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EY Quarterly Tax Bulletin: EMEIA Insurance

Spring 2017

Welcome

Welcome to the Spring edition of the EY Quarterly Tax Bulletin: EMEIA Insurance. In this issue, we reflect on the progress made on the OECD's multilateral instrument to amend tax treaties, the chances of US tax reform and the current state of play on some of the European Union's tax initiatives. Designed for tax professionals working for groups in the insurance sector with operations across the EMEIA area, each quarterly bulletin brings you a selection of short articles and topical news items. Our focus is on tax, legal and regulatory developments. If you would like to discuss any of the issues raised in this edition, please get in touch with the relevant contacts listed at the end of each article, or your usual EY contact.

OECD releases multilateral instrument to implement treaty-related BEPS measures

The OECD has released the text of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS) under BEPS Action 15 (the MLI) and explanatory notes. The MLI constitutes an unprecedented step change in international taxation and will have a significant impact on the taxation of multinational insurance groups given the expectation that it may amend at least 2,000 tax treaties.

One of the main purposes of the MLI is to enable countries to meet the treaty-related minimum standards that were agreed as part of the final BEPS package. The MLI is therefore intended to enable all countries to implement treaty-related measures produced as part of the final BEPS package in a coordinated and consistent manner across the network of existing treaties without the need to bilaterally renegotiate each such treaty. Some signatories to the MLI may develop consolidated versions of their tax treaties as modified by the MLI, though doing so is not a prerequisite for the application of the MLI.

The MLI will be applied alongside existing tax treaties, modifying their application in order to implement the BEPS measures. The treaty-related BEPS measures covered by the MLI include elements of: Action 2 on hybrid mismatch arrangements, Action 6 on treaty abuse, Action 7 on the artificial avoidance of the permanent establishment status; and Action 14 on dispute resolution. The substance of the tax treaty provisions relating to these actions was set out in the final BEPS package released in October 2015.

The MLI was developed over the past year via negotiations involving more than 100 jurisdictions including OECD member countries, G20 countries and other developed and developing countries, under a mandate delivered by G20 Finance Ministers and Central Bank Governors at their February 2015 meeting.

Recognising the complexity of designing a general instrument that applies to multiple tax agreements and to the specific provisions included in bilateral tax treaties, the MLI provides flexibility for contracting jurisdictions to implement those parts of the MLI applicable to their needs. Many of the provisions of the MLI overlap with provisions found in existing tax agreements. Where the provisions of the MLI conflict with existing provisions covering the same subject matter, this conflict is addressed through one or more compatibility clauses which may, for example, describe the existing provisions which the MLI is intended to supersede, as well as the effect on tax agreements that do not contain a provision of the same type.

Countries have the right to opt out of certain parts of the MLI and to have these specific articles not apply to their tax treaties. For the minimum standard provisions, the right to opt-out only exists to the extent the tax agreement in question already includes a similar minimum standard. Where a minimum standard can be satisfied in alternative ways, the MLI does not give preference to a particular way of meeting it. However, in cases where contracting jurisdictions each adopt a different approach to meeting a minimum standard those contracting jurisdictions must endeavour to reach a mutually satisfactory solution consistent with the minimum standard.

While it is not certain at this stage which countries will become signatories to the MLI, or the extent to which the provisions (other than the minimum standards) might apply with respect to any particular treaty, it is clear that a broad range of international groups in the insurance sector will be affected by the proposal in the coming years. Developments in this area should be monitored and existing arrangements should be carefully evaluated in light of the potential treaty changes across the world.

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Republican President and Congress increase likelihood of US tax reform

The victory of Donald Trump in the US presidential election, together with the Republican Party retaining control of both the House of Representatives and Senate, has raised the prospect of the long-mooted comprehensive reform of the US tax system finally coming to fruition. President Trump will need to consider whether to push forward with reform based upon one of two published approaches; the outline tax reform he championed during his election campaign or the House Republican Tax Reform Blueprint. It is still too early to ascertain how Trump will proceed, and we have considered the content of both approaches below.

