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Corporate Taxes 2017/18

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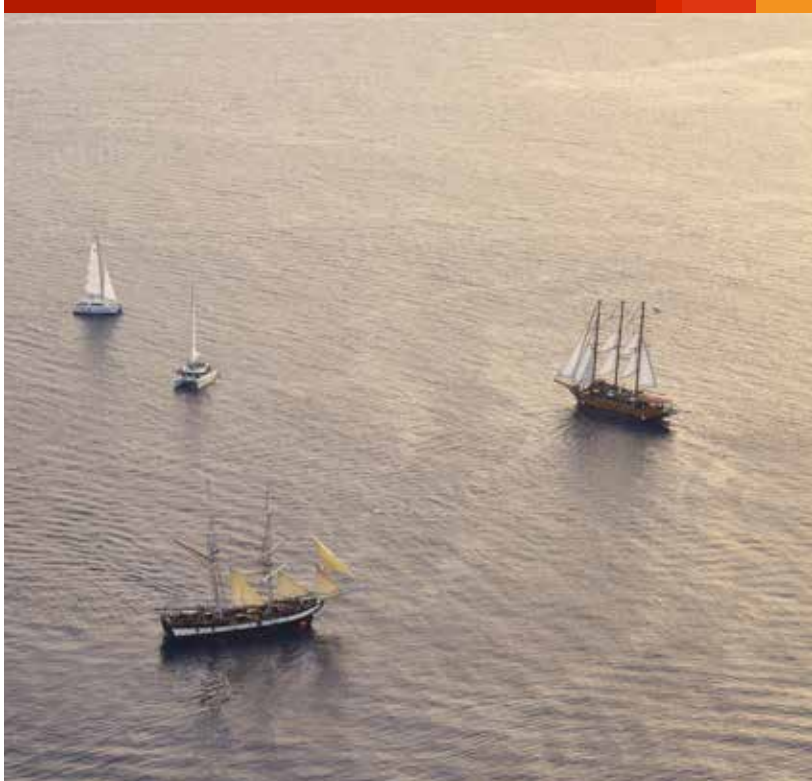

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Worldwide Tax Summaries

Corporate Taxes 2017/18

All information in this book, unless otherwise stated, is up to date as of 1 June 2017.

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

Foreword

Welcome to the 2017/18 edition of *Worldwide Tax Summaries – Corporate Taxes*, one of the most comprehensive tax guides available. This year's edition provides detailed information on corporate tax rates and rules in 157 countries worldwide.

As governments across the globe are looking for greater transparency and with the increase of cross-border activities, tax professionals often need access to the current tax rates and other major tax law features in a wide range of countries. The country summaries, written by our local PwC tax specialists, include recent changes in tax legislation as well as key information about income taxes, residency, income determination, deductions, group taxation, credits and incentives, withholding taxes, indirect taxes, and tax administration. All information in this book, unless otherwise stated, is up to date as of 1 June 2017.

Our online version of the summaries is available at *www.pwc.com/taxsummaries*. The Worldwide Tax Summaries (WWTS) website also covers the taxation of individuals and is fully mobile compatible, giving you quick and easy access to regularly updated information anytime on your mobile device.

Some of the enhanced features available online include Quick Charts to compare rates across jurisdictions. You may also access WWTS content through Tax Analysts at *www.taxnotes.com*.

If you have any questions, or need more detailed advice on any aspect of tax, please get in touch with us. The PwC tax network has member firms throughout the world, and our specialist networks can provide both domestic and cross-border perspectives on today's critical tax challenges.

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Significant developments

Canada's corporate summary reflects all 2017 federal, provincial, and territorial budgets. The 2017 federal budget continues to tighten perceived loopholes or inequities in various aspects of the tax system and proposes to spend more than 500 million Canadian dollars (CAD) over five years to prevent tax evasion and improve tax compliance (*see Tax evasion and aggressive tax avoidance in the Tax administration section for more information*). The Canada Revenue Agency (CRA) will:

- expand its review of international electronic funds transfers
- increase verification activities
- hire additional auditors and specialists with a focus on the underground economy
- develop robust business intelligence infrastructure and risk assessment systems to target high-risk international tax and abusive tax avoidance cases, and
- improve the quality of investigative work that targets criminal tax evaders.

In addition, Canada's Minister of National Revenue accepted the 14 recommendations in Canada's House of Commons Standing Committee on Finance report 'The Canada Revenue Agency, Tax Avoidance and Tax Evasion: Recommended Actions'. The report reviewed the CRA's efforts to enhance tax compliance by individuals and corporations, and to address situations of non-compliance. It also considered the development and use of offshore corporate structures. When implemented, several of the recommendations could increase both tax revenue and the cost of tax compliance.

This summary is based on enacted and proposed legislation and assumes that the proposed legislation will become law. Generally, budget proposals and draft legislation are enacted into law, especially if there is a majority federal government, which is currently the case.

Eligible capital property (ECP)

Recently enacted legislation repeals the ECP regime and replaces it with a new capital cost allowance (CCA) pool, Class 14.1, starting 1 January 2017. The CCA (i.e. depreciation for tax purposes) rate will be 5% declining balance. Transitional rules will apply. *See Eligible capital property (ECP) in the Deductions section for more information*.

Derivatives

The 2017 federal budget clarifies the timing of the recognition of gains and losses on derivatives held on income account for taxpayers that are not financial institutions. The budget:

- allows taxpayers to elect to mark-to-market all eligible derivatives held on income account, for taxation years beginning after 21 March 2017, and

- prevents the avoidance or deferral of income tax through the use of offsetting derivative positions in straddle transactions, for any loss realised on a position entered into after 21 March 2017 (exceptions apply).

See Derivatives in the Income determination section for more information.

Investment fund mergers
The 2017 federal budget:

- extends the mutual fund merger rules to the reorganisation of a mutual fund switch corporation (i.e. a mutual fund corporation with multiple classes of shares, where typically each class is a distinct investment fund) into multiple mutual fund trusts on a tax-deferred basis, for qualifying reorganisations occurring after 21 March 2017
- allows insurers to effect tax-deferred mergers of segregated funds (i.e. life insurance policies that have many of the characteristics of mutual fund trusts) if carried out after 2017, and
- permits segregated funds to apply non-capital losses arising in taxation years beginning after 2017 to other taxation years beginning after 2017.

See Investment fund mergers in the Income determination section for more information.

Foreign branches of life insurers
The 2017 federal budget introduces measures to ensure that Canadian life insurers are taxable in Canada on income from the insurance of Canadian risks that are shifted to a foreign branch. For taxation years of Canadian taxpayers beginning after 21 March 2017, the proposed anti-avoidance rule will:

- apply when 10% or more of the gross premium income (net of reinsurance ceded) earned by a foreign branch of a Canadian life insurer is premium income in respect of Canadian risks, and
- deem the foreign branch's insurance of Canadian risks to be part of a business carried on by the life insurer in Canada and the related insurance policies to be life insurance policies in Canada.

See Foreign branches of life insurers in the Income determination section for more information.

Back-to-back loan arrangements
The 'back-to-back loan' rules prevent taxpayers from interposing a third party between a Canadian borrower and a foreign lender to avoid rules that would otherwise apply if a loan were made directly between the two taxpayers. Recently enacted legislation expands these rules. *See Back-to-back loan arrangements in the Group taxation section for more information*.

Country-by-country (CbC) reporting
Recently enacted legislation implements annual CbC reporting for taxation years beginning after 2015, for multinational enterprises (MNEs) with total annual consolidated group revenue of 750 million euros (EUR) or more (approximately CAD 1 billion). *See Country-by-country (CbC) reporting in the Group taxation section for more information*.

Common Reporting Standard (CRS)

Recently enacted legislation implements the Organisation for Economic Co-operation and Development's (OECD's) CRS for Automatic Exchange of Information, effective 1 July 2017. Canadian financial institutions will be required to obtain and report to the CRA certain information related to financial accounts of non-residents. *See Common Reporting Standard (CRS) in the Other issues section for more information*.

Income tax objection process

The CRA intends to improve the income tax objection process in response to recommendations in the 2016 Fall Reports of the Auditor General of Canada. One report examined whether the CRA efficiently manages income tax objections, and determined that the CRA did not resolve income tax objections in a timely manner. *See Income tax objection process in the Tax administration section for more information*.

Voluntary Disclosures Program (VDP)

On 8 December 2016, the CRA released 'Report on the Voluntary Disclosure Program', which sets out the 11 recommendations of the Offshore Compliance Advisory Committee (OCAC). The report states that the recommendations are designed to 'enhance and improve' the VDP. If implemented, the recommendations could significantly change the VDP. *See Voluntary Disclosure Program (VDP) in the Tax administration section for more information*.

Factual control

The 2017 federal budget clarifies that for taxation years beginning after 21 March 2017, in determining whether a taxpayer has factual control of a corporation, relevant factors to be considered need not include whether the taxpayer has a legally enforceable right or ability to effect a change in the board of directors, or the board's powers, or to exercise influence over the shareholder or shareholders who have that right or ability. *See Factual control in the Other issues section for more information*.

Taxes on corporate income

As a general rule, corporations resident in Canada are subject to Canadian corporate income tax (CIT) on worldwide income. Non-resident corporations are subject to CIT on income derived from carrying on a business in Canada and on capital gains arising upon the disposition of taxable Canadian property (*See Capital gains in the Income determination section for more information*). The purchaser of the taxable Canadian property is generally required to withhold tax from the amount paid unless the non-resident vendor has obtained a clearance certificate.

