CENTURION

Tax Talk

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A review of recent global tax legislation changes relevant to some of our clients and an overview of other worldwide tax titbits.

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Tax Titbits

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UK levies additional tax on non-resident property buyers

The UK recently passed its Finance Bill in March 2021, which includes a new Stamp Duty Land Tax (SDLT) surcharge ("surcharge") for buyers of residential property who are not resident in the UK. SDLT is a tax levied on the purchase of property in England and Northern Ireland and payable by the purchaser.

The UK Government has pledge to alleviate homelessness and aims, with the introduction of the surcharge, to tackle the issue of foreign buyers reportedly causing property price inflation. The surcharge is meant to improve the affordability of housing prices for UK residents and helping people get onto and move up the housing ladder. The surcharge was first announced in 2018 when the government, during its Budget, shared its intention to increase the amount of SDLT payable by non-UK residents when purchasing residential property in England and Northern Ireland. In February 2019, the government commenced a consultation where options for implementing a surcharge on non-UK resident purchasers were explored. Finally, in July 2020, the government published a summary of its consultation confirming the surcharge.

Effective 1 April 2021, when a non-resident purchases freehold or leasehold residential property in England and Northern Ireland, SDLT rates will be 2% higher than what would apply if the purchase was made by a UK resident. The surcharge thus operates as an extra 2% of tax added to all residential rates of SDLT and includes the 'second home' surcharge starting at 3%, the flat 15% rate for corporate purchases of homed valued at more than £500,000 and the rates of lease duty. The Finance Bill has also clarified that, unlike the current 3% 'second home' surcharge, the SDLT surcharge will apply to purchases of mixed residential and non-residential properties.

The surcharge will also apply in case of joint purchases where any one of the purchaser is not a UK resident, with the only exception being Crown employees and married or civil partner couples. The surcharge will apply to the whole purchase price, not merely the proportion attributable to the non-resident's share. The surcharge thus applies to any non-resident individuals, unit trusts, partnerships and corporates buying UK residential property, as well as beneficiaries under life-interest and bare trusts and trustees of other types of trust. While its direct impact will primarily be on overseas individuals purchasing residential property, it will also impact corporates outside the UK that used to claim for multiple dwellings relief when bulk-buying residential property in the UK, such as the PRS schemes, will no longer benefit from applying residential rates instead of the bulk-buy commercial rates.

There are however some exclusion to the surcharge, namely some types of collective residential property such as schools, purpose-built student accommodation and care homes, as well as acquisitions of leases with less than 7 years to run.

Currently, purchasers of residential property located in England and Northern Ireland pay SDLT irrespective of where they live or their residence status. This will change with the surcharge now in place, where residency will play a vital role. Each purchaser type will have a set of specific conditions which will determine whether they are UK resident or non-resident for the purposes of the surcharge. We will analyse the residency test of individuals, companies and other entities such as partnerships and trusts.

Residency of individuals

The residency of an individual is not decided by reference to the normal UK Statutory Residence Test used for income and capital gain tax purposes, or by reference to nationality, citizenship, visa or "right to reside" rights. For the purpose of the surcharge, an individual will be deemed resident for the SDLT surcharge test if they have been in the UK for at least 183 days in a continuous period of 365 days which includes the date of purchase falls. The surcharge will not apply if the purchase is made jointly with a spouse or civil partner, where either one of the purchasers is a UK resident. If the purchase is made alone by a non-resident spouse or civil partner, the surcharge will be applicable.

If the residency test is not met when making the purchase, but then the individual is able to subsequently satisfy the test, the surcharge will still need to be paid but the individual will have two years from the date of purchase to amend their SDLT return and reclaim the surcharge. The UK tax authority (HMRC) confirmed that a "pragmatic approach" will be taken, where evidence can include a person's digital footprint, credit card and bank statements, work diaries, planners, timesheets, mobile phone usage and bills, utility bills, membership and usage of clubs.