While bipartisan cooperation may still be necessary to achieve meaningful policy accomplishments in some areas, it is possible that tax reform could be enacted using "budget reconciliation legislation." Budget reconciliation would permit a bill to pass in the Senate with a simple majority of 51 votes as opposed to the usual 60-vote majority. Utilising this sort of legislation would allow the Republicans to implement their tax reforms with a simple majority in both the House and Senate, greatly increasing their ability to push through changes.

Both Trump's and the House Republican plan for tax reform include substantial cuts to the headline rate of US corporate income tax, from the current 35% down to 15% (according to the Trump plan) or 20% (according to the House Republican Blueprint). In addition, the alternative minimum tax on corporations would be abolished along with most forms of tax credits, except for the research and development credit. The Blueprint plan outlines enhanced deductions for intangible and tangible property by permitting companies to immediately deduct the cost of business property, with the exception of land. Correspondingly though, this plan restricts the deductibility of interest payments.

Trump's plan and the Blueprint plan are aligned in proposing that accumulated untaxed foreign earnings should be subject to a one-off tax. The House Republicans suggest an 8.75% tax rate on previously untaxed accumulated foreign earnings held in cash or cash-equivalent form, and a 3.75% tax rate on all other accumulated earnings, payable over eight years. Trump's plan provides for a flat rate of 10%. Under the House Republican Blueprint, corporate tax would also become territorial so that profits made outside the US would, in general, no longer be subject to US tax. It is not clear, as yet, where Trump stands on a fully territorial system.

One interesting aspect of the House Republican Blueprint is the radical proposal to transmute corporate income tax into a "border adjusted cash flow tax." This would tax corporate cash flow with deductions for export sales and no deduction for the cost of imports. There would also be some deductions for wages. This would mean the tax would primarily be on domestic consumption with an economic effect similar to VAT, which taxes imports and domestic consumption while zero-rating exports. This is intended to eliminate incentives for US businesses to move or locate operations outside of the United States under a territorial tax system. Several considerations on developing a workable border adjustability concept must be factored in, including whether to exempt financial transactions. However, Trump himself is understood to have expressed scepticism about the border adjustment element of the Blueprint.

Major reforms and cuts to the taxation of individuals are also planned as part of both tax reform packages. Both the President's and the House Republicans' plans include a change in individual rates to 12%, 25%, and 33%. In addition, Trump has proposed capping itemized deductions at US$100,000 for single taxpayers and US$200,000 for married taxpayers. However, at this stage only the broadest of outlines can be delineated. Detailed proposals will have to wait for agreement between the President and the House Republicans.

Another key area of focus for businesses over the coming weeks will be Trump's approach to international trade. During his campaign, he promised to scrap the Transatlantic Trade and Investment Partnership (TTIP) with the EU as well as US participation in the Trans-Pacific Partnership (TPP). He also said he wished to make changes to the North American Free Trade Agreement (NAFTA). At present, it is still too early to understand the impact this may have on the international trading environment, although Trump has already issued an executive order to withdraw from the TPP.

For more detail on the American political scene, please see EY's Global Tax Alert.

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Solvency II: release of CRO Forum paper on deferred tax

The CRO Forum of chief risk officers has recently published a paper on the treatment of deferred taxes under Solvency II. The paper states that its purpose is to generate general but sound principles for tax under Solvency II, but it also acknowledges that the "paper's good practice view can deviate from regulators' views". We would agree that it is likely that some of the content of this paper could be contentious with European regulators. However, we expect that different aspects may be of concern to different regulators.

The CRO Forum's role is to advance risk management practice in the insurance industry globally, but with a focus on Europe. It has been involved in developments under Solvency II, promoting alignment between the regulatory regime and industry best practice. One of the ways it does this is through industry publications, of which the paper on deferred tax is one.