Canadian CIT and withholding tax (WHT) can be reduced or eliminated if Canada has a treaty with the non-resident's country of residence. *A list of treaties that Canada has negotiated is provided in the Withholding taxes section, along with applicable WHT rates*.

Federal income tax

The following rates apply for 31 December 2017 year-ends. For non-resident corporations, the rates apply to business income attributable to a permanent establishment (PE) in Canada. Different rates may apply to non-resident corporations in other circumstances. Non-resident corporations may also be subject to branch tax (*see the Branch income section*).

	Federal rate (%)
Basic rate	38.0
Less: Provincial abatement (1)	(10.0)
Federal rate	28.0
Less: General rate reduction or manufacturing and processing deduction (2)	(13.0)
Net federal tax rate (3, 4)	15.0

Notes

1. The basic rate of federal tax is reduced by a 10% abatement to give the provinces and territories room to impose CITs. The abatement is available in respect of taxable income allocated to Canadian provinces and territories. Taxable income allocable to a foreign jurisdiction is not eligible for the abatement and normally is not subject to provincial or territorial taxes.
2. The general rate reduction and manufacturing and processing deduction do not apply to the first CAD 500,000 of active business income earned in Canada by Canadian-controlled private corporations (CCPCs), investment income of CCPCs, and income from certain other corporations (e.g. mutual fund corporations, mortgage investment corporations, and investment corporations) that may benefit from preferential tax treatment.
3. Provincial or territorial taxes apply in addition to federal taxes. Provincial and territorial tax rates are noted below.
4. For small CCPCs, the net federal tax rate is levied on active business income above CAD 500,000; a federal rate of 10.5% applies to the first CAD 500,000 of active business income. Investment income (other than most dividends) of CCPCs is subject to the federal rate of 28%, in addition to a refundable federal tax of 10⅔%, for a total federal rate of 38⅔%.

Provincial/territorial income tax

All provinces and territories impose income tax on income allocable to a PE in the province or territory. Generally, income is allocated to a province or territory by using a two-factor formula based on gross revenue and on salaries and wages. Provincial and territorial income taxes are not deductible for federal income tax purposes. The rates given apply to 31 December 2017 year-ends and do not take into account provincial tax holidays, which reduce or eliminate tax in limited cases.

Province/territory	Income tax rate (%) (1, 2)
Alberta	12.0
British Columbia	11.0
Manitoba	12.0
New Brunswick	14.0
Newfoundland and Labrador	15.0
Northwest Territories	11.5
Nova Scotia	16.0
Nunavut	12.0
Ontario (3)	11.5 or 10.0
Prince Edward Island	16.0
Quebec (4)	11.8
Saskatchewan (5, 6)	11.75 or 9.75
Yukon (7)	13.49 or 2.5

Notes

1. When two rates are indicated, the lower rate applies to manufacturing and processing income.
2. In all provinces and territories, the first CAD 500,000 (CAD 450,000 in Manitoba) of active business income of a small CCPC is subject to reduced rates that range from 0% to 8%, depending on the jurisdiction.
3. The lower Ontario rate applies to profits from manufacturing and processing, and from farming, mining, logging, and fishing operations, carried on in Canada and allocated to Ontario.

Corporations subject to Ontario income tax may also be liable for corporate minimum tax (CMT) based on adjusted book income. The CMT is payable only to the extent that it exceeds the regular Ontario income tax liability. The CMT rate is 2.7% and applies when total assets are at least CAD 50 million and annual gross revenue is at least CAD 100 million on an associated basis.

4. Quebec's rate decreased from 11.9% to 11.8% on 1 January 2017, and will decrease to 11.7% on 1 January 2018, to 11.6% 1 January 2019, and to 11.5% on 1 January 2020.
5. Saskatchewan's general rate decreases from 12% to 11.5% on 1 July 2017, and to 11% on 1 July 2019.
6. The minimum rate that applies to Saskatchewan's manufacturing and processing profits decreases from 10% to 9.5% on 1 July 2017, and to 9% on 1 July 2019. The manufacturing and processing reduction from the general rate is determined by multiplying the maximum rate reduction (2%) by the corporation's allocation of income to Saskatchewan.
7. Yukon's general rate decreases from 15% to 12% on 1 July 2017.

British Columbia Liquefied Natural Gas Income Tax Act
Effective for taxation years beginning after 31 December 2016, British Columbia's Liquefied Natural Gas Income Tax Act introduces an income tax on income from liquefaction activities at or in respect of a liquefied natural gas (LNG) facility located in the province. This LNG income tax is in addition to federal and provincial income taxes.

The LNG income tax is a two-tier income tax, calculated as follows:

- Tier 1 tax rate of 1.5% applies on the net operating income (NOI), which is the taxpayer's profit or loss (with specific adjustments) less up to 100% of the net operating loss account, and less an investment allowance (the Tier 1 tax paid is added to a tax credit pool that can be used to reduce Tier 2 tax), and
- Tier 2 tax rate of 3.5% applies on the net income (NI), which is the NOI less up to 100% of the capital investment account (CIA) (the Tier 2 tax will not apply until the CIA is fully depleted and is reduced by the tax credit pool balance).

The Tier 2 tax rate of 3.5% applies for taxation years starting after 31 December 2016, and will increase to 5% for taxation years starting after 31 December 2036.

The provincial government also introduced a non-refundable Natural Gas Tax Credit under the British Columbia Income Tax Act. This credit is available to LNG taxpayers that have an establishment in British Columbia and may potentially reduce the effective provincial CIT rate to a minimum of 8% (from 11%). Any unused credit can be carried forward indefinitely.

Corporate residence

Under the Income Tax Act, a corporation incorporated in Canada (federally or provincially/territorially) will be deemed to be resident in Canada. A corporation not incorporated in Canada will be considered to be resident in Canada under Canadian common law if its central management and control is exercised in Canada. Where a corporation's central management and control is exercised is a question of fact, but typically it is where the Board of Directors meets and makes decisions, provided the Board takes action.

A corporation incorporated outside of Canada but with its central management and control situated both in and outside Canada will be deemed to be a non-resident of Canada if it qualifies as a non-resident of Canada under treaty tie-breaker rules.

A corporation incorporated in Canada will cease to be a Canadian resident if it is granted Articles of Continuance in a foreign jurisdiction. Similarly, a foreign corporation will become resident in Canada if it is continued in Canada or is a predecessor corporation of an amalgamated corporation that is resident in Canada.

Permanent establishment (PE)
Canada's tax treaties generally provide that the business profits of a non-resident corporation are not subject to Canadian tax unless the non-resident corporation carries on business in Canada through a PE situated in Canada and the business profits are attributed to that PE. Canada's tax treaties may also restrict the imposition of branch tax to situations where the non-resident corporation carries on business in Canada through a PE situated in Canada and/or limit the applicable branch tax rate. While the wording of tax treaties varies, a PE generally is defined as:

- a fixed place of business through which the business of the non-resident corporation is wholly or partly carried on
- a place of management, a branch, an office, a factory, and a workshop; a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources; a building site, construction, or assembly project that exists for a specified period, and
- a dependent agent or employee who has and habitually exercises an authority to conclude contracts in the name of the non-resident corporation.

In some circumstances, a Canadian PE may also arise where services are rendered in Canada and certain requirements (e.g. relating to the duration of the services) are met.

The Canadian domestic definition of PE (federal and provincial/territorial) generally mirrors the above.

The interpretation of what constitutes a PE is expected to be re-evaluated in light of the final report issued in 2015 by the OECD and Group of 20 (G20) on Action 7, which is focused on preventing the artificial avoidance of PE status.

Other taxes

Consumption taxes

Federal goods and services tax (GST)
The federal GST is levied at a rate of 5%. It is a value-added tax (VAT) applied at each level in the manufacturing and marketing chain and applies to most goods and services. However, the tax does not apply to zero-rated goods, such as exports and basic groceries, or to tax-exempt supplies, such as health care, educational services, and certain services provided by financial institutions.

Generally, businesses pay GST on their purchases and charge GST on their sales, and remit the net amount (i.e. the difference between the GST collected and the input tax credit for the tax paid on purchases). Suppliers are entitled to claim input tax credits for the GST paid on expenses incurred relating to their supplies of standard-rated and zero-rated goods and services, but not on expenses relating to the making of tax-exempt supplies.

Harmonised sales tax (HST)

Five provinces have fully harmonised their sales tax systems with the GST and impose a single HST. The HST includes the 5% GST and a provincial sales tax (PST) component. It is imposed on essentially the same base as the GST. HST rates follow.

Province	HST rate (%)
New Brunswick	15
Newfoundland and Labrador	15
Nova Scotia	15
Ontario	13
Prince Edward Island	15

Retail sales tax

British Columbia, Manitoba, and Saskatchewan each levy a retail sales tax at 7%, 8% (7% after 30 June 2023), and 6% (5% before 23 March 2017), respectively, on most purchases of tangible personal property for consumption or use in the province and on the purchase of specific services.

Quebec's sales tax is structured in the same manner as the GST and applies to most goods and services that are subject to the GST. The Quebec sales tax (QST) rate is 9.975%, resulting in an effective combined QST and GST rate of 14.975% (i.e. 9.975% provincial component plus the 5% GST). Quebec administers the GST in that province.

Neither Alberta nor the three territories (the Northwest Territories, Nunavut, and the Yukon) impose a retail sales tax. However, the GST applies in those jurisdictions.

