelieved losses as at 31 December 2017 for a maximum of five years beginning with 2018. The amount deductible in any year from tax otherwise payable will be limited to 15% of the loss, capped at a maximum of 50% of the tax payable in respect of dividends.

Tax will be charged at 20% of the taxable base grossed up by 5/4, so that a distribution of 80 will bear tax of 20 (an effective rate of 25%).

Interest and royalties paid to foreign companies remain free of withholding tax. Dividends will also be free of withholding tax as now, since it will be the distributing company that will bear the burden of the tax, not the dividend recipient.

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Progressive income tax introduced

Among the other reform measures is the introduction of a progressive income tax, with rates of 20%, 23% and 31.4% replacing the current flat rate of 23%.

The rates will apply as follows:

Annual taxable income (EUR)	Rate of tax (%)
First 20 000	20.0
Next 35 000	23.0
Balance over 55 000	31.4

Investment income (previously taxed at 10%) and capital gains (previously taxed at 15%) will both be taxable at 20%, but dividends from a Latvian company that has paid the new corporate tax will be exempt. Latvian dividends paid out of pre-1 January 2018 earnings (exempt from the new corporate tax) will remain taxable at 10%. Foreign dividends will be exempt if they have been subject to corporate tax or have been paid under deduction of foreign withholding tax.

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Solidarity tax rates unconstitutional

The Latvian Constitutional Court (*Satversmes tiesa*) has held that the rates at which the solidarity tax is charged are discriminatory and hence unconstitutional.

Solidarity tax, which is intended to equalise the tax burden by taxing individuals with very high incomes more heavily (in the previous absence of a progressive tax on income), is charged at the rates applicable to social security contributions on earned income (i.e. income liable to social security contributions) in excess of the social security ceiling (EUR 52 400 in 2017), but not on investment income. It thus effectively removes the contributions

ceiling without creating any further entitlement to social security benefits in return.

In a case brought by 58 individuals, the Court has held that while the solidarity tax is not in breach of the constitution in itself, the rates at which it is charged are discriminatory, since individuals who have reached pensionable age and certain other groups who are not fully socially insured pay lower rates than those who are fully insured.

The Court has given the Government until 1 January 2019 to remedy the violation of the Constitution. It is not known how the authorities will react. It would presumably be quite straightforward to cut the link with social security rates and simply increase the new top rate of income tax or create further higher rates accordingly.

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Luxembourg

Luxembourg to introduce new IP Box régime

Luxembourg is to introduce a new beneficial tax régime for income from intellectual property (a so-called IP Box). Unlike the previous régime, which was abolished (subject to transitional provisions) on 30 June 2016, the new IP Box is BEPS-compliant, in that it adopts a modified nexus approach to eligibility.

The Luxembourg government has taken the opportunity of broadening the scope of the new Box to include a wider variety of patents and computer-software copyrights, but trademarks and designs will not be eligible.

The new régime is intended to apply as from 1 January 2018.

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Commission rules against Luxembourg on Amazon tax arrangement

See under European Union.

Malta

Malta to introduce notional-interest deduction

Malta is to introduce a deduction for equity financing in its corporate tax law from 2018, with effect for financial years ending in 2017. It will apply to 'undertakings', hence to partnerships as well as to bodies corporate.

The deduction will be for an amount of 'notional interest', at a rate based on interest offered by Maltese government bonds, on an entity's 'risk capital', which will include share premium, interest-free debt, retained earnings and certain capitalised reserves, and will take effect from 1 January 2018. As with all such measures, already adopted by several countries, the intention is to put equity financing on the same footing as debt financing, the interest on which is already allowed as a deductible expense for tax purposes (subject to certain restrictions).

The deduction for notional interest (NID) will be optional and must be claimed by the undertaking concerned. The NID must not exceed in any given year of assessment 90% of the undertaking's chargeable income for that year, but any excess NID may be carried forward. Any residual chargeable income is subject to tax at the standard rates. Claims will only be accepted if all shareholders or partners of the undertaking consent to the claim, which must then be made in the undertaking's income tax return.