EY understands that the paper's intention is to seek greater consistency across the industry in the EU on the topics it addresses, and that engaging in dialogue with regulators is likely to be necessary to achieve that aim, particularly on issues where the regulators' views are not consistent. The outlined best practice has not been accepted by all regulators to date, and therefore is likely to generate a response from them in certain jurisdictions.

Examples of areas that may be controversial with some regulators include:

- **Risk margin** – the paper states deferred tax assets recognized on temporary valuation differences, such as the risk margin, are not subject to recoverability testing on the basis that recovery will be automatic on reversal. Thus, where in the Solvency II balance sheet, the deferred tax asset is offset against deferred tax liabilities, this approach gives rise to an additional source of future taxable income from existing business that is capable of supplying loss absorbing capacity. This issue has been discussed previously with the UK's Prudential Regulatory Authority and other regulators who did not accept this analysis
- **Restriction on loss utilisation** – it is stated that a recoverability test will not be required where the deferred tax liabilities on the Solvency II balance sheet exceed the tax losses from the shock event. This is on the basis that the reversal of the taxable temporary differences can be managed so that they will emerge at the same time as the losses are available for use. In jurisdictions where there are restrictions on the utilisation of tax losses, this assumption may need to be substantiated within the overall tax regime

EY understands Forum members are being encouraged to discuss the paper with their local regulators to create opportunities for consistency on these matters. Insurance groups may wish to ensure that they are involved in these conversations.

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The EU considers further measures against tax avoidance and evasion as the UK enacts new rules

The European Commission is considering new disincentives for intermediaries involved in allegedly aggressive tax planning schemes. A survey, which closed this month, asked for comments on the need for EU action; the different options identified; and key design features of a possible disclosure regime. The Commission notes its key objectives are to:

- Dissuade intermediaries and users of potentially aggressive tax planning schemes from promoting and using them
- Ensure that national tax authorities have timely access to relevant information on such schemes
- Avoid distortions in the single market due to diverging reporting requirements in respect to such schemes so as to ensure a level playing field among intermediaries
- Facilitate administrative cooperation between tax authorities to tackle cross-border abuse
- Improve taxpayer voluntary compliance by introducing reassurances on the fairness of the system

It is likely that any European disclosure requirement would resemble the OECD's final report on BEPS Action 12 (mandatory disclosure rules) and be informed by the UK's regime for the disclosure of tax avoidance schemes.

Ministers at November's ECOFIN meeting also agreed various measures to deal with avoidance and evasion. For example, it was decided that the EU would screen potentially non-cooperative jurisdictions according to a number of "good governance" criteria based on tax transparency, fair taxation, and the implementation of anti-BEPS measures. It is intended that the screening of jurisdictions would be done by the Code of Conduct Group (Business Taxation) with a view to the European Council endorsing the list by the end of 2017. A spokesman noted that while a low tax rate was not one of the criteria, it could be a factor, along with others, in deciding whether a jurisdiction should be on the list. Please see our Global Tax Alert for more details.

In another development, the Legal Service of the Council of the EU has given a written opinion on the Commission's proposal to introduce public country-by-country reporting (CbCR) in the EU. The proposal would require large multinational companies operating in the EU to draw up and publicly disclose tax information, including a breakdown of profits, revenues, taxes and employees. In the opinion of the Legal Service, the aim and content of this proposal relate to fiscal provisions and, since the proposals affect the single market, the proposals must be based upon Article 115 of the Treaty on the Functioning of the European Union. This would mean that unanimous consent of all Member States would be required. The opinion may have important consequences for the potential introduction of public CBCR. Although the UK and Dutch Governments, among others, have publicly expressed support for public CBCR, the attitude of some other Member States remains unclear. French courts have also found that draft public CBCR rules are unconstitutional.

Meanwhile, the UK Government is continuing to push through a number of measures to tackle tax evasion and what it sees as aggressive tax avoidance. The Criminal Finances Bill 2016, which is currently being considered by the House of Commons, introduces a new corporate criminal offence of failing to prevent facilitation of tax evasion, with separate provisions for UK and foreign tax evasion offences. Where a company has reasonable compliance procedures to prevent their staff from facilitating evasion (for example, by referring customers to entities that help them evade taxes), this should provide a defence against a criminal charge. For this reason, groups may wish to review their internal compliance to ensure that it meets the description of reasonable prevention procedures in the Bill. The Government expects the Bill to be enacted in spring 2017 and to come into force in September.