Customs and import duties

Customs tariffs (also known as duties) are tariffs or taxes levied on goods imported into Canada. The amount of customs duty that applies to imported goods depends on a number of factors, including the nature of the duty (i.e. *ad valorem* or specific), tariff classification, country of origin, and value for duty declared. The Tariff Schedule to the Customs Tariff, which is based on the World Customs Organization's Harmonized Commodity Description and Coding System, sets out the customs duty rates for goods imported into Canada. Goods that originate from most countries with which Canada does not have a free trade agreement (FTA) or other preferential tariff arrangement will generally attract the 'Most Favoured Nation' (MFN) duty rate or tariff treatment.

Canada has 11 FTAs currently in force. Canada's major FTA is the North American Free Trade Agreement (NAFTA), which applies to goods imported from both the United States (US) and Mexico. Most goods that originate in the NAFTA territory and qualify as originating for NAFTA are eligible for duty-free treatment (exceptions apply) when imported into Canada from the other NAFTA partner. Canada's other FTAs are with Chile, Colombia, Costa Rica, the European Free Trade Association (which includes Iceland, Liechtenstein, Norway, and Switzerland), Honduras, Israel, Jordan, the Republic of Korea, Panama, and Peru. Under these FTAs, the countries may be eligible for reduced tariff benefits at rates more favourable than the MFN rate. Most imports are tariff-free or scheduled for reduction to tariff-free status after a tariff phase-out period under the specific FTA (certain exceptions apply).

Canada has concluded, but has not yet implemented, three additional FTAs as follows:

- Canada and the European Union (EU) Comprehensive Economic and Trade Agreement (CETA).
- The Canada-Ukraine FTA (CUFTA).
- The Trans-Pacific Partnership (TPP) Agreement.

Canada is currently in negotiations with several other countries (e.g. Japan and India). Like the NAFTA, these FTAs will set out the rules of origin for determining whether goods are eligible for preferential tariff treatment, among other things.

Canada also extends preferential tariff rates to many (but not all) products imported from certain countries via the General Preferential Tariff (GPT), the Least Developed Countries Tariff (LDCT), the Commonwealth Caribbean Countries Tariff (CCCT), the Australia Tariff (AUT), and the New Zealand Tariff (NZT). To qualify for preferential tariff rates, goods must meet various requirements with respect to the rules of origin and transhipment, among other things.

Other import duties and levies
Importations into Canada may also be subject, in certain cases, to anti-dumping duties and/or countervailing duties, excise duties, and excise taxes. In limited circumstances, Canada may also impose a surtax on certain imports. A surtax is a duty imposed by an Order in Council (a decision by the federal government) to address certain issues (e.g. to enforce Canada's rights under a trade agreement or to respond to acts by the government of a country that adversely affect trade in Canadian goods or services). If the goods to which the surtax applies are already dutiable, it is an extra duty. The Order in Council will set out the amount of the surtax, the goods to which it applies, and typically its duration.

Excise taxes and duties
Excise duties are levied at various rates on spirits, wine, beer, malt liquor, and tobacco products manufactured in Canada.

Excise tax is imposed on petroleum products and automobiles. In addition, a 10% federal excise tax is imposed on insurance against a risk in Canada if it is placed by insurers through brokers or agents outside Canada or with an insurer that is not authorised under Canadian or provincial/territorial law to transact the business of insurance. Certain premiums are exempt, including those for life, personal accident, marine, and sickness insurance.

Property taxes
Property taxes are levied by municipalities in Canada on the estimated market value of real property within their boundaries and by provinces and territories on land not in a municipality. In most provinces and territories, a general property tax is levied on the owner of the property. Some municipalities levy a separate business tax, which is payable by the occupant if the premises are used for business purposes. These taxes are based on the rental value of the property at tax rates that are set each year by the various municipalities. School taxes, also generally based on the value of real property, are levied by local and regional school boards or the province or territory.

Land transfer tax
All provinces and territories levy a land transfer tax or registration fee on the purchaser of real property within their boundaries. These levies are expressed as a percentage,

in most cases on a sliding scale, of the sale price or the assessed value of the property sold and are generally payable at the time title to the property is registered. Rates generally range from 0.02% to 3%, depending on the province or territory, but may be higher if the purchaser is a non-resident. Some exemptions (or refunds) are available. Additional land transfer taxes apply for properties purchased in the municipalities of Montreal or Toronto. Other municipalities may also impose these taxes and fees.

In British Columbia, a new 15% land transfer tax (in addition to general land transfer tax) is imposed on foreign entities (i.e. foreign nationals and corporations and certain Canadian corporations controlled by such foreign persons) and certain trusts and/or their trustees that have a foreign connection (a taxable trustee) that purchase residential property in the Greater Vancouver Regional District, for transfers registered after 1 August 2016. Failure to pay the new tax or file the required forms can result in interest, plus significant penalties, and/or imprisonment. Anti-avoidance rules will capture transactions that are structured to avoid the new tax. Relief from the additional 15% land transfer tax is available after 1 August 2016 to:

- foreigners who become Canadian citizens or permanent residents within one year of purchasing a principal residence, or
- foreign workers coming to British Columbia under the British Columbia Provincial Nominee Program who purchase a principal residence.

In Ontario, a new 15% land transfer tax (in addition to general land transfer tax and Toronto's land transfer tax) is imposed on foreign entities (i.e. foreign nationals and corporations and certain Canadian corporations controlled by such foreign persons) and taxable trustees that purchase residential property in the Greater Golden Horseshoe (a defined region of Southern Ontario surrounding and including the City of Toronto), for agreements of purchase and sale signed after 20 April 2017. For the new tax to apply, the land transferred must contain at least one, but not more than six, single family residence(s). The tax also applies to unregistered dispositions of a beneficial interest in such residential property, when the purchaser of the interest is a foreign entity or taxable trustee. Failure to pay the new tax can result in penalty, fine, and/or imprisonment. Exemptions from the 15% land transfer tax are available in certain circumstances (including for foreign workers coming to Ontario under the Ontario Immigrant Nominee Program or for refugees under the Immigration and Refugee Protection Act, who purchase a principal residence), and rebates of the tax can be obtained in certain situations.

Federal capital taxes

The federal government does not levy a general capital tax. It imposes the Financial Institutions Capital Tax (Part VI Tax) on banks, trust and loan corporations, and life insurance companies at a rate of 1.25% when taxable capital employed in Canada exceeds CAD 1 billion. The threshold is shared among related financial institutions. The tax is not deductible in computing income for tax purposes. It is reduced by the corporation's federal income tax liability. Any unused federal income tax liability can be applied to reduce Part VI Tax for the previous three and the next seven years. In effect, the tax constitutes a minimum tax on financial institutions.

Provincial capital taxes

The provinces do not levy a general capital tax, but most do impose a capital tax on financial institutions. Capital taxes are deductible for federal income tax purposes. The federal government had proposed to limit the deductibility of capital taxes, but has

delayed implementing this proposal indefinitely. The territories do not impose capital taxes.

Provincial capital taxes on financial institutions are imposed at the following rates for 31 December 2017 year-ends. Certain exemptions and reduced rates apply.

Province	Banks, trust and loan corporations (%)
Alberta	-
British Columbia	-
Manitoba (1)	6
New Brunswick (2)	4 or 5
Newfoundland and Labrador	6
Nova Scotia (3)	4
Ontario	-
Prince Edward Island	5
Quebec (4)	-
Saskatchewan (5)	3.82

Notes

1. Financial institutions in Manitoba with taxable paid up capital under CAD 4 billion are not subject to capital tax.
2. New Brunswick's capital tax rate is 5% for banks and 4% for other financial institutions.
3. The maximum capital tax payable by financial institutions in Nova Scotia is CAD 12 million annually.
4. Quebec applies a compensation tax of 4.48% (2.8% after 31 March 2022; nil after 31 March 2024) on payroll.
5. Saskatchewan's rate for financial institutions that have taxable paid-up capital (PUC) of CAD 1.5 billion or less is 0.7%. Financial institutions that qualified for the 0.7% capital tax rate in taxation years ending after 31 October 2008 and before 1 November 2009 are subject to a 0.7% capital tax rate on their first CAD 1.5 billion of taxable capital and a 4% (3.25% before 1 April 2017) capital tax rate on taxable capital exceeding CAD 1.5 billion, which results in a 3.82% rate for financial institutions with 31 December 2017 year-ends.

Additional taxes on insurers

All provinces and territories impose a premium tax ranging from 2% to 5% on insurance companies (both life and non-life). In addition, Ontario and Quebec impose a capital tax on life insurance companies. Quebec also levies a compensation tax on insurance premiums at a rate of 0.48% (0.3% after 31 March 2022; nil after 31 March 2024).

Part III.1 tax on excess designations

Federal Part III.1 tax applies at a 20% or 30% rate if, during the year, a CCPC designated as eligible dividends an amount that exceeds its general rate income pool (GRIP), or a non-CCPC pays an eligible dividend when it has a positive balance in its low rate income pool (LRIP). A corporation subject to Part III.1 tax at the 20% rate (i.e. the excess designation was inadvertent) can elect, with shareholder concurrence, to treat all or part of the excess designation as a separate non-eligible dividend, in which case Part III.1 tax will not apply to the amount that is the subject of the election.

Eligible dividends are designated as such by the payor and include dividends paid by:

- public corporations, or other corporations that are not CCPCs, that are resident in Canada and are subject to the federal general CIT rate (i.e. 15% in 2017), or
- CCPCs, to the extent that the CCPC's income is:
  - not investment income (other than eligible dividends from public corporations), and

- subject to the general federal CIT rate (i.e. the income is active business income not subject to the federal small business rate).

