EY Quarterly Tax Bulletin: EMEIA Insurance

July 2017

Welcome

Welcome to the July edition of the *EY Quarterly Tax Bulletin: EMEIA Insurance*. In this issue, we look at the current state of play in the tax-transparency arena; and include updates from Italy, Spain and Denmark. 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.

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Update on the tax – transparency agenda

This year marks the large-scale introduction of the automatic exchange of information (AEOI) rules. Financial institutions resident in one of the hundred or so jurisdictions that have brought in AEOI rules are required to report comprehensive information on the financial accounts and assets they hold for non-residents. The first exchanges are due to take place this September, covering about 50 jurisdictions, with another 50 or so jurisdictions commencing AEOI in 2018. The Common Reporting Standard (CRS) developed by the OECD sets out the format for information that financial institutions are required to provide. This includes the name, address, any relevant taxpayer identification number, and the date and place of birth of each non-resident subject to the report. The financial information required covers account numbers, the amounts in the accounts and the institution in which the accounts are held.

Although the procedures for AEOI are loosely based on FATCA, enacted in the US, as of now the US itself will not be reporting any information on foreign account holders. However, it has signed a series of bilateral agreements on FATCA that include commitments to support the required legislation to enable it to share information at some point.

This year should also see the first country-by-country reporting (CBCR) under the minimum standards set out in the OECD's final report on base erosion and profit shifting (BEPS) Action 13. The US is participating in CBCR but only for accounting periods starting on or after 30 June 2016. Most other jurisdictions are bring in CBCR for periods beginning on or after 1 January 2016. However, the argument over CBCR has now moved on to whether the reports should be made public. The UK Parliament has already implemented legislation that authorises the Government to implement public CBCR once international agreement is reached. However, it is unclear how widespread such an agreement would need to be before the UK would participate. Meanwhile, the European Commission has published a draft directive that would require limited public CBCR for groups with a turnover of over €750 million. However, the European Parliament has proposed amendments to require companies to publish much wider information where they meet two of the three criteria of having a balance sheet of €20 million, turnover of €40 million or 250 employees. The European Parliament and Council also disagree on the mechanics of implementing public CBCR, with the latter's legal advice being that it would require unanimity among Member States, while Parliament's legal affairs committee says it only needs a qualified majority. The Parliament is continuing to consider the proposals before the draft directive returns to the Council of Ministers, although it is not included in the current Maltese presidency's road map.

Finally, from 1 January 2018, the EU will provide tax authorities with access to the information currently held by the authorities responsible for money laundering. The fourth Anti-Money Laundering Directive (AMLD 4) requires Member States to maintain a central register containing details of the beneficial ownership of companies. While the register does not need to be completely public, it must be open to tax authorities, entities required to carry out customer due diligence and anyone else who can demonstrate a "legitimate interest" in the information. This contrasts with the approach of the UK, which requires all non-listed companies to disclose a register of people with significant control as part of their publicly available annual return to Companies House. As a Member State of the EU, at least for the time being, the UK is also implementing AMLD 4. It is also proposing a new public register to show the beneficial owners of UK real property where this is held through a corporate or other legal entity.

Overall, the transparency agenda still has some way to run. For many groups, including insurers, a requirement to make public disclosures on their tax position if public CBCR is brought in is likely to be the most controversial change.

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Italy introduces VAT grouping rules

Italy has passed legislation to introduce VAT grouping, starting in 2019. The new regime is available, by election, to VAT-registered entities that are established in Italy; carry on business or professional activities; and are joined by financial, economic and organisational links. "Financial link" means a shareholding giving direct or indirect control of the group members. This can include control through an entity established in other countries which have agreed an adequate exchange of information protocol with Italy. The financial link must exist as from 1 July of the calendar year before the one in which the election for the grouping regime is made. If there is a financial link between entities, the existence of economic and organisational links is presumed, unless a ruling is made to the contrary.

An "all in, all out" principle applies so that, if one of the entities meeting the requirements to belong to a group does not join it within the required time frame, the VAT grouping ceases for all the entities involved. Entities which are not established in Italy and foreign permanent establishments of Italian entities are excluded from the VAT group, as are entities subject to bankruptcy or liquidation, or whose assets have been seized by the courts.