Residency of companies

It is clear that companies which are UK resident will not be subject to the surcharge. However, some companies may be UK tax resident but controlled by non-resident individuals or entities, and are therefore classified as non-resident. There are two types of companies that fall under this non-resident category:

a) A company incorporated outside the UK with its centre of management and control outside the UK. (This includes a company that is treated as non-UK resident under the terms of a Double Taxation Treaty)

b) A company which is UK tax resident but is a close company, as defined by HMRC, i.e. mostly controlled by non-residents.

When assessing whether the company is a close company, reference must be made to the detailed close company rules. These rules have been adapted for the purpose of the surcharge. Some of the adaptations include UK real estate investment trusts (REITs) where members of a group UK REIT and property authorised investment funds (PAIFs) which are resident for corporation tax purposes are automatically treated as UK resident, even if they would otherwise qualify as non-resident under the adapted close company test.

Residency of other entities

The residency of a partnership or trust will be determined by the residence of each member, where all partners or trustees must meet the residency test for individuals. The surcharge will thus be applicable if one member is non-resident. The surcharge will also apply when a trustee holds on bare trust, for instance as a nominee for the purchaser, and the beneficiary or one of the beneficiaries is non-resident under the test for individuals. Where the trust not a bare trust, but a settlement, we are to determine if under the terms of the trust the beneficiary is entitled to occupy the property for life, or to receive income from it. If this is the case, then there will be no surcharge provided the beneficiary meets the residency test for individuals.

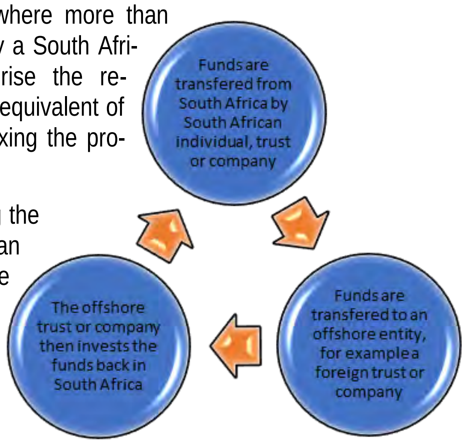
As for the residency of a fund, it will be determined by reference to the residence of the individuals, trustees or entities which constitute the fund.

South Africa permits "back-to-back" offshore funding to encourage inward investment

Effective 1 January 2021, the South African Reserve Bank started allowing "back-to-back" by private individuals and companies that are tax resident in South Africa. This was part of the capital flow management measures announced by the Ministry of Finance in 2020 to encourage inward investments into the country. This relaxation of exchange control requirements pertaining to the "back-to-backs" was highly dependent on the amendments to the Income Tax Act, 1961 so as to ensure that there are adequate tax provisions in place to protect the South African tax base. Thus amendments to the income tax will also come into effect as from 1 January 2021.

Before we move on to analysing the impact brought by these changes, it is important to understand what are "back-to-backs". In the past, South African residents were not allowed to enter into any transaction where capital is exported from South Africa, whether directly or indirectly through any structure or scheme of arrangement. A "back-to-back" (see diagram) is the formation of a foreign company, by a South African resident (individual or company), through which the South African resident "indirectly exports capital" by investing in a foreign non-resident company that in turn reinvests into the Common Monetary Area. The reinvestment can be in the form of South African shares, loans or other assets and the returns on these investments can be in the form of dividends or interests, amongst others.

Having a non-resident company in the "back-to-back" provided many tax planning opportunities, especially with regard to dividends tax. This was due to that fact that the dividend flowing through the structure were taxed at a reduced rate (compared to the current dividends tax rate of 20%) or some were even exempted from tax where a Double Taxation Treaty applied. Amendments brought to the Income Tax Act will therefore have significant tax consequences on Controlled Foreign Companies (CFC), which are companies where more than 50% of its shares are held directly or indirectly by a South African resident. One of the amendments comprise the recomputation of the profit of the CFC to reach the equivalent of taxable income under the Act, thus effectively taxing the proportion of the South African resident.