Non-eligible dividends include dividends paid out of either income eligible for the federal small business rate or a CCPC's investment income (other than eligible dividends received from public companies).

Payroll taxes

Social security taxes
For 2017, employers are required to pay, for each employee, government pension plan contributions up to CAD 2,564.10 and employment insurance premiums up to CAD 1,170.67. However, Quebec employers instead contribute, per employee, a maximum of CAD 2,797.20 in Quebec government pension plan contributions, CAD 912.11 in employment insurance premiums, and CAD 556.08 to a Quebec parental insurance plan.

Recently enacted legislation enhances the government pension plan starting 1 January 2019; employers and employees will be required to pay higher government pension plan contributions (to be phased-in over seven years).

Ontario retirement pension plan (ORPP)
Ontario will not proceed with the ORPP due to recently enacted legislation that enhances the Canadian government pension plan starting 1 January 2019.

Provincial/territorial payroll taxes
Employers in Manitoba, Newfoundland and Labrador, Ontario, and Quebec are subject to payroll tax. Maximum rates range from 1.95% to 4.3%. In addition, Quebec employers with payroll of at least CAD 2 million must allot 1% of payroll to training or to a provincial fund. Employers in the Northwest Territories and Nunavut must deduct from employees' salaries a payroll tax equal to 2% of employment earnings.

Withholding tax for non-resident employees
Under Regulation 102 of the Income Tax Act, employers (whether residents of Canada or not) that pay salaries or wages or other remuneration to a non-resident of Canada in respect of employment services rendered in Canada are required to withhold personal income tax (PIT) unless a waiver has been received prior to commencing work physically in Canada. There are no '*de minimis*' exceptions, and this requirement applies regardless of whether the non-resident employee in question will actually be liable for Canadian income tax on that salary pursuant to an income tax treaty that Canada has signed with another country. Complying is time-consuming and administratively burdensome.

Effective 1 January 2016, an amount paid by a 'qualifying non-resident employer' to a 'qualifying non-resident employee' is exempt from the Regulation 102 withholding requirement.

Generally, a 'qualifying non-resident employer' must meet the following two conditions:

- Is resident in a country with which Canada has a tax treaty (treaty country).
- Is at that time certified by the Minister.

A 'qualifying non-resident employee' must meet the following three conditions:

- Is resident in a treaty country.
- Is exempt from Canadian income tax under a tax treaty.
- Either:
  - is present in Canada for less than 90 days in any 12-month period that includes the time of payment, or
  - works in Canada for less than 45 days in the calendar year that includes the time of payment.

To become certified, a non-resident employer must file Form RC473 (Application for Non-Resident Employer Certification) with the CRA. Certification is valid for two calendar years (at which time employers must submit a new Form RC473), subject to revocation if the employer fails to meet certain conditions or to comply with its Canadian tax obligations.

The conditions to maintain non-resident employer certification include:

- Track and record, on a proactive basis, the number of days each qualifying non-resident employee is either working in Canada or present in Canada, and the income attributable to these days.
- Evaluate and determine whether its employees meet the conditions of a 'qualifying non-resident employee'.
- Obtain a Canadian Business Number.
- Complete and file the annual T4 Summary and slips, if required.
- File the applicable Canadian CIT returns if the corporation is 'carrying on business in Canada'.
- Upon request, make its books and records available to the CRA for inspection.

Withholding tax on payments to non-residents for services rendered in Canada

Under Regulation 105 of the Income Tax Act, every person (including a non-resident), paying to a non-resident, a fee, commission, or other amount in respect of services rendered in Canada (excluding remuneration paid to non-resident employees that are subject to payroll withholding requirements, *see Withholding tax for non-resident employees above*) is required to withhold and remit 15% of the payment to Canadian tax authorities unless a waiver has been received before payment. Regulation 105 withholding is not a final tax, but an instalment payment against possible Canadian tax liability if the non-resident is determined to have a PE in Canada. A non-resident corporation that does not have a PE in Canada can file a 'treaty-based' corporate tax return to have the previously withheld Regulation 105 amounts refunded. These tax returns may result in the Canadian tax authorities challenging the non-resident's assertion that no PE exists within Canada.

Carbon taxes

To encourage Canadians and Canadian businesses to reduce greenhouse gas emissions, the federal government has indicated that all provinces and territories must adopt a form of carbon pricing by 2018. The price on carbon pollution will start at a minimum of CAD 10 per tonne of carbon dioxide-equivalent emissions in 2018 and gradually rise by CAD 10 per year to CAD 50 per tonne in 2022. The provinces and territories can decide if they will implement carbon pricing by (i) putting a direct price on carbon pollution or (ii) adopting a cap-and-trade system. The federal government intends to impose its own pricing system on the provinces and territories that do not adopt their

own carbon pricing by 2018. The following provinces have adopted a carbon pricing plan:

- Alberta: Carbon levy, effective 1 January 2017, and reflects a price of CAD 20 per tonne, increasing to CAD 30 per tonne on 1 January 2018.
- British Columbia: Carbon tax, introduced in 1 July 2008 and is now priced at CAD 30 per tonne.
- Ontario: Cap-and-trade system, effective 1 January 2017.
- Quebec: Cap-and-trade system, introduced 1 January 2013.

Branch income

A non-resident corporation will be subject to income tax at normal corporate rates on profits derived from carrying on a business in Canada. However, Canada's tax treaties generally restrict taxation of a non-resident's business income to the portion allocable to a PE situated in Canada.

In addition, a special 25% 'branch tax' applies to a non-resident's after-tax profits that are not invested in qualifying property in Canada. The branch tax essentially is equivalent to a non-resident WHT on funds repatriated to the foreign head office. In the case of a corporation resident in a treaty country, the rate at which the branch tax is levied may be reduced to the WHT rate on dividends prescribed in the relevant tax treaty (generally 5%, 10%, or 15%). Some of Canada's treaties prohibit the imposition of branch tax or provide that branch tax is payable only on earnings in excess of a threshold amount. The branch tax does not apply to transportation, communications, and iron-ore mining companies. Nor does it apply to non-resident insurers, except in special circumstances.

Whether or not a treaty applies, a non-resident corporation that has a PE in Canada may be subject to federal and provincial capital taxes (i.e. financial institutions only). *See the Other taxes section*.

Income determination

Inventory valuation

In most cases, all property included in inventory can be valued at fair market value (FMV), or each item can be valued at its cost or FMV, whichever is lower. Most well-established and reasonable approaches to inventory costing can be used for tax purposes, except for the last in first out (LIFO) method. Conformity between methods used for book and tax reporting is not mandatory, but the method chosen should be used consistently for tax purposes. Inventory must be valued at the commencement of the year at the same amount as at the end of the immediately preceding year.

Capital gains

Half of a capital gain constitutes a taxable capital gain, which is included in the corporation's income and taxed at ordinary rates. Capital losses are deductible, but generally only against capital gains. Any excess of allowable capital losses over taxable capital gains in the current year can be carried back three years and carried forward indefinitely, to be applied against net taxable capital gains from those years, except in the case of an acquisition of control. No holding period is required. Intent is a major factor in determining whether the gain or loss is income or capital in nature.

Non-resident corporations are subject to CIT on taxable capital gains (50% of capital gains less 50% of capital losses) arising on the disposition of taxable Canadian property. Taxable Canadian property of a taxpayer includes, among other things:

- Real estate situated in Canada.
- Both capital and non-capital property used in carrying on a business in Canada.
- In general, shares in a corporation that are listed on a stock exchange if, at any time in the preceding 60 months:
  - 25% or more of the shares of the corporation are owned by the taxpayer or persons related to the taxpayer, and
  - more than 50% of the FMV of the shares is derived from real property situated in Canada, Canadian resource properties, and timber resource properties.
- In general, shares in a corporation that are not listed on a stock exchange if, at any time in the preceding 60 months, more than 50% of the FMV of the shares is derived, directly or indirectly, from property similar to that described above for shares of a public corporation.

However, in specific situations, the disposition by a non-resident of a share or other interest that is not described above may be subject to Canadian tax (e.g. when a share is deemed to be taxable Canadian property).

The general requirement is that a non-resident vendor of taxable Canadian property must report the disposition to the CRA and obtain a clearance certificate in respect of the disposition. If no certificate is obtained, the purchaser is required to withhold and remit to the CRA 25% of the sales proceeds.

Relief from the reporting and 25% withholding requirements may be available if specified conditions are met (e.g. if the gain from the disposition is not taxable in Canada by virtue of a tax treaty Canada has with another country). However, if the parties to the transaction are related, relief is available only if the CRA is notified.

For taxation years ending after 2 October 2016, draft legislative proposals allow the CRA to reassess tax, after the end of the normal reassessment period (three years after the date of the initial notice of assessment, for most taxpayers), on a gain from the disposition of real or immovable property if the taxpayer does not initially report the disposition.

Dividend income

Dividends received by one Canadian corporation from another Canadian corporation generally can be deducted in full when determining taxable income. However, dividends received by a 'specified financial institution' on certain preferred shares are an important exception and are taxed at full corporate rates.

Dividends on most preferred shares are subject to a 10% tax in the hands of a corporate recipient, unless the payer elects to pay a 40% tax (instead of a 25% tax) on the dividends paid. The payer can offset the tax against its income tax liability. The tax is not imposed on the first CAD 500,000 of taxable preferred-share dividends paid in a taxation year. Nor does it apply to dividends paid to a shareholder with a 'substantial interest' in the payer (i.e. at least 25% of the votes and value).