The UK Government has also published draft legislation in response to comments, including from EY, to its consultation on rules that will introduce tax-based penalties for "enablers" of tax avoidance. Enablers include those providing financing and other facilities for avoidance transactions. The proposed rules could potentially affect financial services groups engaged in business-as-usual activities. However, the proposed rules are now more narrowly focused than earlier drafts and apply only to avoidance comparable to that attacked by the general anti-abuse rule.

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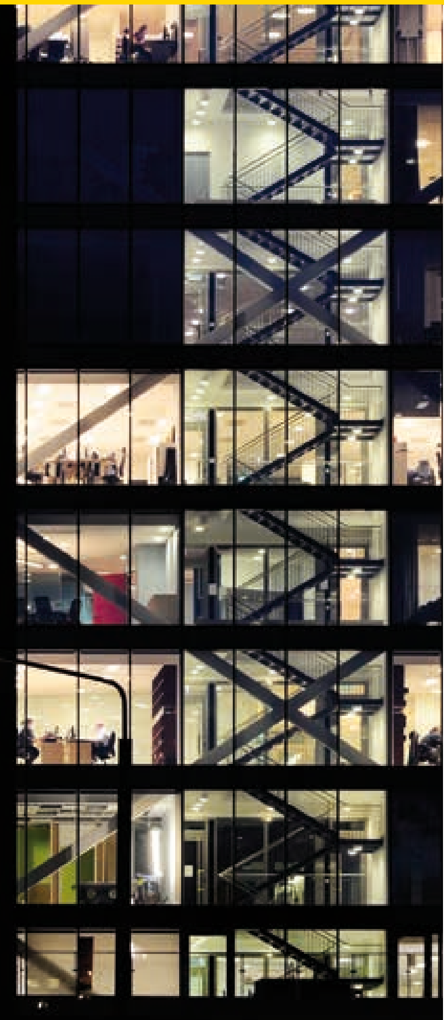
The Dutch Government gives a negative reaction to the EU's common consolidated corporate tax base



The Dutch Government has given its view on the European Commission's recent corporate tax reform package to the Dutch Parliament. As we reported in the last issue of the *Quarterly Tax Bulletin*, the package includes proposals for a Common Corporate Tax Base (CCTB) to be followed by a Common Consolidated Corporate Tax Base (CCCTB). The Commission also proposed adding measures aimed at hybrid mismatches with third countries in the recently agreed anti-tax avoidance directive (ATAD), and a directive on a mandatory dispute resolution mechanism to prevent double taxation.

The Government indicated that it is generally supportive of the proposed directive on dispute resolution. It also supports the proposed amendment to the ATAD to include hybrid mismatches with third countries, but will seek a deferral of the effective date for these rules from 1 January 2019 to 1 January 2024.

However, in respect of the CCTB and the CCCTB, the Dutch Government reiterated its view that it is committed to maintaining and strengthening the investment climate in the Netherlands and explicitly noted its intention to lower the corporate income tax rate.

It noted a number of specific concerns about the CCTB and CCCTB proposals:

- The Netherlands would lose control of its corporate income tax system and would no longer be able to adapt it as required by the international environment
- The proposals may lead to imbalances in the working of existing double tax treaties that the Netherlands has agreed
- To amend the CCTB, for example to counter avoidance, would be difficult because unanimity among Member States would be required
- Implementing the proposals could give rise to a significant administrative burden and changes to the Dutch tax system

Finally, the Dutch Government found that both the CCTB and CCCTB proposals are incompatible with the proportionality principle and the subsidiarity principle under EU law. This means it believes the proposals are more wide ranging than necessary to achieve their aims of strengthening the single market and preventing tax avoidance. Since unanimous consent by all Member States is required for the CCTB and CCCTB to have effect, it is unclear whether the proposals will be implemented in their current form.

