International Tax Updates

1. The OECD work plan for resolving the tax challenges arising from digitalisation of the economy

   The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) approved a Programme of Work to develop a consensus solution to the tax challenges arising from the digitalisation of the economy during its plenary meeting held on 28 & 29 May 2019. The Programme of Work was endorsed by the G20 Finance Ministers during their ministerial meeting held on 8 & 9 June 2019 in Japan.

   The work plan lays out the process for reaching a global consensus on the long-term solution for resolving the tax challenges arising from the digitalisation of the economy by the end of 2020. The Programme of Work will explore the technical issues to be resolved in relation to the two main pillars identified in the policy note issued in January 2019 and the consultation document issued in February 2019.

   The first pillar will explore potential solutions for determining where tax should be paid and on what basis ("nexus"), as well as what portion of profits could or should be taxed in the jurisdictions where clients or users are located ("profit allocation").

   The second pillar will explore the design of a system to ensure that multinational enterprises, in the digital economy and beyond, pay a minimum level of tax. This pillar (i.e. a global anti-base erosion (“GloBE”) proposal) would provide countries with a new tool to protect their tax base from profit shifting to low or no-tax jurisdictions, and is intended to address remaining issues identified by the OECD/G20 BEPS initiative.

   The OECD plans to submit a recommendation on the core elements of the long-term solution to the Inclusive Framework for agreement at the beginning of 2020. Work will then be carried out throughout 2020 to agree on the policy and technical details of the solution and a final report will be delivered by the end of 2020.

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

2. The BVI draft Economic Substance Code

   On 24 April 2019, the International Tax Authority (ITA) of the British Virgin Islands (BVI) published the draft Economic Substance Code. The draft Code set out the interpretation and application of the legislation enacted by the BVI on 1 January 2019 for implementing the OECD’s substance requirements in no or nominal tax jurisdictions. The draft Code comprises the following three parts:

- extracts from the substance legislation;
- rules made by the ITA; and
- guidance issued by the ITA, which is not legally binding.

Some of the clarifications contained in the draft Code are:

- A legal entity will be treated as carrying on a relevant activity in the BVI during any financial period in which it receives income from that activity.

- An entity which owns other forms of investment / asset (e.g. bonds, legal or beneficial interests in real property) is not a "pure equity holding entity" even if it also owns equity participation, and is not treated as carrying on holding business.

- A pure equity holding entity only needs to have an adequate number of employees and adequate premises in the BVI as well as comply with the statutory obligations under the BVI Business Companies Act or Limited Partnerships Act. It does not need to be directed or managed in the BVI. There is also no requirement for it to carry on core income generating activities (CIGAs) in the BVI.

- There are no restrictions on the extent to which a pure equity holding entity may outsource its activity. Where the entity retains the services of a registered agent, the services performed by the agent will be taken into account when assessing economic substance.

- An entity which provides credit as an incidental part of a different sort of business is not regarded as carrying on a finance and leasing business. An entity which holds debt or debt instruments for the purpose of investment is not regarded as being in the business of providing credit facilities. Short term hiring out of vehicles, boats or equipment is not caught as "leasing business".

- A business which owns an intellectual property (IP) merely as an adjunct to its business and which does not earn specific amounts of revenue from the IP is not regarded as an "intellectual property business"

- A legal entity which is a tax resident of another jurisdiction is exempt from meeting the substance requirements. In this regard, evidence required to prove tax residency in another jurisdiction includes: a letter or certificate issued by the competent authority of the jurisdiction stating that the entity is considered to be its tax resident, an assessment to tax, a confirmation of self-assessment to tax, a tax demand, evidence of payment of tax.

For existing entities formed prior to 1 January 2019, the first financial period shall commerce on 30 June 2019 unless the legal entity gives notice to the ITA for electing an earlier commencement date. For entities formed on or after 1 January 2019, the first financial period shall commerce on the date of incorporation or formation and shall terminate on the expiry of one year from that date.

In addition to the draft Code, the BVI government also launched an education campaign on the substance requirements. An Economic Substance Forum was held in the BVI, Hong Kong (on 30 April 2019) and the UK during which the representatives from the BVI explained the substance legislation and the draft Code as well as collected feedbacks from stakeholders. It is understood that the draft Code will be revised based on some of the comments received from the Forum and the final Code will be issued after another round of consultation in June 2019.

For more details and a copy of the draft Code, please refer to this <link> to the website of the BVI Finance.

3. The Cayman Islands issued amendment regulation and revised guidance on the substance requirements

On 30 April 2019, the Tax Information Authority of the Cayman Islands issued the revised "Guidance on Economic Substance for Geographically Mobile Activities" (i.e. Guidance v2.0). Guidance v2.0 replaces the original guidance issued on 22 February 2019. In addition to Guidance v2.0, an amendment regulation was also issued on the same date to introduce various amendments to the substance legislation enacted by the Cayman Islands on 1 January 2019.

The regulation, namely International Tax Co-operation (Economic Substance) (Amendment of Schedule) (No. 2) Regulations, 2019, amended the definitions of various terms used in the substance legislation, including the definitions of (1) domestic company, (2) investment fund, (3) fund management business, (4) shipping business, (5) high risk intellectual property business and (6) relevant income.

In particular, the definition of "fund management business" has been amended such that not only securities management business carried on by fund managers **licensed** in the Cayman Islands but similar business carried on by a relevant entity "otherwise **authorised** to conduct business" under the Cayman Securities Investment Business Law (2019 Revision) for an investment fund will also be subject to the substance requirements.

Guidance v2.0 provides clarification / further guidance in various areas such as:

- clarification on what is regarded as part of an investment fund;
- clarification on what activities are regarded as “service centre business”;
- whether a relevant entity carrying on a relevant activity but without any relevant income needs to meet the substance requirements and the related notification and reporting obligations;
- elaboration on the “subject to tax” requirement where a relevant entity claims itself to be a tax resident of another jurisdiction; and
- additional guidance on how to count the employee time when Cayman Islands CIGAs are outsourced to a service provider.

For more details and a complete list of legislation and guidance on the substance requirements issued by the Cayman Islands, please refer to this <link> to the website of the Department of International Tax Cooperation of Cayman Islands.

4. The UK published draft regulations and guidance on taxing offshore receipts in respect of intangible property

Further to the discussion in our *Newsletter, February 2019* on the new income tax on offshore receipts in respect of intangible property introduced in the UK, the UK HM Revenue & Customs published the draft regulations, explanatory memorandum and guidance on the new tax on 24 May 2019 for consultation with stakeholders.

The new income tax will be charged at 20% on the gross receipts arising on or after 6 April 2019 from intellectual property used to support sale of goods or services in the UK and realised by non-UK resident entities located in low tax jurisdictions.

The draft guidance provides further guidance in respect of the following areas:

- the background, purpose and design of the new tax;
- the charge on the UK-derived amounts and apportionment;
- the exemptions available;
- recovery of tax from related persons;
- the anti-avoidance provisions; and
- the process and procedures for the assessment and collection of the new tax.

For more details and copies of draft regulation and guidance, please refer to this <link> to the website of the UK Government.