



AMERICAN BAR ASSOCIATION

Tax Section

VIRTUAL 2021 MAY TAX MEETING

International Tax Trends: Global Tax Chaos

Foreign Lawyers Forum

May 11, 2021

The Panel

Name	Country	Firm
<u>Moderator:</u>		
Kim Blanchard	United States	Weil, Gotshal & Manges LLP
<u>Panelists:</u>		
Leonardo Homsy	Brazil	Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados
Angelo Nikolakakis	Canada	EY Law LLP
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Peng Tao	China	DLA Piper LLP (US)

Objectives

- In this time of international tax chaos, we will provide an overview of current tax traps to be aware of as you evaluate international structures, including:
 - Interest deduction limitations and anti-hybrid rules to be aware of in deciding where group debt might best be located
 - Transfer pricing considerations relevant to intercompany dealings – what to watch out for
 - What tax incentives might be available, under what conditions and subject to what qualifications
 - When do we need to worry about digital services taxes, which are proliferating around the world
- After summarizing these traps, we will discuss the potential application of tax treaties and when a treaty might be available to ameliorate some of the problems identified
- Finally, we will attempt to prognosticate about where all these developments may be taking us . . .

Interest Deductibility

CANADA

- Layers of restrictions:
 - Specific:
 - “reasonable rate” rule
 - “stapled debt” rule
 - 2007 proposal on funding foreign investments / “double dips”
 - General:
 - Transfer pricing rules
 - Thin-capitalization rules (1.5:1 debt: equity)
 - Budget 2021 proposed “earnings stripping” rule (OECD Action 4)
 - 40% of “tax EBITDA” as of 2023
 - 30% as of 2024

Interest Deductibility

BRAZIL

- Interests are generally CIT-deductible
- Related parties or black/grey-listed entities:
 - Thin cap: 2:1 debt/equity (0.3:1 for black/grey-list)
 - *With* participation in BR entity: debt < 2x the value of the equity participation in the net equity of the Brazilian entity
 - *No* participation in BR entity: debt < 2x net equity of the Brazilian entity
 - Black-grey-list: debt < 30% of the net equity of the Brazilian entity
 - applies also on foreign loans when non-resident guarantor/intervening party is a related party to debtor
 - Transfer pricing: deductibility limited to a benchmark rate (generally Brazilian sovereign bonds or LIBOR) + a spread of 3.5%
- Rules in force ~10years. Nothing new in Brazil

Interest Deductibility

CHINA

- Required to be relating to business operation in general, and no higher than comparable bank loan interests
- Subject to thin cap rule of 2:1 for related party borrowings
- Capitalize if for capital purposes

Anti-Hybrid Rules

EUROPEAN UNION

Deduction / Deduction

EU: Deduction in the country of origin, only

Deduction / No Inclusion

EU: No Deduction

Hybrid
Mismatches

Tax Credit / Tax Credit

EU: Tax Credit limited to actual payment

No Taxation / No Inclusion

EU: Taxation at the level of the
headquarter

Anti-Hybrid Rules

BRAZIL

- **Interest on net equity** (notional interest)
 - Treaty qualification: Dividends vs. Interests
 - Different % of possible tax sparing credit
 - Recent Tax Treaties signed by Brazil: **Interests**
 - Same qualification by Decree No. 2020-14853 of the Dutch State Secretary
 - Tax sparing credit of 20% (instead of 25% if treated as dividends)

Anti-Hybrid Rules

CANADA

- Budget 2021 proposed introduction of OECD Action 2
- Phased in:
 - First round – Chapters 1 & 2 on hybrid instruments (July 2022)
 - Second round – broader implementation (no earlier than 2023)
- Existing rules against foreign tax credit duplication
- Existing audit and assessment activity under transfer pricing rules

Transfer Pricing

CHINA

- China has been incorporating BEPS actions into its transfer pricing rules
 - Contemporaneous documentation (CbC report and automatic exchange of information)
 - Value contribution
 - Beneficial owner
 - Substance for IP licensor
- Proposed rules on simplified APA

Transfer Pricing

BRAZIL

- Do not follow OECD guidelines (arms length)
- Statutory methods
 - taxpayer may choose freely the method of preference
- As part of BR intent to join OECD: studies to bring BR transfer pricing closer to OECD guidelines

Transfer Pricing

CANADA

- Supreme Court declines leave in Cameco
- Proposed “ordering rule” to prioritize transfer pricing over other rules
- Budget 2021 proposed consultation on broader revisions

Transfer Pricing

EUROPEAN UNION

- Planned amendment of the EU Accounting Directive: Introduction of **public country-by-country reporting** for multinational groups with consolidated revenues of more than 750 million Euro.