For more details, please see our **Global Tax Alert.**

In addition to the Netherlands, other countries are also understood to be sceptical. The Parliaments of Ireland, Sweden, Denmark, Malta and Luxembourg have all joined the Dutch Parliament in showing the proposals a "yellow card." Under the Lisbon Treaty, if parliaments from a third of EU Member States raise a yellow card, the European Commission would be obliged to review its plans. That threshold has not been met in this case, but given the proposals require unanimity, it is clear that reaching agreement on them will be challenging.

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UK Chancellor gives his Autumn Statement and draft Finance Bill 2017 published

The UK Government announced in its Autumn Statement that the proposals to modernise loss relief and to restrict interest deductibility to give effect in UK law to BEPS Action 4 will go ahead, and will apply to insurance groups in the same way as other industry sectors. Draft legislation (for inclusion in Finance Bill 2017) to implement these proposals was published in December 2016 but was incomplete; further material was published as this article went to press which we are in the process of analysing.

The draft Finance Bill includes legislation to limit the relief available for losses brought forward in any year to 50% of the profits of that year, while relaxing the rules that streamed losses so that they could only be used against certain kinds of profits. In particular, carried forward losses will in future be available for offset by way of group relief. The new loss rules will come into effect from 1 April 2017.

For insurers with existing tax losses carried forward, the loss relief modernisation rules will have an immediate cash tax impact and a possible effect on deferred tax in group and entity accounts as well as in the Solvency II regulatory balance sheet. For many insurers, the greater concern from the rules is the potential capital impact under Solvency II, as the changes, when substantively enacted, will need to be taken into account in assessing the "Loss Absorbing Capacity of Deferred Tax" on the occurrence of a shock event as part of the calculation of the Solvency Capital Requirement. The additional draft legislation does not address this issue, on which the industry and advisors are continuing to engage with Government. Insurers with substantial deferred tax assets will also need to consider, in light of the proposed changes, whether they have sufficiently granular and robust data to support their recognition of deferred tax assets, whether for "real world" and/or "stressed" balance sheet purposes.

The proposed restriction on interest deductibility, based on BEPS Action 4, will also take effect from 1 April 2017. The proposals restrict net UK interest deductions to either 30% of earnings before interest, tax, depreciation and amortisation (EBITDA). Alternatively, groups can elect to use a group ratio rule whereby interest is restricted to a percentage of EBITDA equal to the worldwide net interest of the group divided by its worldwide EBITDA. However, interest deductible under the group ratio rule is restricted to 100% of UK EBITDA.

There are several areas of the rules which we expect to be problematic for insurance groups, particularly in relation to the inclusion of market value movements on loan relationships. In most periods, insurers will be in a net interest income position, so that a restriction is not in point, but in the event of a significant market value fall, the rules would create a mismatch that can lead to a permanent, not merely temporary, disallowance of the market value movement. Representations were made to the Government on this point, and it is currently working with the industry to develop a solution.

Furthermore, there is an intention to include insurers within the remit of the modified debt cap, an overarching restriction on UK net interest deductions equal to the group's worldwide net interest expense. This means that an insurer which receives net interest income worldwide (as many insurance groups would expect to) but makes net interest payments in the UK, will receive no UK net interest deductions at all.

The combination of the changes to tax relief for losses and interest mark a major change in the UK's corporation tax regime. Many businesses have already analysed in some depth how the changes will affect them, and others should now do so, in order to identify any further unexpected consequences of the rules, and to determine the importance to their own circumstances of the ongoing discussions with HM Treasury.