The election for VAT grouping has to be electronically filed. Where it is made between 1 January and 30 September, the grouping regime is effective from 1 January of the following year. However, where the election is made from 1 October to 31 December, the grouping regime is effective from 1 January of the second year following the election. The election is binding for three years after which it is automatically renewed annually, unless revoked. The earliest an election can be made is 1 January 2018, so the first VAT groups can come into existence from 1 January 2019.

A VAT group is deemed to be a single taxable person with its own VAT number, while the group members are no longer treated as VAT-registered persons and their individual VAT numbers are suspended. Consequently, supplies of goods and services between the group members are outside the scope of VAT, while supplies of goods and services to third parties are treated as made by the group as a whole. The group also has to comply with all the VAT obligations (including invoicing, VAT accounting, and filing an annual VAT return) imposed on a VAT-registered person. It is entitled to make refund claims and exercise other rights relating to VAT. All VAT obligations and rights are to be performed by the representative of the VAT group. This can be either the parent company of the group or the member with the highest VAT turnover or revenues in the fiscal year before the VAT group is set up. However, all the members of the VAT group are jointly and severally liable for VAT, penalties and interest deriving from assessments and audits.

One of the most significant effects of the new VAT grouping regime is that the principles set in the *Skandia* judgment of the Court of Justice of the European Union (C-7/13) become applicable to Italy. Consequently, the supply of services between an entity belonging to an Italian VAT group and its foreign branch or between a foreign head office and its Italian branch, which belongs to an Italian VAT group, becomes subject to VAT.

Under the new rules, the VAT group may opt to use various regimes that are currently available to insurers and other financial services companies. These include:

- The exemption from the requirement for invoicing (unless required by the client), registering and reporting exempt financial services in the VAT return. On the other hand, input VAT cannot be deducted under this optional regime, whether or not it relates to goods and services used in a taxable or exempt transaction.
- The exemption from the requirement to invoice exempt financial services (unless required by the client). The group is allowed to record both taxable and exempt transactions on aggregate basis in a simplified VAT register (the so-called Registro dei Corrispettivi).
- VAT groups which carry on more than one business activity with different recovery rates may elect to account for VAT separately in respect of each activity.

In contrast, elections to apply these optional regimes made by the individual members before they join the group expire when the VAT group is formed.

The Italian tax authorities are expected to provide guidelines about the application of the new rules in the following months. Even though this guidance is not yet available, insurance groups should consider whether it is advantageous for them to form a VAT group in Italy.

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Spain brings in new restrictions for corporate losses

A number of restrictions on the use of tax reliefs have been introduced in Spain. These rules especially affect groups, including insurance groups, with overseas branches and other kinds of investments.

Relief for carried-forward tax losses

The maximum amount of profits that can be relieved with carried-forward losses is limited to 60% (70% for fiscal years ending on or after 1 January 2017). However, under the new rules, further restrictions apply to larger companies for periods beginning on or after 1 January 2016. For those with a turnover exceeding €20 million in the 12 months prior to the beginning of the relevant fiscal year, carried-forward loss utilisation is now limited to 50% of taxable profits. For companies with turnover exceeding €60 million, the limitation is 25% of taxable profits. All companies can use carried-forward losses of up to €1 million without restriction.

Utilisation of double tax credits

The use of credits is limited to 50% of the Spanish tax due for companies with turnover exceeding €20 million in the 12 months prior to the beginning of the relevant fiscal year. The restriction also applies to double tax credits carried forward from prior years and used during periods beginning on or after 1 January 2016.

Recapture of the portfolio impairments

Until 2013, certain impairments on shareholdings were allowed as corporate income tax expenses. When the portfolio impairment regime was abolished, rules were introduced pursuant to which an impairment expense taken in a prior year had to be added back to the tax base if the shares regained value or the company that issued the shares paid a dividend. Under the new rules in force for periods beginning on or after 1 January 2016, taxpayers that deducted an impairment for tax purposes and have not already completely added it back are subject to "minimum claw back". Under these rules, they must add back the outstanding portfolio impairment amount spread over a five-year period, starting with the 2016 fiscal year, unless they otherwise have to add back the amounts over a shorter period thanks to existing rules.