If NID is claimed by an undertaking, the shareholders or partners will be deemed to have received income equal to the interest on risk capital claimed as a deduction by the undertaking in the same year of assessment in which the deduction is made. The deemed income will be characterised as 'interest' for the purposes of Maltese tax law.

Anti-avoidance rules will apply to prevent abuse.

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The Netherlands

Corporate anti-avoidance rules on the cards

New corporate anti-avoidance measures are included in the Tax Plan for 2018 presented to the Netherlands Parliament on 19 September.

The measures include:

- *Application of a double motive test to loans from third parties*: interest is currently deductible on related-party loans if both the debt and the transaction have a genuine business purpose. This test is now to extend to loans from third parties
- *Denial of double deduction for intra-group write-downs*: losses on a debt claim that one group company has against another will no longer be deductible if the write-down relates to losses incurred by another group company
- *Denial of deduction for liquidation losses of an intermediate holding company*: a group will no longer be available to deduct liquidation losses in respect of an intermediate holding company that has left the group

These measures would take effect from 1 January 2018, if adopted.

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Russia

General anti-avoidance rule introduced

With effect from 20 August 2017, the Russian tax code contains a general anti-avoidance rule.

Under the rule (article 54.1), taxpayers will no longer be entitled to claim a deduction from taxable income and thereby obtain a reduction in tax payable if they are considered to have deliberately misrepresented their economic activities or assets, or to have made inaccurate statements in a tax return, so as to achieve a reduction in otherwise taxable profits or in his tax liability.

Among factors that may suggest such deliberate action on the taxpayer's part are:

- Control by the taxpayer over the actions of his counterparty
- Transfers between related or affiliated parties, including transactions with intermediaries, special terms and conditions regarding payments and
- Evidence of concerted actions between the taxpayer and other parties.

On the other hand, factors that will not in themselves point to such deliberate action on the part of the taxpayer when viewed in isolation are:

- Signature of source documents by an unidentified or unauthorised person
- A breach of tax obligations by a counterparty (such as failure to pay tax due) and
- The possibility of using other avenues or options to achieve the same economic result

The burden of proving that a taxpayer has fallen foul of the new rule is on the tax authorities.

However, even if taxpayers pass these tests, they will not be able to obtain a deduction unless:

- The main purpose of the transaction is not to avoid or minimise tax or obtain or increase a tax refund and
- The obligation under the transaction is fulfilled by a party to the contract concluded with the taxpayer and/or by a legitimate assignee of the counterparty

We can foresee difficulties in establishing what is the taxpayer's main purpose, especially when an element of planning is involved. The tax authorities have published preliminary guidance, but it may well take considerable time before a clear picture emerges of the dividing line between legitimate tax planning and unacceptable avoidance falling within the rule.

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Switzerland

Swiss government trials revised corporate tax package

Following the defeat in a national referendum of its previous corporate-tax reform package (Corporate Tax Package III) – see *European Tax Brief*, Vol. 7 Issue 1 (April 2017), under 'Popular vote rejects corporate tax reform' – the Swiss government has published a new detailed draft reform package ('Tax Proposal 17').

The new package includes the following main measures:

- Introduction of an OECD-compliant patent-box régime at the cantonal level
- Introduction of a superdeduction of 150% for approved research and development costs incurred in Switzerland, again at a cantonal level
- A limitation of the above reliefs to no more than 70% of taxable profits
- Abolition of the privileged special finance-branch, domiciliary, mixed and holding-company régimes, with a transitional relief by way of releasing existing hidden reserves (including goodwill)
- The option for cantons to reduce the net worth tax on equity capital
- New statutory rules for company immigration and emigration
- An increase to 70% of the proportion of income from significant participations subject to income tax
- An increase from 17% to 20.5% in the cantonal share of federal tax revenues

Missing from the new proposals is the previous proposed introduction of a notional-interest deduction. Further differences with the failed package are the reduction from 80% to 70% of the maximum deduction for R&D and the patent-box reliefs and a reduction from 21.2% of the proposed cantonal share of federal tax revenues. Most cantons still envisage reducing their rates of corporate income tax to act as a counterbalance to the loss of the special régimes.