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French National Assembly proposes increases to French financial transaction tax

During the debate of the French Finance Bill for 2017, the National Assembly voted to increase the French financial transaction tax (FFTT) rate from 0.2% to 0.3% and to extend its scope to include intraday transactions. The increase will apply from 1 January, 2017 and the expansion of scope a year later. It was initially proposed that both changes should have effect from 1 January 2017, which would have made it very challenging for traders to adjust their systems in time. Nonetheless, significant modifications to systems will still be required to deal with FFTT on intraday transactions, to be in place by 1 January, 2018. The move may also have a negative effect on the attractiveness of Paris as a financial centre, which cuts across efforts being made by regulators to attract business in the aftermath of the UK voting to leave the EU. The impact of the taxation of the intraday transactions on the hedge funds and high-frequency trading platforms (a particular target of the proposed rules) may be especially severe.

For the record, the Deputies in the National Assembly also voted to include a diverted profits tax in the Finance Bill for 2017. However, this measure was struck out by the French Constitutional Court in late December 2016.

As we noted in the last *Quarterly Tax Bulletin*, the French Constitutional Court ruled that the legal provisions providing a 3% dividend tax exemption for distributions made only within a French tax consolidation violates the French Constitution. The Amended Finance Bill for 2016 extends the 3% dividend tax exemption to distributions made to qualifying companies subject to a corporate tax equivalent to the French corporate income tax in an EU Member State or another state which has concluded a tax treaty including an administrative assistance clause with France. The exemption also applies to distributions made between French resident entities qualifying for the tax consolidation regime, but which have not elected into it.

The exemption will not apply to distributions made to entities located in a non-cooperative state or territory, unless the French entity can demonstrate that the activities there relate to genuine operations that do not have, as an object or purpose, diversion of profits or tax fraud. This provision applies for distributions made from 1 January 2017.

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Luxembourg transfer pricing rulings issued before 23 Dec 2016 are non-binding from 1 Jan 2017

On 27 December 2016, the Luxembourg tax authorities issued a new transfer pricing circular of concern to groups engaged in intra-group financing activities in Luxembourg. This replaces the previous circulars released in this area in 2011 and follows a new article included in the Luxembourg Income Tax Law to clarify the concept of the arm's-length principle. This was adopted as part of the 2017 Budget Law on 23 December 2016. The circular states that any individual decisions on the application of the arm's-length principle by the Luxembourg tax authorities before the new article came into force will be considered non-binding after 1 January 2017. It also provides guidance on how Luxembourg will apply transfer pricing rules going forward.

The circular underlines the importance of a comparability analysis and explains how to conduct such a review in line with OECD principles. It also covers the approach to be taken when conducting a functional analysis at the initiation of a financing transaction stressing, among other things, the ongoing management and the assets used. In contrast with previous guidance from 2011, the circular requires a comprehensive risk analysis to determine the adequate level of oversight required to support and manage risks. Transactions having no commercial rationality are to be disregarded, together with their tax consequences.

Minimum substance requirements of a financing company in Luxembourg are introduced that mean the company must meet the following conditions:

- The majority of the management must either be Luxembourg residents or non-residents carrying on a qualifying professional activity in Luxembourg who are taxable in Luxembourg on at least 50% of their income
- Where legal persons are on the board, the company must have its registered office and central administration in Luxembourg
- The company must have personnel suitably qualified to control its transactions
- Key management decisions must be made in Luxembourg
- Where companies are required to hold general meetings, at least one general meeting a year must be held in Luxembourg
- The company must not be considered a tax resident of another state

There are simplified measures for group companies exercising a purely intermediary financing activity and meeting the substance requirements. These provide for a specified minimum return of at least 2% after tax to be treated as being at arm's length. A deviation from a 2% minimum return is acceptable in exceptional circumstances. However, the minimum return safe harbour is not available for transactions entered into by group financing companies which are exercising a purely intermediary financing activity and have a limited functional profile.

For more details on the circular please see our Global Tax Alert.

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Spain increases corporate income tax interim payments

The Spanish Council of Ministers has passed Royal Decree 2/2016 that increases the interim corporate income tax payments that large companies must make. A company with a turnover exceeding €10 million during the 12 months prior to the beginning of the relevant fiscal year is considered large.