Dividends received by private corporations (or public corporations controlled by one or more individuals) from Canadian corporations are subject to a special refundable tax of 38$^{1}/_{3}$%. The tax is not imposed if the recipient is connected to the payer (i.e. the

recipient owns more than a 10% interest in the payer) unless the payer was entitled to a refund of tax in respect of the dividend. When the recipient pays dividends to its shareholders, the tax is refundable at a rate of 38⅓% of taxable dividends paid.

Stock dividends
If the payer is resident in Canada, stock dividends are treated for tax purposes in the same manner as cash dividends. The taxable amount of a stock dividend is the increase in the PUC of the payer corporation because of the payment of the dividend. Stock dividends received from a non-resident are exempt from this treatment. Instead, the shares received have a cost base of zero.

Avoidance of corporate capital gains
Section 55 of the Income Tax Act contains an anti-avoidance rule that generally taxes as capital gains certain otherwise tax-deductible, inter-corporate dividends in certain situations. Stemming from a Tax Court of Canada decision that involved the creation of an unrealised capital loss that was used to avoid capital gains tax on the sale of another property, legislation that applies to dividends received after 20 April 2015 amends section 55 to ensure it applies when one of the purposes for a dividend is to effect a significant reduction in the FMV of any share or significant increase in the total cost of properties of the dividend recipient. Other related rules ensure this amendment is not circumvented.

Synthetic equity arrangements
For dividends that are paid or become payable after April 2017 (after October 2015 for agreements or arrangements generally entered into, acquired, extended, renewed, or modified after 21 April 2015), the dividend rental arrangement rules are modified to deny the inter-corporate dividend deduction on dividends received by a taxpayer on a Canadian share in respect of which there is a synthetic equity arrangement. A synthetic equity arrangement, in respect of a share owned by a taxpayer, will be considered to exist when the taxpayer (or a person that does not deal at arm's length with the taxpayer) enters into one or more agreements that have the effect of providing to a counterparty all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share.

When a person that does not deal at arm's length with the taxpayer enters into such an agreement, a synthetic equity arrangement will be considered to exist if it is reasonable to conclude that the non-arm's length person knew, or ought to have known, that the effect described above would result. An exception to the revised rule will apply, in general terms, when the taxpayer can establish that no 'tax-indifferent investor' (including tax-exempt Canadian entities and certain trusts, partnerships, and non-resident entities) is a counterparty. Certain other exceptions are provided.

Interest income
Interest that accrued, became receivable by, or was received by a corporation is taxable as income from a business or property.

Rental income
Rents received by a corporation are taxable as income from a business or property.

Royalty income
Royalties received by a corporation are taxable as income from a business or property.

Derivatives

Derivatives are sophisticated financial instruments whose value is derived from the value of an underlying interest. The 2017 federal budget proposes two measures to clarify the timing of the recognition of gains and losses on derivatives held on income account.

Elective use of the mark-to-market method

In the past, it was uncertain if taxpayers could mark to market their derivatives held on income account under the general principles of profit computation. A recent Federal Court of Appeal decision allowed a taxpayer that was not a financial institution to use the mark-to-market method on the basis that it provided an accurate picture of the taxpayer's income. For taxation years beginning after 21 March 2017, taxpayers can elect to mark to market all of their eligible derivatives held on income account. The election will remain effective until it is revoked with the consent of the Minister of National Revenue. Without this election, the 2017 federal budget provides that income or losses from derivatives on income account are to be reported on a realised basis. For eligible derivatives that were previously subject to tax on a realisation basis, the recognition of any accrued gain or loss at the beginning of the first election year will be deferred until the derivative is disposed of.

Straddle transactions

In its simplest form, a straddle is a transaction in which a taxpayer concurrently enters into two or more positions (often derivative positions) that are expected to generate equal and offsetting gains and losses on account of income. The taxpayer then may attempt to benefit from a deferral of recognition of income on the 'gain leg' or through a shifting of that gain to a tax-indifferent investor. The 2017 federal budget introduces a stop-loss rule that will effectively defer the realisation of any loss on the disposition of a position to the extent of any unrealised gain on an offsetting position. A gain in respect of an offsetting position would generally be unrealised where the offsetting position has not been disposed of and is not subject to mark-to-market taxation. The stop-loss rule will be subject to a number of exceptions and will apply to any loss realised on a position entered into after 21 March 2017.

Investment fund mergers

Merger of mutual fund switch corporations into mutual fund trusts

Canadian mutual funds can be in the legal form of a trust or a corporation. Mutual fund switch corporations are mutual fund corporations with multiple classes of shares, where typically each class is a distinct investment fund. For qualifying reorganisations occurring after 21 March 2017, the 2017 federal budget proposes to extend the mutual fund merger rules to facilitate the reorganisation of a mutual fund switch corporation into multiple mutual fund trusts on a tax-deferred basis. The rules will apply to a class of shares if all or substantially all of the assets allocable to that class are transferred to a mutual fund trust and the shareholders of that class become unitholders of that mutual fund trust.

Segregated fund mergers

Segregated funds are life insurance policies that have many of the characteristics of mutual fund trusts. The 2017 federal budget proposes to allow insurers to effect tax-deferred mergers of segregated funds if carried out after 2017. In addition, segregated funds will be permitted to apply non-capital losses arising in taxation years beginning after 2017 to other taxation years beginning after 2017. The use of these losses will

be subject to the normal limitations for the carrying forward and back of non-capital losses and will be restricted following a segregated fund merger.

Foreign exchange gains and losses

The foreign exchange gains and losses of a Canadian taxpayer that arise from business transactions (i.e. on income account), including the activities of a branch operation, are generally fully includable in income or fully deductible. Any method that is in accordance with generally accepted accounting principles (GAAP) may be used to determine foreign exchange gains or losses on income transactions, provided that the treatment is consistent with previous years and conforms to the accrual method of accounting.

A foreign exchange gain or loss that is on capital account is treated the same as any other capital gain or loss. The accrual method of accounting cannot be used for purposes of reporting gains or losses on capital account. This follows from the CRA's view that a taxpayer has not made a capital gain or sustained a capital loss in a foreign currency until a transaction has taken place. Therefore, paper gains and losses are disregarded.

Debt parking to avoid foreign exchange gains

To avoid realising a foreign exchange gain on the repayment of a foreign currency debt, some taxpayers have entered into debt-parking transactions. As a result, recently enacted legislation introduces rules that require any accrued foreign exchange gain on foreign currency debt to be realised when the debt becomes a parked obligation, generally for debt that becomes a parked obligation after 21 March 2016. The debtor will be deemed to have a gain, if any, that it otherwise would have if it had paid an amount (expressed in the currency in which the debt is denominated) to satisfy the principal amount of the debt equal to:

- when the debt becomes a parked obligation as a result of it being acquired by the current holder, the amount for which the debt was acquired, and
- in other cases, the FMV of the debt.

A foreign currency debt will become a parked obligation if:

- at that time, the current holder of the debt does not deal at arm's length with the debtor or, when the debtor is a corporation, has a significant interest (i.e. generally together with non-arm's length persons, 25% or more of the votes or value) in the corporation, and
- at any previous time, a person who held the debt dealt at arm's length with the debtor and, when the debtor is a corporation, did not have a significant interest in the corporation.

Exceptions will apply to certain *bona fide* commercial transactions, and related rules will provide relief to financially distressed debtors.

Partnership income

For Canadian tax purposes, a partnership is treated as a conduit, and the partners are taxed on their share of the partnership income, whether or not distributed. A corporation is not restricted from being a member of a partnership. Income is determined at the partnership level and then allocated among the partners according to the terms of the partnership agreement. However, certain deductions, such as depletion allowances, exploration and development expenses, and donations, will flow

through to be deducted by the various partners directly, as will any foreign tax credits, dividend tax credits, or investment tax credits (ITCs). Partners generally may deduct expenses incurred directly, such as interest on borrowings to acquire partnership interests, in computing income from the partnership.

Corporate partners are generally prevented from deferring taxation on partnership income in respect of partnerships in which they (together with related parties) hold an interest greater than 10% (share of income or entitlement to assets); income from these partnerships must be accrued up to the end of the corporation's taxation year. The accrual is based on the partnership income for the fiscal period ending in the corporation's taxation year (the 'formulaic amount'), unless a lower amount is designated by the partner. Penalties can apply if the designated amount reported is less than both the formulaic amount and the actual prorated income of the subsequent partnership fiscal period. Upon request, permission to change the partnership's fiscal period may be granted. Partnerships in multi-tier structures must adopt the same fiscal period (generally, 31 December).

Joint venture income

An unincorporated joint venture is not recognised as a separate legal entity, and no specific statutory rules govern the taxation of a joint venture in Canada. However, many business arrangements that are set up as joint ventures may be considered partnerships, and treated as such for Canadian tax purposes. Whether a partnership exists in a particular situation is a legal question based on the specific facts and circumstances.

Consistent with the partnership anti-deferral rules (*discussed in Partnership income above*), corporate participants must report their actual share of joint venture income or loss up to the end of their own year-end.

