International Tax Updates

1. The OECD introduced substantial activities requirement for no or nominal tax jurisdictions

In November 2018, the Inclusive Framework on Base Erosion and Profit Shifting ("BEPS") issued a document entitled "Resumption of Application of Substantial Activities Factor to No or only Nominal Tax Jurisdictions".

The document was issued as a follow-up work under BEPS Action 5 on countering harmful tax practices. Given that all preferential regimes for geographically mobile income are now required to meet the substantial activities requirement under BEPS Action 5, the Inclusive framework has decided to apply similar substantial activities requirement to "no or only nominal tax" jurisdictions to level the playing field and ensure that business activity does not simply relocate to a zero tax jurisdiction in order to avoid the substance requirement.

The document identifies the following 11 types of mobile business activities that are subject to the substantial activities requirement: headquarters, distribution centres, service centres, financing, leasing, fund management, banking, insurance, shipping, holding companies and the provision of intangible property ("IP").

The document requires a no or nominal tax jurisdiction to have domestic legislation in place that:

- defines the core income generating activities ("CIGAs") for each in-scope business activity;
- ensures the relevant CIGAs are undertaken by the entity enjoying the zero or nominal tax rate in the jurisdiction ("the relevant entity") or are undertaken within the jurisdiction;
- requires the relevant entity to have an adequate number of full-time qualified employees and incur an adequate amount of operating expenditures in the jurisdiction;
- put in place a transparent mechanism to ensure compliance with the substantial activities requirement (e.g. a requirement for the relevant entity to report the detailed information in relation to the substantial activities requirement); and
- put in place an effective enforcement mechanism for non-compliance with the substantial activities requirement (e.g. sanctions and exchange of information about the non-compliance).

The document also includes certain special rules on the substantial activities requirement with respect to income derived from IP, including a rebuttable presumption that the substantial activities requirement is not met in certain "higher risk scenarios" involving IP and related parties if the relevant CIGAs are not undertaken in the jurisdiction.

Subsequently, a number of zero or nominal tax jurisdictions (e.g. Barbados, Bermuda, the British Virgin Islands ("BVI"), Cayman Islands, Guernsey, Isle of Man and Jersey) have responded by introducing legislation that imposes the substance requirements for the above mobile business activities identified by the OECD in their jurisdictions. In some jurisdictions such as the BVI and Cayman Islands, the substance legislation became effective on 1 January 2019. It is expected that more detailed guidance on the interpretation of the substance legislation and the implementation of the substance requirement will be issued by the competent authorities of the BVI and Cayman Islands later.

For more details and a copy of the OECD document, please refer to this <link> to the OECD's website.

For copies of the substance legislation in the BVI and Cayman Islands, please refer to these two links: <link> and <link>.

2. The OECD issued policy note and public consultation document on taxation of digital economy

On 29 January 2019, the OECD released a policy note on the work of the Inclusive Framework on BEPS on addressing the tax challenges of the digitalisation of the economy.

The policy note emphasises that members of the Inclusive Framework are committed to continue working together towards a final report in 2020 aimed at providing a consensus-based long-term solution, and that a progress report will be issued by June 2019. The policy note identifies two central pillars which could form the basis for reaching a global solution.

The first pillar focuses on how the existing rules that allocate the taxing rights of the income of multinational enterprises among jurisdictions, including traditional transfer-pricing rules and the arm's length principle, could be modified to take into account the changes that digitalisation has brought to the world economy. This will require a re-examination of the so-called "nexus" rules and the rules that govern how much profit should be allocated to the business conducted in a jurisdiction. The Inclusive Framework will look at proposals based on the concepts of marketing intangibles, user contribution and significant economic presence and how they can be used to modernise the international tax system to address the tax challenges of digitalisation.

A second pillar aims to resolve the remaining BEPS issues and will explore two sets of interlocking rules designed to give jurisdictions a remedy to tax profits in cases the other jurisdiction with taxing rights applies a low effective tax rate to those profits. The two inter-related rules are (1) an income inclusion rule and (2) a tax on base eroding payments.

For more details and a copy of the policy note, please refer to this <link> to the OECD's website.

Subsequently, the OECD issued a public consultation document on 13 Feb 2019 to seek public comments on the key issues identified on the possible solutions to the tax challenges arising from the digitalisation of the economy.