The decree increases interim payments from 17% to 24% of the taxpayer's corporate tax base and also introduces a new mandatory minimum interim payment of 23% of the taxpayer's accounting profits. This is increased to 25% for certain large banks and other financial institutions. The new measures have come into effect immediately and, therefore, should have been taken into account for interim payments filed on 20 October 2016 and 20 December 2016.

Interim payments need to be determined from taxpayers' corporate tax base arising over the first 3, 9 and 11 months of the calendar year. The increased rate of 24% is now approaching 25% of the standard rate in Spain meaning the payments resemble instalments rather than interim payments. Furthermore, the new minimum mandatory interim payment of 23% (or 25% for financial institutions) is calculated from the taxpayer's accounting profits without making any book-to-tax adjustments such as for the participation exemption or carried forward losses. Nonetheless, exceptionally, certain income derived from debt reductions taking place in the context of bankruptcy proceedings, as well as from the capitalization of credits, or exempt income derived by non-profit organizations, are excluded from the minimum interim payment base. Furthermore, certain entities applying special reduced corporate income tax rates (e.g., Spanish REITs, collective investment vehicles, pension funds, etc.) are not affected by these new measures.

The new rules will have a significant impact on the cash management of large companies with accounting profits in Spain, because they accelerate a great portion of their tax liability that was previously scheduled to be paid seven months after their year-end.

Meanwhile, in common with other countries, Spain has brought forward to September 2017 the date at which it will be obliged to exchange information on financial accounts in respect of 2016. Exchange of fiscal information will apply to those other countries that have made similar declarations by virtue of the Multilateral Agreement between Competent Authorities on the Automatic Exchange of Information on Financial Accounts, signed in Berlin on 29 October 2014.

The Spanish Tax Authorities have also published a draft ministerial decree regulating the local common reporting standard process. Qualifying financial institutions are required to report information on certain financial accounts by 31 May following the end of the relevant year. Information contained in the reports should include the taxpayer's Tax ID, name, address, tax residency, tax period, the account balance at the year-end and certain specific information on the account.

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Simplification of electronic invoice storage for French VAT purposes

In line with current trends towards electronic solutions for invoicing, article 16 of the French Amending Finance Law 2016 modified the previous rule regarding invoice archiving that required invoices be stored in the original form in which they were sent or made available, whether paper or electronic. However, from April 2017, it will be possible to store paper-based invoices either in the original or in an electronic format. This will allow companies to scan and store electronically invoices that they issue or receive in paper form. By April 2017, a ministerial order will list the permitted digitisation methods of paper-based invoices to ensure their authenticity, integrity and legibility during the mandatory storage period of six years.

The invoicing rules provided by the European Directive 2010/45/EU were transposed into French national law from 1 January 2013. As a consequence of this implementation, the current French VAT rules define the "electronic invoice" as an invoice created, sent, received and stored in any electronic format. The freedom of choice of electronic formats resulting from this rule was an innovation compared to past national rules, providing that only invoices issued by using either an advanced electronic signature or electronic data interchange (that is, "secure" electronic formats) could ensure the authenticity of origin, integrity of content and legibility of an invoice sent by electronic means, from their issue date until the end of its storage period.

French regulations are intended to balance the freedom provided by electronic formats, so that invoices on paper or in "non-secured" electronic form can serve as original invoices, with the obligation for the issuer or recipient of such invoices to establish business controls creating a reliable audit trail between the invoice and the supply of goods or services. These controls can be requested by the French Tax Authorities during a tax audit and, if they are inadequate, the recovery of input VAT may be challenged. However, it is important to stress that the existence of the "reliable audit trail" requirement is not intended to eclipse the guiding principle of the French regulation, which aims to maximise the simplification of the use of electronic invoicing.

For other VAT changes in the Amending Finance Law 2016 please see our Global Tax Alert.