Non-resident trusts (NRTs) and offshore investment funds

An NRT will generally be deemed to be resident for Canadian tax purposes if (i) it has Canadian resident contributors or (ii) certain former Canadian residents have contributed to an NRT that has Canadian resident beneficiaries. However, an election can be filed to deem the creation of a separate notional trust for tax purposes, referred to as a 'non-resident portion trust'. Canadian tax will apply only to the income or gains from the properties held by the trust that are not included in the non-resident portion trust. Properties included in the non-resident portion trust are those properties that have not been directly or indirectly contributed by a Canadian resident or certain former Canadian residents (or property substituted for those properties or income derived from those properties). Many direct or indirect transfers or loans of property or services can be deemed to be contributions to an NRT.

An NRT is deemed to be resident in Canada if a Canadian-resident taxpayer transfers or lends property to the trust (regardless of the consideration received) and the property held by the trust may revert to the taxpayer, pass to persons to be determined by the taxpayer, or be disposed of only with the taxpayer's consent.

The offshore investment fund rules affect Canadian residents that have an interest as a beneficiary in these funds. If the rules apply, the taxpayer will be required to include in its income an amount generally determined as the taxpayer's cost of the investment multiplied by a prescribed income percentage (i.e. the prescribed rate of interest plus 2%) less any income received from the investment. Also, for certain non-discretionary trust funds in which a Canadian-resident person, and persons that do not deal at arm's

length with the person, have interests in aggregate of 10% or more of the total FMV of the total interests in the trusts, the trust is deemed to be a controlled foreign affiliate of the Canadian beneficiary and is thereby subject to the Canadian foreign accrual property income (FAPI) rules (*discussed below*).

Earnings of specified investment flow-throughs (SIFTs)
Certain earnings of SIFTs (i.e. publicly traded income trusts and partnerships) are subject to a SIFT tax and are deemed to be a dividend when distributed. The rules are intended to discourage corporations from converting to income trusts. The rules do not apply to Real Estate Investment Trusts (REITs) that meet certain conditions.

Foreign income
Canadian resident corporations are subject to Canadian federal income taxes on worldwide income, including income derived directly from carrying on business in a foreign country, as earned. In addition, Canadian resident corporations may be taxable currently on certain passive and active income earned by foreign subsidiaries and other foreign entities. Relief from double taxation is provided through Canada's international tax treaties, as well as foreign tax credits and deductions for foreign income or profits taxes paid on income derived from non-Canadian sources.

Foreign investment income earned directly by Canadian resident corporations, other than dividends, is taxed as earned, with a non-business foreign tax credit and a deduction for foreign income or profits taxes available, subject to certain limitations. Dividends received by Canadian resident private corporations (or public corporations controlled by one or more individuals) from non-connected foreign corporations are subject to the special refundable tax of 38⅓% (*see above*), to the extent that the dividends are deductible in determining taxable income.

The tax treatment of foreign dividends received by a Canadian resident corporation will depend on whether the payer corporation is a foreign affiliate of the recipient. Dividends received by a Canadian resident corporation from foreign corporations that are not foreign affiliates are taxed when received, with a non-business foreign tax credit and a deduction for foreign income or profits taxes available, subject to certain conditions. Dividends received by a Canadian resident corporation from foreign affiliates may be permitted to flow tax-free, subject to certain limitations pertaining to the nature of the earnings from which the dividends were paid, the foreign income or profits taxes paid, and WHTs paid in respect thereof.

To date, 22 Tax Information Exchange Agreements (TIEAs) have entered into force (one on behalf of five jurisdictions), one has been signed (but not yet in force), and Canada is currently negotiating seven other TIEAs. To encourage non-treaty countries to enter into TIEAs:

- an exemption is available for dividends received by a Canadian resident corporation from the active business earnings of its foreign affiliates resident and carrying on their active business operations in non-treaty countries that have entered into a TIEA with Canada, and
- active business income earned by foreign affiliates in non-TIEA, non-treaty countries that have not signed the Convention on Mutual Administrative Assistance in Tax Matters will be treated as FAPI, which is taxable to the relevant Canadian resident corporation on an accrual basis, if a TIEA with Canada is not concluded within a specified period from a written request to commence negotiations or from the commencement of negotiations.

See Controlled foreign affiliates and foreign accrual property income (FAPI) in the Group taxation section for a discussion on foreign affiliates, controlled foreign affiliates, and FAPI.

Shareholder loan rules
Non-resident controlled Canadian corporations are permitted to make certain loans to foreign parent companies or related non-resident companies without being subject to the deemed dividend WHT if appropriate elections are filed. The election may be filed on a loan-by-loan basis, and the Canadian corporation must then include in income interest at a prescribed rate (currently, approximately 5%). The legislation also applies to loans made by, or to, certain partnerships.

Recently enacted legislation amends the shareholder loan rules to include rules that are similar to the existing back-to-back loan rules, except that the proposed rules will apply to debts owing to Canadian-resident corporations rather than debts owing by Canadian-resident taxpayers, for back-to-back shareholder loan arrangements that are outstanding:

- If there is only one intermediary, after 21 March 2016 (debts arising before 22 March 2016 are deemed to arise on 22 March 2016 for the purposes of these rules).
- If there are multiple intermediaries, after 31 December 2016 (debts arising before 1 January 2017 are deemed to arise on 1 January 2017 for purposes of these rules).

A back-to-back shareholder loan arrangement will be considered to exist when an 'intermediary' that is not connected with the shareholder:

- is owed an amount by the shareholder (the shareholder debt), and
- owes an amount to the Canadian corporation or has a specified right (as defined) relating to a particular property, and

this obligation or property is linked to the shareholder debt (certain conditions must be met).

If the rules apply to the debt owing by a shareholder of a Canadian-resident corporation, the shareholder will be deemed to be indebted directly to the corporation.

Cross-border surplus stripping
Section 212.1 of the Income Tax Act contains an 'anti-surplus-stripping' rule that applies when a non-resident person (or designated partnership) disposes of its shares in a corporation resident in Canada (the subject corporation) to another corporation resident in Canada (the purchaser corporation) with which the non-resident person does not deal at arm's length. The rule is intended to prevent the tax-free receipt by the non-resident person of distributions in excess of the PUC of its shares in the subject corporation and an artificial increase in the PUC of such shares. This rule results in a deemed dividend to the non-resident person or a suppression of the PUC of the shares that would otherwise have been increased as a result of the transaction.

An exception to the anti-surplus-stripping rule ensures the rule does not apply when a non-resident corporation is 'sandwiched' between two Canadian corporations and the non-resident corporation disposes of the shares of the lower-tier Canadian corporation to the Canadian parent corporation to unwind the structure.

Some non-resident corporations with Canadian subsidiaries have used this exception by reorganising the group into a sandwich structure to qualify for this exception in

a manner that increases the PUC of the shares of those Canadian subsidiaries. As a result, recently enacted legislation amends this exception, for dispositions occurring after 21 March 2016, to ensure that this exception does not apply when a non-resident corporation:

- owns, directly or indirectly, shares of the Canadian purchaser corporation, and
- does not deal at arm's length with the Canadian purchaser corporation.

The government will also continue to challenge, under other provisions (including the general anti-avoidance rule), certain transactions undertaken before 22 March 2016 if in its view the taxpayer has inappropriately relied on the exception to the anti-surplus stripping rule.

'Foreign affiliate dumping' rules
Transactions described as 'foreign affiliate dumping' involve an investment in a foreign affiliate by a corporation resident in Canada (CRIC) that is controlled by a non-resident of Canada. When these rules apply, a dividend will be deemed to have been paid by the CRIC to its foreign parent, to the extent of any non-share consideration given by the CRIC for the 'investment' in the foreign affiliate, and any increase in the PUC pertaining to the investment will be denied. The rules define 'investment' broadly to include:

- an acquisition of shares in or a contribution of capital to the foreign affiliate
- an indirect acquisition by the CRIC of shares of the foreign affiliate that results from a direct acquisition by the CRIC of the shares of another corporation resident in Canada if the total FMV of all of the shares that are held, directly or indirectly, by the other corporation and are shares of foreign affiliates held by the other corporation exceeds 75% of the total FMV of all properties owned by the other corporation
- transactions where the foreign affiliate becomes indebted to the CRIC (or a related Canadian company), and
- an acquisition of certain options in shares or debt of the foreign affiliate.

Any deemed dividend is automatically reduced to the extent of available PUC, in accordance with the PUC offset rules (subject to compliance requirements), and any remainder will be subject to Canadian WHT (as reduced by the applicable treaty).

Draft legislative proposals (released 16 September 2016) further expand these rules. They can now apply when the CRIC makes an investment in a non-resident corporation that is not a foreign affiliate of the CRIC but is a foreign affiliate of another corporation resident in Canada that does not deal at arm's length with the CRIC. They also introduce an election (to be filed by 31 December 2016) that restores a taxpayer's ability to obtain deemed dividend treatment by opting out of the PUC offset rules in respect of certain transactions that occurred after 28 March 2012 and before 16 August 2013.