Recapture of losses generated by non-Spanish permanent establishments and subsidiaries

Prior to 2013, losses from a foreign permanent establishment could be taken from a Spanish company's taxable profits. Limitations are now introduced on the tax exemption when a taxpayer transfers a permanent establishment at a gain if losses from the permanent establishment have previously been used. The exempt part of the gain is reduced by the net amount of losses incurred by the permanent establishment prior to 2013, which exceed the net profit generated by the permanent establishment from 2013 onwards. For fiscal years beginning on or after 1 January 2017, new rules prevent deductions for losses on the transfer of shares in companies that qualify for the participation exemption regime. Under these rules, losses derived from the transfer of shares that meet the requirements for the application of the Spanish participation exemption regime cannot be deducted for tax purposes. Losses also cannot be deducted if they derive from the transfer of shares in entities that are resident in a tax haven where a territory does not comply with the so-called "subject-to-tax" requirement. This means that the company whose shares are sold must be subject to a corporate tax similar to Spanish corporate income tax at a minimum 10% rate. However, Spanish law presumes that this test is passed when the company is resident in a country that has signed a tax treaty with Spain with an exchange of information clause.

Losses generated upon the liquidation of a subsidiary are deductible, unless the liquidation takes places within the framework of certain types of reorganizations (such as mergers or demergers, regardless of whether they rely on the tax free regime or not). In any event, the loss that can be deducted for tax purposes must be reduced by dividends received in the ten years where they have been exempt or have given rise to a tax credit.

Losses derived from the sale of a permanent establishment are no longer deductible, but losses triggered upon the closing down of a permanent establishment may continue to be taken for tax purposes. The loss which can be deducted for tax purposes when a permanent establishment is closed down is reduced by the sum of any profits from the permanent establishment that have benefitted from the participation exemption regime in earlier years.

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European Court to consider Dutch dividend withholding tax on foreign investment funds

The Dutch Supreme Court has requested a preliminary ruling from the Court of Justice of the European Union (CJEU) in two cases that relate to refunds of withholding tax to a German and a UK resident investment fund. The investment funds had filed several Dutch dividend withholding tax refund claims with the Dutch tax authorities in respect of Dutch securities on the basis that the withholding tax was unlawful under EU law. In 2015, the Dutch Supreme Court concluded that foreign investment funds are not comparable to Dutch fiscal investment institutions (which are eligible for refunds) as they are not withholding agents for Dutch dividend withholding tax purposes. The Supreme Court's view was that, if the refund were granted, foreign investors investing in Dutch securities through a foreign investment fund would effectively be better off (no Dutch withholding tax burden) than foreign direct portfolio investors investing in Dutch securities. The Supreme Court therefore ruled, based on lack of comparability, that the EU treaty freedoms do not require the Netherlands to refund Dutch dividend withholding tax incurred by foreign investment funds on their Dutch portfolio dividend income.

However, as a result of subsequent developments in the CJEU's case law, the validity of the Supreme Court decision has been challenged. Based on recent CJEU decisions, foreign direct portfolio investors directly investing in Dutch securities may be eligible for a refund of Dutch dividend withholding tax. In contrast to the previous Supreme Court decision, the CJEU has effectively concluded that it was contrary to EU law to impose a higher dividend withholding tax on non-residents than the dividend withholding tax imposed on resident shareholders.

In light of these developments, the Dutch Supreme Court has decided to refer the two current cases to the CJEU for a preliminary ruling. The Dutch Supreme Court acknowledges that the correctness of its 2015 decision is not beyond challenge. The Supreme Court has furthermore asked the CJEU to clarify to what extent a foreign investment fund can be considered to be comparable to a Dutch fiscal investment institution that is entitled to a dividend withholding tax refund.

The request for the preliminary ruling from the CJEU is a positive development for foreign investment funds holding Dutch securities as the validity of the strict Supreme Court decision from 2015 will now be assessed by the CJEU. In anticipation of the final outcome in the two cases, foreign investment funds should assess their Dutch withholding tax position and, where appropriate, consider filing protective claims with the Dutch tax administration.

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India introduces secondary transfer pricing adjustments and interest restrictions

India's Finance Act 2017 has received presidential assent and came into effect from 1 April 2017. From the perspective of inbound investors in India, two key changes are the introduction of a transfer pricing secondary adjustment provision and an interest limitation rule.