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The European Court's 2014 decision in Skandia back on the agenda

Following a period of relative inactivity, the Skandia America Corporation USA (C-7/13) case (Skandia) appears to be back on EU tax authorities' agendas. The case focused on the interaction of European VAT grouping rules and the treatment of intra-entity charges, which are typically disregarded for VAT purposes. The Skandia case means institutions across the EU may incur additional and irrecoverable VAT.

In its judgment on Skandia, the European Court held that a VAT group (in this case, a Swedish one) is a discrete and separate taxpayer in its own right. As a result, when an entity joins a local VAT group, it loses its own identity. It went on to conclude that a previously ignored head office-to-branch supply became a "true" supply when the Swedish branch receiving those services was VAT-grouped. Because of normal taxing rules, these services were subject to Swedish VAT. Because the Swedish branch, like most financial services businesses, had a limited right to VAT recovery, this additional VAT created an irrecoverable and above-the-line cost.

Although not expressly considered by the European Court, the same logic appears to apply where the facts of this particular case are reversed: that is to say, a VAT-grouped branch's services provided to a stand-alone branch in another territory should again be subject to VAT. This is colloquially known as the "reverse Skandia."

Given the popularity of VAT grouping across the EU (to date, more than half of the 28 Member States have implemented it in one form or another), taxing intra-entity services — be they branch-to-branch, head office-to-branch and so forth — would be a significant departure. It is, therefore, unsurprising that many EU tax authorities have been slow to respond. To date, only a handful have fully implemented the decision while others, including the UK, have done so in part only. The UK's implementation recognises the reverse Skandia but only where the supplying branch is in a jurisdiction which has itself implemented the decision. In practice, the policy has had a very limited impact with supplies from many key EU and all non-EU jurisdictions continuing to be disregarded.

The issue, along with a host of other points relating to VAT grouping, was discussed at a recent EU-wide meeting held in Dublin. Whilst there has been no immediate output, it is likely that the European Commission and each tax authority will refocus their collective attention on the issue. In our view, some increased consistency in policy should be anticipated. Although this is unlikely to be fully harmonised, insurance groups with significant cross border flows may wish to look again and take stock of what impact taxing these services would have.

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What's new: other alerts on major tax developments affecting EMEIA

German draft law restricting royalty deductions published

The Ministry of Finance has published a first technical draft of legislation restricting the tax deduction of royalties and similar payments made to related parties if such payments are subject to a preferential tax regime in the jurisdiction of the recipient which is not OECD compliant, and are effectively taxed at a rate below 25%.

Swedish court rules PE exists in Sweden due to recurring nature of activities

The Swedish Administrative Court of Appeal in Gothenburg has found a German company to have a permanent establishment in Sweden due to its annually recurring short-term activities in the winter environment in northern Sweden.

UK Prime Minister outlines position in Brexit negotiations

In a much anticipated speech on 17 January 2017, the UK Prime Minister, Theresa May, announced the UK's 12 priorities for Brexit negotiations. The resolution of the tension between maintaining access to the single market and controlling immigration had been a key unresolved political issue, as had the continuing membership of the Customs Union. The Prime Minister addressed both of these points while setting out her position on a number of other key issues.

OECD releases discussion on treaty entitlement of non-CIV funds in respect of BEPS Action 6 (treaty abuse)

The OECD has released a discussion draft for comment that includes three draft examples with respect to treaty entitlement of non-CIV funds when the principal purposes test, one of the minimum standards to protect against treaty shopping, is applied.

Italy enacts new law on VAT reporting obligations

The Italian Parliament has enacted a fiscal law mainly aimed at encouraging electronic invoicing and the recovery of VAT through the introduction of new reporting requirements. The rules are primarily intended to tackle tax evasion.

Spanish Supreme Court rules Brazilian Interest on Net Equity payments qualify for the participation exemption

The Spanish Supreme Court has issued a new decision confirming that, for domestic law purposes, the legal nature of income received by Spanish entities from Brazilian subsidiaries in the form of Brazilian Interest on Net Equity payments is equivalent to a distribution of profits and thus can utilize the Spanish domestic participation exemption for dividends as applicable for tax years starting prior to 1 January 2015.

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