From an income tax perspective, when computing the taxable income, dividends from a South African company are treated as exempt income. Per the amendments, when computing the equivalent of taxable income for a CFC, 20/28 of the South African dividend must now be included as taxable income.

In simple terms, this means than when then the shareholder of a CFC is a South African company, and 28% of this amount is taxed, the effective tax rate becomes 20% (that is 28% of 20/28), which is the rate of dividends tax for South African companies. The amendment thus acts as an adjustment mechanism such that tax payable by the shareholder on the CFC's profits and tax withheld on the South African dividend will not exceed an effective rate of 20%.

Another amendment relates to shareholders disposing of their listed shares at market value, where such shares are transferred from a South African exchange to a foreign exchange. Currently, exchange control approval is required before a resident is permitted to migrate a listed share. Per the new amendment, when shares are 'exported' to a foreign exchange, it will trigger a deemed disposal and thus potentially, a tax liability. The disposal of shares in a CFC will also not qualify for the participation exemption, thus a resident will need to pay capital gains tax in respect of the portion of the sale price that represents the value of the South African assets.

Many changes come with the removal of the restrictions pertaining to the "back-to-backs". South African residents who inherit foreign assets from another resident may now retain the assets abroad and invest in a "back-to-back" provided that the foreign assets inherited are declared by an Authorised Dealer to the Financial Surveillance Department ("FinSurv"). The assets cannot however be placed at the disposal of other residents. Another consequent change to note is with regard to loans received from foreign lenders, where previously loan funds could not be sourced from the authorised foreign assets of a South African resident and there could not be any direct or indirect South African interest in the foreign lender. Now, loans from foreign lenders are no longer subjected to these restrictions.

Beneficial Ownership Reporting Coming to USA

Following a similar path as the EU, UK and other similarly positioned OECD and Financial Action Task Force (FATF) nations, the US, on 1 January 2021, passed the Corporate Transparency Act ("Act") as part of the fiscal year 2021 National Defence Authorization Act (NDAA), which imposes extensive reporting requirements on the beneficial owners of companies and similar corporate entities and making such information available for certain anti-money laundering (AML) and other countering of terrorist financing purposes. These new reporting requirements show an unprecedented federalisation of corporate law where the Act amends Title 31 of the United States Code and will cause millions of existing legal entities to file new beneficial ownership disclosure forms with the federal government.

Currently, there is an estimated two million corporations and limited liability companies (LLCs) that are formed under state law each year and most, if not all, states do not require the disclosure of any information about the beneficial owners of such entities. While the Act comes with a mission to prevent wrongdoers from exploiting the anonymity of corporations and LLCs for criminal gain, it rightfully avoids being discriminatory by imposing beneficial ownership information reporting requirements on all "reporting entities".

For an accurate understanding of the act, two terms are key - "reporting entities" and "beneficial owners". For the purposes of the Act, reporting entities include corporations, LLCs and other similar entities that are formed under the law of a US state, or formed under the law of a foreign country and registered to do business in the US. While the Act specifically excludes a number of entities from its definition of "reporting entities" – for example an entity with a physical presence in the US that employs more than 20 full-time employees and has more than USD 5 million in gross receipts or sales – it remains unclear on other types of entities such as partnerships and trusts.

As for "beneficial owners", they are defined as any individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, exercises substantial control over the entity or owns or controls not less than 25% of the ownership interests of the entity. It is understood that minors, creditors, any nominee, intermediary, custodian or agent acting on behalf of another individual, individuals acting solely as employees, and individuals whose only interest in a reporting entity is through a right of inheritance do not qualify as beneficial owners.