The secondary adjustment provision was introduced to address the economic consequences arising from a primary transfer pricing adjustment. For example, if a transfer pricing adjustment deems that some income should be paid to India, a secondary adjustment might deem the amount of that income to be a loan and require that the resulting notional interest be subject to tax. Thus, under the rules, where the amount of a primary adjustment is not paid to India within the prescribed time, it is treated as an advance made by the taxpayer. Interest on the deemed advance is treated as taxable income in the hands of the taxpayer. Therefore, to prevent a secondary adjustment from applying, the amount of the transfer pricing primary adjustment should be paid to the taxpayer.

The provisions relating to secondary adjustments are generally applicable for primary adjustments made from the 2016-17 financial year onwards. A secondary adjustment is required where a primary adjustment to the transfer price occurs in one of the following circumstances:

- It is voluntarily made by the taxpayer in the tax return.
- It is made by a tax officer and accepted by the taxpayer.
- It is determined by an Advance Pricing Agreement entered into by the taxpayer.
- It is made as per the safe harbour rules.
- It results from a Mutual Agreement Procedure resolution.

Secondary adjustments are only required if the amount of the primary adjustment exceeds INR10 million (EUR140,000).

Insurers with investments in India may wish to review their transfer pricing policies in light of the introduction of a secondary adjustment mechanism.

The new Indian rules limiting interest deductions have effect from the 2017-18 financial year and follow on from the OECD's final reports on Action 4 of the base erosion and profit shifting (BEPS) project. Deductions for interest expenses incurred by an Indian company on loans from an associated enterprise or guaranteed by an associated enterprise are restricted to 30% of its earnings before interest, taxes, depreciation and amortisation (EBITDA). Any amount over this limit is treated as "excess interest" which is disallowed. However, a disallowed amount can be carried forward for the following eight financial years and set off against the taxable income in future periods, subject to the ceiling of 30% of EBITDA. The provisions are applicable to an Indian company or a permanent establishment of a foreign company in India if it incurs expenditure in the nature of interest exceeding INR10 million (EUR140,000) in a financial year.

However, these rules are likely to be of less concern to financial services entities since both banks and insurance companies are specifically excluded. Furthermore, the rules are not as restrictive as proposed by the OECD under BEPS Action 4 because they do not apply to interest paid on debt from third parties, provided it is not guaranteed by an associated enterprise. Nonetheless, multinational enterprises may need to review the impact of the change on their finance and treasury structures for Indian operations.

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Danish Tax Board rules a sales manager working from home constitutes a permanent establishment

An important decision has been published by the Danish Tax Board which shows how the activities of individuals not located in a formal office can nevertheless constitute a permanent establishment of a non-resident taxpayer. The Tax Board ruled that a Scandinavian sales manager's occasional use of a home office constituted "core business activities" of a German corporation, thereby creating a permanent establishment.

The German corporation had hired a sales manager resident in Denmark to carry out sales activities and customer service in Denmark and other Scandinavian countries. The main tasks of the sales manager included:

- Sales of software solutions in Scandinavia
- Management of key accounts and distributors
- Customer visits and ongoing care, including drafting of quotations
- Identification of new clients and business development
- Market analysis and promotion of products through trade shows, fairs and similar activities
- Competitor analysis
- Management of internal customer relations management system
- Forecasting and promotion or introduction of new products to the Scandinavian markets

The sales manager reported directly to the international sales manager of the German company, and had no permanent office or other premise made available in Denmark. All deliveries to customers of the German company's software and hardware products were carried out directly from Germany.

The sales manager received a laptop and a mobile phone from the German corporation and had his travel expenses reimbursed.

Most of his work was carried out at the premises of clients, partners and suppliers. However, the employment contract did require the sales manager to work from home and carry out some administrative work from there. The sales manager was not entitled to enter into binding agreements on behalf of the German corporation or negotiate the details of sales contracts and other agreements binding on the German corporation.

The Tax Board ruled that it was irrelevant whether the premises occupied by the sales manager were owned, rented or made available to the non-resident corporation, as long as its business activities are effectively and habitually carried out at the premises and that the business activities do not qualify as preparatory or auxiliary. It held that the administrative work carried out at the sales manager's home was carried out in connection with work for the employer and qualified as a core business of the German corporation. However, due to the lack of a detailed description of the administrative work, the Tax Board did not discuss whether the work in question could be preparatory or auxiliary.