GERMANY

- Case Law on IC-Financing
 - Not at arm's length without security
 - Constitutional complaints are pending

Tax Incentives

BRAZIL

- High tax jurisdiction
 - Various tax incentives and exemptions
 - Variable per segment (e.g., infrastructure and manufacturing), region, etc.

- Tax reform | simplification of tax system
 - Terminate tax incentives
 - Revoke dividend exemption (c/w reduction of CIT)

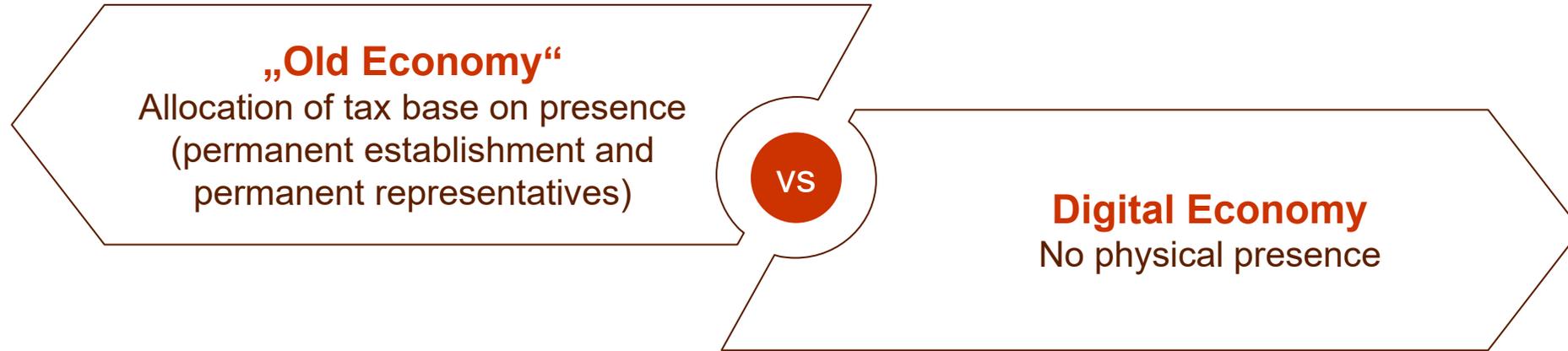
- Federal Law 160/17: current ICMS (VAT) incentives limited in time
 - 2032: industrials
 - 2025: international trade via ports and airports
 - 2022: commercial entities

Tax Incentives

CHINA

- Towards encouraging high-tech industry and R&D
 - Increase bonus deduction to 75% for R&D
 - 100% for manufacturing enterprises
- Location based incentives still available on a case by case basis
 - Hainan free trade zone: 15%
 - Lingang area of Shanghai free trade zone: 15% for 5 years from incorporation
- Withholding tax deferral for re-investment of dividends
- Temporary relief for minimizing Covid-19 impacts and boosting post-pandemic economy

Digital Services Tax



Indirect Taxes

- Subject digital services to VAT or other indirect taxes in the country in which the recipient is located

Direct Taxes

- Pillar I: A portion of multinationals' residual profit should be taxed in the jurisdiction where customer or user is located.

Digital Services Tax

EUROPEAN UNION

- Intention to reach an agreed global solution on international taxation of the digital economy within the OECD by mid-2021
- However, they confirm that the EU is ready to move forward if there is no prospect of a global solution
- The EU Commission wants to have a digital levy in place by January 1, 2023 at the latest

Digital Services Tax

BRAZIL

- Bill of Law proposing a new “CIDE-Digital”
 - **Scope:** gross revenue arising from certain digital activities
 - Including advertising placement, digital platforms (goods and services) and transmission of data
 - **Tax Basis:** total gross revenue from in-scope activities earned during the calendar year. In case the gross revenue arising from the placing of advertising in a digital platform encompasses advertising placed to users located in other countries, the tax basis would include the gross revenue proportionate to the advertising placed to users located in BR. Similar mechanism applies to gross revenue arising from the transmission of data.