Foreign affiliate technical amendments
Draft legislative proposals (released 16 September 2016) are intended to ensure that Canada's international tax rules are applied appropriately, and:

- make relieving changes to the 'upstream loan' rules by including:
  - a reserve deduction for previously-taxed FAPI when the specified debtor is the Canadian resident taxpayer or a person resident in Canada that does not deal at arm's length with the taxpayer

  - an exception when the debtor is a non-arm's-length foreign affiliate of the taxpayer (that is not a controlled foreign affiliate of the taxpayer) when the shares of the affiliate are owned by the taxpayer and other persons, including arm's-length non-resident persons, persons resident in Canada, and/or controlled foreign affiliates of the taxpayer, and
  - upstream loan continuity rules that ensure that a reorganisation (defined narrowly) involving a debtor (the 'original debtor') or creditor (the 'original creditor') following the making of an upstream loan does not result in double taxation either by causing the upstream loan rules to apply multiple times in respect of what is in substance the same debt or preventing the repayment of the upstream loan
- amend previously proposed rules to ensure an appropriate stub-year FAPI inclusion on dispositions of foreign affiliate shares; these proposals introduce a taxation year-end at the stub period end time to ensure the stub-period FAPI is properly reflected in the foreign affiliate's taxable surplus, as well as a *de minimis* exception and an exception for Canadian amalgamations
- introduce an elective rule that provides tax-deferred treatment for dispositions of taxable Canadian property on a foreign merger
- include a relieving measure to treat the foreign division of a non-resident corporation as giving rise to a dividend, rather than a shareholder benefit, if all of the shares of the new corporation are received by the shareholders of the original corporation on a *pro rata* basis, and
- expand an existing exception to ensure the foreign tax credit generator rules do not apply solely because the investee is a fiscally transparent entity in the foreign jurisdiction.

Foreign branches of life insurers
The 2017 federal budget proposes to ensure that Canadian life insurers are taxable in Canada with respect to income from the insurance of Canadian risks that are allocated to a foreign branch. The proposals will be modelled on existing anti-avoidance rules and will form part of the FAPI regime. The proposed anti-avoidance rule will apply when 10% or more of the gross premium income (net of reinsurance ceded) earned by a foreign branch of a Canadian life insurer is premium income in respect of Canadian risks. When the proposed rule applies, it will deem the foreign branch's insurance of Canadian risks to be part of a business carried on by the life insurer in Canada and the related insurance policies to be life insurance policies in Canada.

Other anti-avoidance rules that are part of the FAPI regime will be extended to foreign branches of life insurers to ensure that the proposed rule cannot be avoided through the use of either so called 'insurance swaps' or the ceding of Canadian risks (*see Captive insurance below*). In addition, if an insurer has insured foreign risks through its foreign branch and it can reasonably be concluded that foreign risks were insured by the life insurer as part of a transaction or series of transactions, one of the purposes of which was to avoid the proposed rule, the life insurer will be treated as if it has insured Canadian risks.

The proposed measures will apply to taxation years of Canadian taxpayers that begin after 21 March 2017.

Captive insurance
For taxation years beginning after 10 February 2014, an anti-avoidance rule in the FAPI regime intended to prevent Canadian taxpayers from shifting income from the insurance of Canadian risks offshore has been clarified to ensure it applies to certain

tax planning arrangements sometimes referred to as 'insurance swaps' (the 2014 enacted legislation). If the anti-avoidance rule applies, the foreign affiliate's income from the insurance of the foreign risks and any income from a connected agreement or arrangement will be included in computing its FAPI.

Legislation enacted in June 2016 further amends this anti-avoidance rule to curtail alternative arrangements that are intended to achieve tax benefits similar to those that the 2014 enacted legislation was intended to prevent. For taxation years that begin after 20 April 2015:

- a foreign affiliate's income in respect of the ceding of Canadian risks is included in computing the affiliate's FAPI, and
- if a foreign affiliate cedes Canadian risks and receives as consideration a portfolio of insured foreign risks, the affiliate is considered to have earned FAPI in respect of the ceding of the Canadian risks in an amount equal to the difference between the FMV of the Canadian risks ceded and the affiliate's costs in respect of having acquired those Canadian risks.

The 2017 federal budget further extends this anti-avoidance rule to foreign branches of Canadian life insurers (*see Foreign branches of life insurers above*).

Emissions trading regimes

Under emissions trading regimes, regulated emitters must deliver emissions allowances to the government. These allowances may be purchased by emitters, earned in emissions reduction activities, or provided by the government at a reduced price or no cost. Currently, no specific tax rules deal with emissions trading regimes. Recently enacted legislation introduces specific rules to clarify the tax treatment of emissions allowances and to eliminate the double taxation of certain free allowances, for emissions allowances acquired generally in taxation years beginning after 2016. Specifically, emissions allowances will be treated as inventory for all taxpayers; however, the 'lower of cost and market' method cannot be used to value the inventory.

If a free allowance is received, there will be no income inclusion on receipt of the allowance. In addition, the deduction for an accrued emissions obligation will be limited to the extent that the obligation exceeds the cost of any emissions allowances that the taxpayer has acquired and that can be used to settle the obligation. If a deduction is claimed in respect of an emissions obligation that accrues in one year (e.g. 2017) and that will be satisfied in a future year (e.g. 2018), the amount of this deduction will be brought back into income in the subsequent year (2018) and the taxpayer will be required to evaluate the deductible obligation again each year, until it is ultimately satisfied.

If a taxpayer disposes of an emissions allowance otherwise than under the emissions allowance regime, any proceeds received in excess of the taxpayer's cost, if any, for the allowance will be included in computing income.

Deductions

Business expenses that are reasonable and paid out to earn income are deductible for income tax purposes unless disallowed by a specific provision in the Income Tax Act. Some expenses are deductible subject to limitation (e.g. charitable donations, entertainment expenses, and the cost of providing an automobile to employees).

Deduction of capital expenditures is specifically prohibited, but special provisions may allow depreciation or amortisation of these expenditures.

Because Canadian corporations are taxable on worldwide income, there are no territorial limits on the deductibility of related expenses. Payments to affiliates are deductible if they reflect arm's-length charges. Transfers of losses and other deductions between unrelated corporate taxpayers are severely limited after an acquisition of control.

Depreciation and amortisation

Depreciation for tax purposes (capital cost allowance) is generally computed on a pool basis, with only a few separate classes (pools) of property. Annual allowances are generally determined by applying a prescribed rate to each class on the declining-balance basis. For example, the prescribed annual rate is 20% on most furniture and fixtures, 30% on automotive equipment, and 4% to 10% on most buildings. In the year of acquisition, only half of the amount otherwise allowable may be claimed on most classes of property.

Generally, capital cost allowance (CCA) may not be claimed until the taxation year the property is available for use. The taxpayer can claim any amount of CCA up to the maximum. CCA previously claimed may be recaptured if assets are sold for proceeds that exceed the undepreciated cost of the class. Temporary incentives to accelerate depreciation for eligible manufacturing and processing machinery and equipment acquired after 2015 and before 2026 revise the rate and/or method to 50% declining-balance (from 50% straight-line before 2016 and after 18 March 2007, and 30% declining-balance before 19 March 2007).

Eligible capital property (ECP)

Before 2017, three-quarters of capital expenditures for goodwill and certain other intangible properties were included in a cumulative eligible capital (CEC) pool and could be amortised at a maximum annual rate of 7%, on a declining-balance basis. A portion of proceeds could be taxable as recapture or as a gain on disposition.

Starting 1 January 2017, recently enacted legislation repeals the ECP regime and replaces it with a new CCA pool, Class 14.1. Transitional rules apply. 100% of eligible capital expenditures are included in Class 14.1 and subject to a 5% declining-balance CCA rate. The rules that apply to depreciable property, such as the 'half-year rule', recapture, and capital gains, also apply to the properties included in Class 14.1.

Special rules apply to expenditures that do not relate to a specific property of a business. Every business is considered to have goodwill associated to it (even if no expenditures on goodwill have been made). Expenditures that do not relate to a particular property will increase the capital cost of the goodwill of the business and, consequently, the balance of the Class 14.1 pool.

A receipt that does not relate to a specific property will reduce the capital cost of the goodwill of the business, and therefore the balance of the Class 14.1 pool, by the lesser of the cost of the goodwill (which may be nil) and the amount of the receipt. Any excess will be treated as a capital gain. Any previously deducted CCA will be recaptured to the extent that the receipt exceeds the balance of the Class 14.1 pool.

CEC balances at 31 December 2016 are transferred to the new Class 14.1 pool as of 1 January 2017. The CCA depreciation rate for the transferred property in the

Class 14.1 pool is 7% until 2027. Proceeds received after 31 December 2016, relating to property acquired, expenditures made, or goodwill generated before 1 January 2017, reduce the Class 14.1 pool at a 75% rate.

Mining and oil and gas activity

Generally, mining and oil and gas companies are allowed a 100% deduction for grassroots exploration costs. Other development costs are deductible at the rate of 30% on a declining-balance basis. Generally, for expenses incurred after 20 March 2013, subject to a phase-in over three calendar years, from 2015 to 2017, pre-production mine development expenses will be treated as 'Canadian development expenses' (CDEs) (30% declining balance) instead of as 'Canadian exploration expenses' (CEEs) (100% deduction). If certain grandfathering criteria are met, taxpayers can continue to treat pre-production mine development expenses as CEEs. In addition, mining expenses incurred after 28 February 2015 that relate to environmental studies, and community consultations that are required to obtain an exploration permit or meet a legal or informal obligation under the terms of the permit, will be treated as CEEs, which may provide an immediate 100% deduction.

The 2017 federal budget proposes that for oil and gas expenses generally incurred after 2018, expenditures related to drilling or completing a discovery well (or building a temporary access road to, or preparing a site of, any such well) will generally be classified as CDEs, instead of as CEEs.

Capital property costs are subject to the depreciation rules *noted above under Depreciation*. In addition, in certain cases, significant asset acquisitions and assets acquired for a new mine or major expansion benefit from accelerated depreciation of up to 100% of the income from the mine. For certain oil sands assets acquired after 18 March 2007, accelerated depreciation was eliminated in 2015. For other mining assets, the accelerated depreciation is being phased out over the 2017 to 2020 calendar years, generally for expenses incurred after 20 March 2013, unless certain grandfathering criteria are met.