While the facts of the case are specific to a sales manager, the decision calls into question the extent to which working from home can give rise to a permanent establishment, even where an employee is not given the use of any office space.

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End of the tax year puts UK employment taxes in the focus

Following the end of the UK's fiscal year on 5 April, employers will now have provided staff and HMRC with various annual summary reporting and remittances connected with employee remuneration, taxes and benefits in kind. However, there are several other current developments in employment taxes that insurance groups need to be aware of.

Apprenticeship levy: From April 2017, the apprenticeship levy came into effect, applying a 0.5 % levy on an employer's "pay bill". EY are recommending that employers take the following steps in order to operate the levy:

- Determine how they wish to allocate the levy allowance between payrolls
- Test the payroll system to ensure it is capable of assessing and reporting the levy correctly
- Consider the impact and potential changes to modified national insurance contribution schemes
- Register for their Digital Apprenticeship Service

More generally, the financial sector is likely to be among the biggest payers of the levy, given the number of relatively highly paid personnel on a typical UK payroll. As such, we are seeing an increasing focus from finance directors as to how the levy cost can be reduced or the funds raised from the apprenticeship levy can be used to support their own training, redeployment and recruitment.

PAYE Refresh project: The end of May 2017 saw the launch of HMRC's PAYE Refresh Project. This forms a central plank of the Government's Making Tax Digital initiative and builds upon the consultation document *Transforming the tax system through the better use of information*. The intention of PAYE Refresh is to assist the Government in collecting income tax "in year" by taking into account contemporaneous "off payroll" income data from sources, such as an individual's digital tax account and issuing more frequent coding adjustments. In the short term, this is expected to result in an increase in employee queries, particularly in the transition years as tax coding adjustments feature both tax underpaid carried forward from previous years as well as in-year adjustments. Tax departments are advised to ensure that the impact of this initiative is fully understood and are prepared to deal with an increase in such queries.

Optional remuneration arrangements (OpRA): The OpRA legislation came into force from 6 April 2017. This legislation applies to any benefits where the employee had, or has, an opportunity to receive cash instead of a benefit. Although the rules were brought in primarily to deal with the tax advantages of certain "salary sacrifice" schemes, the scope of the law can also apply to flexible benefit plans, arrangements offering employees cash alternatives and other options.

While it is tempting for employers with flexible benefit plans or similar starting before the tax year to think they are insulated from this legislation for another year under the OpRA grandfathering provisions, this is not how the legislation works. New joiners, lifestyle events, promotions and variations other than those beyond the control of the parties will be affected. We are strongly recommending that all employers, if they have not already done so, review their compensation plans to understand how they are affected, with a view towards planning for change and communicating to employees.

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What's new: other alerts on major tax developments

Hungary: The Hungarian Government has submitted a draft bill to Parliament which includes repealing the 10% minimum shareholding currently required to qualify for the exemption from corporate income tax on a sale of shares or contribution in kind.

Poland: The Ministry of Finance has warned that certain structures involving investment funds, which seek to prevent income from transparent entities from being taxable, are potentially within the scope of the general anti-abuse rule.

Germany: Parliament has adopted new rules that limit tax deductions for royalties paid to non-cooperative jurisdictions and stipulate how gains arising from debt cancellations on a restructuring have to be taxed.

Norway: The Ministry of Finance has issued a consultation document on extending the scope of its interest restriction rules to include interest on third party as well as connected party debt.

Italy: The Council of Ministers has enacted a decree to change the tax treatment of carried interest, to place a time limit on notional interest deductions, to align the arm's length standard more closely to OECD norms, and to exclude trademarks from the patent box.

France: The tax authorities have amended guidelines to extend the withholding tax exemption on French dividends paid to certain foreign regulated collective investment vehicles.

Estonia: The Minister of Finance has submitted a bill to cut the tax on regular dividends but tax long-term loans to affiliates where these are used to extract profits.

Russia: The Ministry of Finance has published a letter restricting the circumstances under which reduced withholding tax rates on dividends are available when intermediate holding companies are involved.

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EYG no. 04053-174Gbl

EY-000035352.indd (UK) 07/17.
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