Unless an exclusion applies, each reporting entity must submit to the US Department of the Treasury's ("Treasury") Financial Crimes Enforcement Network ("FinCEN") a report that identifies each beneficial owner of the reporting company and each applicant with respect to that reporting company. An applicant is the person who "files" an application to form a corporation, LLC or other similar entity. As to the deadline for a reporting company to report beneficial ownership and applicant information to FinCEN, a reporting company that has been formed or registered before the effective date of the regulations has two years after the effective date to report all required information to FinCEN. A reporting company that has been formed or registered after the effective date of such regulations will be required to provide such information to FinCEN at the time of formation or registration. The reporting requirements for partnerships and trusts are currently unclear, and we await more precision from the Act as regulations develop.

Will other jurisdictions follow UK's crypto-businesses regulations?

Despite the uncertainties surrounding the pandemic and its effects on the crypto-asset market, 2020 witnessed a worldwide motivation to regulate the crypto-business. In December 2020, due to Covid-19 restrictions and the complexity of applications, the Financial Conduct Authority (FCA) announced that cryptocurrency businesses, that have applied for registration before 16 December 2020 and whose applications are still being processed, may continue operating under a temporary licensing regime for another six months (i.e. until 9 July 2021). Firms that did not submit an application by 15 December 2020 will not be eligible for the temporary registration regime. They will need to return crypto-assets to customers and stop trading by 10 January 2021 or may run the risk of being subject to the FCA's criminal and civil enforcement powers.

The FCA also became the anti-money laundering and counter terrorist financing (AML/CTF) supervisor for crypto-asset businesses, which includes firms that exchange money to and from crypto-assets and those that safeguard their customers' crypto-assets. Thus, existing crypto-asset business will have to comply with the Money Laundering Regulations and register with the FCA by 10 January 2021 while new businesses beginning operations after 10 January 2021, will need to obtain the full registration from the FCA before conducting their business.

Luxembourg's new law targets corporate entities located in non-cooperative tax jurisdictions

Since the 1960s when Luxembourg rose as Europe's financial centre, it became the jurisdiction of choice for corporations and high-net worth individuals due to its favourable tax regime which encourages corporations to establish special purpose entities. Both the absence of withholding taxes on royalties and interest payments made by companies based in Luxembourg and the high level of dividend, interest and royalty payments as a percentage of GDP highly suggest that the country's tax regime is used in tax avoidance structures by allowing payment to escape taxation. Recently, Luxembourg had to review certain aspects of its tax system and comply with some international tax reform. Thus, to respond to the recommendations of the EU Council to have a legislative defensive measure in taxation regarding the listed non-cooperative tax jurisdictions, the Luxembourg Parliament (*Chambre des Députés*) adopted a bill of law on the non-deductibility of interest and royalty payments made to related parties in non-cooperative jurisdictions.

Effective 1 March 2021, interest or royalties, paid or accrued, will not be tax deductible at the level of the Luxembourg taxpayer if the beneficiary of the interest or royalties is a collective entity and the beneficial owner of the interest or royalties is an associated enterprise and is located in a country or territory included in the list of non-cooperative jurisdictions for tax purposes. The EU list of non-cooperative jurisdictions for tax purposes revised by the Council on 22 February 2021 is composed of American Samoa, Anguilla, Dominica (new), Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, US Virgin Islands, Vanuatu and Seychelles. The disallowance of interest or royalties deduction shall not apply if the Luxembourg taxpayer is able to prove that the operation to which interest or royalties correspond has been put in place for valid commercial reasons reflecting the economic reality.

This new tax measure is not a new Luxembourg withholding tax, and will only be applicable if the above conditions are cumulatively met. It also complements other tax measures already adopted, such as the obligation to notify the Luxembourg tax authorities of any intra-group transactions carried out by Luxembourg taxpayers with related parties resident in non-cooperative tax jurisdictions.

The law does not provide any clarifications on the definitions of "beneficial owner," "related enterprise" or "valid commercial reasons which reflect economic reality," which are important concepts in assessing the risks for companies. Thus companies, especially those operating in the non-cooperative jurisdictions, will need to carefully consider the tax implications brought by this new tax reform.

Automatic exchange of tax information from digital platforms in Europe

On 21 November 2020, the European Member States reached consensus on a proposal for the seventh Directive on Administrative Cooperation ("DAC7") which follows the European Commission's aim to promote fair and simple taxation.