Section 2 of the consultation document focuses on the first pillar, namely the allocation of taxing rights (the "broader tax challenges") by suggesting modifications to the profit allocation and nexus rules based on the concept of user contribution or marketing intangibles. In particular, the following three proposals that are currently examined by the Inclusive Framework are discussed in the section:

- the "user participation" proposal;
- the "marketing intangibles" proposal; and
- the "significant economic presence" proposal.

Section 3 of the consultation document focuses on the second pillar and discusses the global anti-base erosion proposal. This proposal seeks to address the remaining BEPS challenges through the development of the following two inter-related rules:

- an income inclusion rule that would tax the income of a foreign branch or a controlled entity if that income is subject to a low effective tax rate in the jurisdiction of establishment of residence; and

- a tax on base eroding payments that would deny a deduction or treaty relief for certain payments unless that payment is subject to an effective tax rate at or above a minimum rate.

Comments are sought from the public on a number of policy issues and technical aspects in relation to the above four proposals. Interested parties are invited to send their comments to the OECD no later than 1 March 2019.

For more details and a copy of the public consultation document, please refer to this <link> to the OECD's website.

3. Abolishment of the Macau offshore business regime

The law giving effect to the abolishment of the Macau offshore business regime (i.e. Decree-Law 15/2018) was approved by the Macau Legislative Assembly on 18 December 2018, gazetted on 27 December 2018 and became effective on 28 December 2018.

The key provisions in Decree-Law 15/2018 include:

- no more offshore business licence will be granted;

- existing offshore business licences will automatically become invalid on 1 January 2021;

- Macau Offshore Companies (MOCs) changing their commercial names and registered business activities within 180 days from the date on which the licence becomes invalid will be exempted from the relevant stamp duties, notarisation fees and business registration fees;

- income derived by a MOC from intellectual property acquired on or after 16 October 2017 is no longer eligible to Complementary Tax exemption starting from 1 July 2018;

- purchase of moveable and immovable properties by a MOC is no longer eligible to Stamp Duty exemption; and

- managers and specialist technicians of a MOC who obtain a resident permit after Decree-Law 15/2018 became effective are no longer eligible to Professional Tax exemption.

For more details and a copy of the law gazetted, please refer to this <link> to the website of the Macau SAR Government.

4. The UK introduced a new tax on offshore receipts in respect of intangible property

The UK has introduced a new income tax on offshore receipts in respect of intangible property. The new measure will be effective from 6 April 2019, with a targeted anti-abuse rule applicable to certain avoidance arrangements entered on or after 29 October 2018.

The new measure targets multinational groups that generate significant income from intangible property through UK sales, and have made arrangements such that the income is received in offshore jurisdictions where it is taxed at no or low effective rates.

In brief, a UK income tax will be imposed on the owners of intangible property or those that are entitled to income that is referable to the sale of goods or services in the UK in relation to that intangible property and who are not resident in the UK or a territory having a full tax treaty with the UK (i.e. a tax treaty which contains a non-discrimination provision) unless one of the below exemptions applies. The income tax will be charged at 20% on the gross receipts that are referable to the sale of goods or services in the UK and realised by the non-UK resident entity from the ownership of, or rights over, the relevant intangible property.

Exemptions from the tax are available:

- where the value of UK sales of goods or services is less than £10m in a given tax year;

- where all, or substantially all, of the business activity in relation to the intangible property has always taken place in the territory of residence and the intangible property has not been acquired from a related party;

- where the tax paid in the jurisdiction of residence in relation to the relevant income is at least 50% of the UK Income Tax that would otherwise arise under this measure; and

- for partnerships which are regarded as separate entities for tax purposes and resident in a full treaty territory.

Any person within the same control group during the relevant tax year will be jointly and severally liable for the tax due under this new measure.

In addition, there is a targeted anti-abuse rule which has effect for arrangements entered into on or after 29 October 2018. The rule targets arrangements where one of the main purposes is to either (1) avoid the tax under this new measure (including arrangements involving a transfer of the ownership of intangible property to another group entity resident in a jurisdiction having a full tax treaty with the UK) or (2) seek the benefit of a tax treaty where the benefit is contrary to the purpose of that tax treaty.

For more details and a copy of the policy paper on the new measure issued by the HM Revenue & Customs, please refer to this <link> to the website of the UK Government.