The new package is open for consultation until 6 December, after which it will undergo debate in Parliament. If all goes according to plan, a final legislative package will be put to a referendum (should one be called) in 2019, with a view to implementation in 2020.

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Ukraine

VAT refund procedure simplified

Since 2015, taxable persons in Ukraine have had to keep a special central electronic VAT account from which VAT payments are to be made, and have not been able to issue a VAT invoice before entering the corresponding VAT debit in the VAT account. In certain circumstances, if taxable persons do not have sufficient credits (input VAT) in the account to cover the newly created liability, they may have to make an advance payment.
Furthermore, all VAT invoices must be registered with the tax authorities and entered in the unified register of VAT invoices. The existence of a registered VAT invoice is sufficient grounds for the taxable person as customer to book the amount of VAT charged by that invoice as a credit in its own VAT account.

As a further development to make the procedure of VAT reimbursement from the state budget more transparent, an open register of VAT refund applications kept on the tax authority's website went live online on 1 July 2017. If the tax authority finds nothing untoward in the application after 30 days, repayment is made in chronological order of applications.

At the same time (1 July 2017), in order to balance taxpayers' interests with those of the state and to prevent possible tax fraud on the part of taxpayers, the tax authority introduced an automatic system of suspension of VAT invoice registration, where the invoice meets certain risk criteria.

Certain invoices are exempt from being susceptible to suspension. These include VAT invoices issued by companies with annual turnover less than UAH 500 000 thousand (provided that any director of such a company does not hold a similar position in two or more other legal entities) as well as by companies that paid more than UAH 5 million in tax (including social security contributions but excluding import VAT) in the previous tax year.

It is to be hoped that the above changes will contribute to simplification of the VAT system and to a smoother process of VAT reimbursement to taxable persons.

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New list of foreign entities subject to transfer-pricing rules

Ukraine's transfer-pricing regulations apply not only to transactions between related parties but also to a number of other specifically defined business transactions.

Thus, business transactions with non-resident entities that are liable to corporate profit taxes (including in respect of income received outside their home state) and / or are not resident for tax purposes in the jurisdiction under whose law they were established are subject to transfer-pricing rules. The list of such legal entities by reference to their home jurisdiction was published recently in Decree No 480 of 4 July 2017.

The listed entities include:

Jurisdiction	Entity
Belgium	Limited Partnership
United Kingdom	Partnership (Ordinary Partnership), Limited Partnership, Limited-Liability Partnership
Italy	General Partnership, Limited Partnership
Canada	General Partnership, Limited Partnership, Trust, Extra-Provincial Corporation
The Netherlands	General Partnership, Limited Partnership, Partnership, Fund, Private Mutual Fund
Germany	Civil-Law Partnership, Dormant Partnership, Partnership Limited by Shares, Limited Partnership, General Partnership
United States (Delaware, California, Nevada, New Jersey, New York, Texas, Florida)	General Partnership, Limited-Liability Partnership

However, if an entity listed in the Decree has paid a corporate profit tax in the reporting year, business transactions with that entity will not thereby be brought within the transfer-pricing rules, unless other criteria specified in the law for the application of transfer-pricing legislation are met.

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United Kingdom

Commission announces investigation into UK CFC rules

See under European Union.

Car-leasing scheme was supply of services

See under European Union.

Currency table

For ease of comparison, we reproduce below exchange rates against the euro and the US dollar of the various currencies mentioned in this newsletter. The rates are quoted as at 20 November 2017, and are for illustrative purposes only.

Currency	Equivalent in euros (EUR)	Equivalent in US dollars (USD)
Euro (EUR)	1.0000	1.1788
Ukrainian hryvnia (UAH)	0.0319	0.0376

Up-to-the-minute exchange rates can be obtained from a variety of free internet sources (e.g. http://www.oanda.com/currency/converter).

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