DAC7 aims at strengthening the existing framework for the exchange of information and administrative cooperation, by providing a better flow of information with respect to taxpayers that generate income through digital platforms.

DAC7 therefore introduces a reporting obligation on some digital platforms to collect and report information to their local tax authority on income generated by some sellers on those digital platforms. For purposes of simplification and mitigation of costs, the Reporting Platform Operators only have to report in one single Member State. The disclosed information will be automatically exchanged with other relevant Member States. In order to prevent baseless requests or fishing expeditions by Member States, Member States are only obligated to exchange the information if it is foreseeably relevant for the levying of taxes in scope of the Directive.

A Reporting Platform Operator is a Platform that is tax resident in a Member State, is incorporated under the laws of a Member State, has its place of management in a Member State or has a permanent establishment in a Member State and which either facilitates relevant activities by Reportable Sellers that are resident of a Member State or facilitates the rental of immovable property located in a Member State. Non-EU Platform Operators will be relieved from reporting obligations if they already report similar information in a non-EU jurisdiction provided that the information is exchanged by the non-EU jurisdiction with all Member States. This reporting obligation thus imposes an additional compliance burden for the digital platform companies where companies will be confronted with an additional due diligence which will need to be completed by 31 December of each year.

DAC7 also intends to prevent income tax and VAT shortfalls and amendments will consequently be made to the relevant to also capture VAT and other indirect taxes.

Russia increases individual income tax for high earners

Effective 1 January 2021, a 15% individual income tax rate will apply to the annual income of Russian individual tax residents in excess of a threshold of RUB 5 million. The current 13% individual income tax rate will continue to apply as long as an individual's income does not exceed the threshold. The 15% tax rate will apply to most types of income, with the exception of capital gains from the sale of assets (including real estate but excluding securities), payments under insurance contracts and pension plans, and gifts of assets (excluding securities). These will be subjected to a 13% tax, even if they exceed the threshold.

Based on the information submitted by tax agents, the Russian tax authorities may send a notification to a Russian individual taxpayer requiring payment for additional tax due to the aggregate annual income exceeding the threshold. The additional tax will need to be paid at the 15% rate by December 1st of the year following the end of the tax period. Individuals will however not be required to file tax returns for the payment of additional tax and will only have to make payments based on the notifications received.

Singapore provides transfer pricing guidance to multinationals

For many years, Hong Kong and Singapore have been resilient economic rivals, both offering world-class infrastructures and facilities while boasting tax-friendly policies and effortless company incorporation. Both countries have been competing with each other for dominance to become the best country in Asia, and worldwide, to do business. Enjoying from social stability and the second place from the Ease of Doing Business ranking by The World Bank, Singapore has attracted many multinational enterprises (MNEs) to have their centralised operations and often their regional Headquarters in Singapore. Due to recent scrutiny on these structures, by international tax authorities and countries having Double Tax Agreements with Singapore, and increasing compliance requirements, the Inland the Revenue Authority of Singapore (IRAS) published a tax guide on 19 March 2021 entitled "Transfer Pricing Guidelines Special Topic - Centralized Activities in Multinational Enterprise Groups".

Multinationals often use transfer pricing as a method to show higher profits in low-tax countries and lower profits in high-tax countries, thus overcoming transaction costs and restrictions on trade and capital flows when transferring from their headquarters to their subsidiaries. With the Guide, IRAS aims at providing administrative guidance for MNEs with regard to transfer pricing while acknowledging that centralised activities are usually undertaken by Headquarters. The Guide addresses the arm's length principle and observes that a transfer pricing methodology should be determined only after the functions, risks and assets used by Headquarters have been carefully analysed and related party transactions have been accurately outlined. The Guide also reiterates the vital role of documentation and provides key instructions to MNEs on how to develop the appropriate transfer pricing policies to remunerate Singapore-based Headquarters of an MNE on the value it creates to the group.