Digital Services Tax

BRAZIL

- Bill of Law proposing a new “CIDE-Digital”
 - **Taxpayer:** entity in Brazil or abroad, earning revenues from activities and which is part of an economic group that earned, in the previous calendar year, a (i) global gross revenue higher than or equivalent to 3 billion Reais and, cumulatively, a (ii) gross revenue higher than 100 million Reais in Brazil
 - **Rates:** progressive tax rates up to 5%

Digital Services Tax

CANADA

- Budget 2021 proposed DST, at 3% of “revenue from certain digital services reliant on the engagement, data and content contributions of Canadian users”
- Relatively narrow focus on
 - online marketplaces (e.g. Amazon, Air BNB, Uber)
 - Excludes online sales on own account and streaming
 - social media (Facebook)
 - online advertising (Google)
- Applicable 2022, unless Pillar I adopted

Treaties

CANADA

- Essentially adopted only minimum standards under MLI
- Adopted PPT “as an interim measure”, pending negotiation of LOBs
- Did not adopt PPT discretionary relief provision (i.e., derivative benefits)
- No guidance of interpretation and application
- Introduced but did not adopt unilateral PPT
- Adopted unilateral anti-conduit (“back-to-back”) rules
- Treaty Shopping case (Alta Lux) pending at Supreme Court

Treaties

BRAZIL

- Controversies on technical services
 - Treaty qualification: *Business Profit (art. 7) Vs. Royalties (art. 12)*
 - Protocol including technical services under the Royalties treatment
 - Exceptions: Austria, Finland, France, Japan and Sweden
 - Possible new trend: Fees for Technical Services (new art. 13)

- Controversies on Brazilian CFC rules
 - New rules introduced by in 2014 (same old controversies?)
 - Different treatment for tax havens

Treaties

CHINA

- Expansion of main purpose test to all treaty clauses (protocols to Hong Kong and Macau treaties)
- Relaxation of PE enforcement during Covid-19 period
- Further relaxation of procedures for enjoying treaty benefits from approval to self-assessment from Jan 1, 2020
 - Supporting materials are not required to be provided upon filing, but for examination by the tax authority later if ever
- Updated beneficial owner requirements from 2018
 - More safe harbors are available

Treaties

EUROPEAN UNION

- ECJ - Danish cases
 - ECJ, 26 February 2019 - C-116/16 and C-117/16; ECJ, 26 February 2019 - C-115/16, C-118/16, C-119/16 and C-299/16
 - Exemption under directives require the intermediary company to be the beneficial owner of the dividends/interest
 - If it is acting as a mere conduit company, in particular if the pass-through entity does not have sufficient substance, the exemption is not applicable
- Anti-Tax Avoidance Directive (ATAD)
 - Obligation for all EU member states to introduce certain measures against tax avoidance by January 1, 2020
 - Germany is late with the implementation

Treaties

GERMANY

- Draft new anti treaty/directive shopping rule (Art. 6 ATAD, BEPS AP 6)
 - Germany's current rule infringes EU law (ECJ 200 December 2017 (C-504/16 and C-613/16))
 - Draft published which further tightens the requirements
- Draft Tax Haven Defense Act
 - No tax deduction from transactions with black listed countries
 - No participation exemption for shareholders resident in such countries
 - Further restrictions on CFC Rules and withholding tax exemptions

Long Term Implications

- **China** - Digital transformation to collect and audit
- **Brazil** - Tax Reform c/w more emphasis to fiscal responsibility – Brazil
- **Germany** – Further increase of the compliance requirements in particular for international transactions and additional aggressive tax legislation to “combat” tax efficient structuring
- **Canada** – Increasing reliance on transfer pricing, general anti-avoidance rule, and increasingly aggressive compliance, disclosure (Budget 2021) and enforcement
- **Globally**, taxpayers need to model cross-border activity very carefully in order to minimize instances of double taxation, and to be nimble as laws continue to develop and change

For more information

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Questions?

All attendees can submit questions via the chat feature on the virtual meeting interface.