For assets acquired after 19 February 2015, and before 2025, CCA rates increased from:

- 8% to 30% for equipment used in natural gas liquefaction, and
- 6% to 10% for buildings at a facility that liquefies natural gas.

Provinces levy mining taxes on mineral extraction and royalties on oil and gas production. Most are deductible for income tax purposes. Effective for taxation years beginning after 31 December 2016, British Columbia introduced an LNG income tax. *See British Columbia Liquefied Natural Gas Income Tax Act in the Taxes on corporate income section*.

ITCs are available federally (and in some provinces if certain criteria are met) to individuals who invest in shares to fund prescribed mineral exploration expenditures. The federal credit in 2017 for qualified 'flow-through' share investments is 15% of qualifying mining grassroots exploration expenditures. The individual and corporate credits can be used to offset current taxes payable or carried over to certain previous or subsequent taxation years.

Extractive Sector Transparency Measures Act

The Extractive Sector Transparency Measures Act requires public disclosure of government payments made by mining and oil and gas entities engaged in the

commercial development of oil, gas, or minerals in Canada or elsewhere. It also applies to entities that control another entity that engages in these activities. However, an entity will be required to report only if it:

- is listed on a stock exchange in Canada, or
- has a place of business in Canada, does business in Canada, or has assets in Canada, and, based on its consolidated financial statements, meets minimum asset, revenue, and/or employee thresholds.

This mandatory reporting standard for extractive companies applies to payments of CAD 100,000 or more in a year that have been made to foreign and domestic governments at all levels, including Aboriginal groups. Both monetary payments and payments 'in kind' must be reported.

Scientific research and experimental development (SR&ED)
Canada provides a generous combination of deductions and tax credits for SR&ED. Current expenditures on SR&ED can be deducted in the year incurred or carried forward indefinitely to be used at the taxpayer's discretion to minimise tax payable. *See Scientific research and experimental development (SR&ED) credit in the Tax credits and incentives section for information on the tax credits currently available*.

Start-up expenses
Expenses related to the incorporation, reorganisation, or amalgamation of a corporation (e.g. cost of affidavits, legal and accounting fees, costs of preparing articles of incorporation) are not deductible for income tax purposes. They are considered to be eligible capital expenditures, for which, starting 1 January 2017, 100% of the capital cost of the expenditure is included in Class 14.1 and subject to a 5% declining-balance CCA rate (*see Eligible capital property [ECP] above for the rules that applied to the ECP regime before 1 January 2017*). Expenses incurred after the date of incorporation generally are deductible for income tax purposes if reasonable in amount and incurred to earn income from the business.

Interest expenses
Interest on borrowed money used for earning business or property income, or interest in respect of an amount payable for property acquired to earn income, is deductible, provided the interest is paid pursuant to a legal obligation and is reasonable under the circumstances.

Doubtful accounts and bad debts
A reasonable reserve for doubtful accounts may be deducted for tax purposes. The reserve calculation should be based on the taxpayer's past history of bad debts, industry experience, general and local economic conditions, etc. Special rules apply for determining reserves for financial institutions. A taxpayer can deduct the amount of debts owing that are established to have become bad debts during the year, provided the amount has previously been included in the taxpayer's income or relates to loans made in the ordinary course of business. Recoveries of bad debts previously written off must be included in income in the year of recovery.

Business meals and entertainment
Deductions for business meals and entertainment expenses are limited to 50% of their cost. This includes meals while travelling or attending a seminar, conference, or convention, overtime meal allowances, and room rentals and service charges, etc. incurred for entertainment purposes. If the business meal and entertainment costs are

billed to a client or customer and itemised as such, the disallowance (i.e. the 50% not deductible) is shifted to the client or customer.

Insurance premiums
Insurance premiums relating to property of a business are generally deductible, but life insurance premiums are generally not deductible if the company is the named beneficiary. However, if a financial institution lender requires collateral security in the form of life insurance, a deduction is allowed for the associated net cost of any pure insurance for the period.

Charitable contributions
Charitable donations made to registered Canadian charitable organisations are deductible in computing taxable income, generally to the extent of 75% of net income. A five-year carryforward is provided.

Fines and penalties
Most government-imposed fines and penalties are not deductible. Fines and penalties that are not government-imposed are generally deductible if made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property.

Taxes
Federal, provincial, and territorial income taxes are not deductible in determining income subject to tax. The tax treatment of federal capital taxes and provincial payroll and capital taxes is discussed in the *Other taxes section*.

Net operating losses
Net operating losses generally may be carried back three tax years and forward 20. Special rules may prohibit the use of losses from other years when there has been an acquisition of control of the corporation.

Corporate loss trading
Where there has been an acquisition of control of a corporation, an anti-avoidance measure to support the restrictions on the deductibility of losses, and the use of certain other tax benefits, applies:

- when a person or group of persons acquires shares of a corporation to hold more than 75% of the FMV of all of the shares of the corporation without otherwise acquiring control of the corporation, and
- if it is reasonable to conclude that one of the main reasons that control was not acquired was to avoid the loss restriction rules.

Payments to foreign affiliates
Interest, rents, royalties, management fees, and other payments made to related non-residents are deductible expenses to the extent that they are incurred to earn income of the Canadian corporation and do not exceed a reasonable amount. In certain cases, the receipt of these payments by a foreign affiliate of the Canadian corporation or of a related person can give rise to FAPI, which is taxable on an accrual basis in Canada.

Group taxation

Group taxation is not permitted.

Transfer pricing

Canadian transfer pricing legislation and administrative guidelines are generally consistent with OECD Guidelines. Statutory rules require that transactions between related parties be carried out under arm's-length terms and conditions. The CRA has indicated that it will apply the revised OECD guidance on transfer pricing by MNEs arising from the BEPS project (the BEPS final report was issued October 2015; *see Base erosion and profit shifting (BEPS) in the Tax administration section for more information*). The government's view is that the revised guidance is generally consistent with the CRA's interpretation and application of the arm's-length principle and that, consequently, practices are not expected to change significantly.

Penalties may be imposed on adjusted income if contemporaneous documentation requirements are not met. A taxpayer will be deemed not to have made reasonable efforts if the taxpayer does not maintain complete and accurate documentation to evidence that it has determined and used arm's-length prices for its related-party transactions. The documentation must be prepared and complete in all material aspects on or before the taxpayer's documentation due date, which is six months after the end of the taxation year for corporations.

The transfer pricing penalty is 10% of the transfer pricing adjustment if the adjustment exceeds the lesser of CAD 5 million and 10% of the taxpayer's gross revenue for the year. The penalty is not deductible in computing income, applies regardless of whether the taxpayer is taxable in the year, and is in addition to any additional tax and related interest penalties.

Canada has an Advance Pricing Arrangement (APA) program that is intended to help taxpayers obtain a level of certainty on transfer prices acceptable to the local tax authorities and, when negotiated as bilateral or multilateral APAs, with tax authorities in other jurisdictions. Under this program, 342 APAs have been completed or are in progress.

Many of Canada's international tax agreements contain provisions concerning income allocation in accordance with the arm's-length principle. These include a Mutual Agreement Procedure, which is a treaty-based mechanism through which taxpayers can petition competent authorities for relief from double taxation resulting from transfer pricing adjustments.

Transfer pricing adjustments

When the Canadian transfer pricing rules have applied to adjust, for tax purposes, amounts related to transactions between a Canadian corporation and one or more non-arm's length non-residents (a 'primary adjustment'), the related benefit to the non-residents is treated by the CRA as a deemed dividend (a 'secondary adjustment'), subject to WHT, which can be eliminated, at the discretion of the Minister of Revenue, if the amount of the primary transfer pricing adjustment is repatriated to the Canadian corporation.

Country-by-country (CbC) reporting

Recently enacted legislation implements annual CbC reporting for taxation years beginning after 2015 for MNEs with total annual consolidated group revenue of EUR 750 million or more (approximately CAD 1 billion). To facilitate the sharing of this information with its international treaty partners, Canada (and 56 other jurisdictions) have signed the OECD's Multilateral Competent Authority Agreement on CbC reporting. The reporting would include key metrics for each country the MNE operates

in, such as: revenue, profit, tax paid, stated capital, accumulated earnings, number of employees, and tangible assets, as well as a description of the main activities of each of its subsidiaries. The reporting would be due within one year of the end of the fiscal year to which the report relates, with a view that the first exchanges between jurisdictions of CbC reports would occur by June 2018. Before any such exchanges, the CRA will formalise an exchange arrangement with the other jurisdiction and ensure that appropriate safeguards are in place to protect the confidentiality of the reports. The CRA recently issued:

- Form RC4649 'Country-by-Country Report': Reporting form that follows the CbC reporting format recommended by the OECD in its October 2015 BEPS report on transfer pricing documentation and CbC reporting.
- Publication RC4651 (E) 'Guidance on Country-By-Country Reporting in Canada': Provides further guidance that is generally consistent with the OECD's recommendations, but includes several differences.

Thin capitalisation

Thin capitalisation rules can limit interest deductions when interest-bearing debt owing to certain non-residents (or persons not dealing at arm's length with certain non-residents) exceeds one and a half times the corporation's equity. The rules also apply to debts of:

- a partnership of which a Canadian-resident corporation is a member, and
- Canadian-resident trusts and non-resident corporations and trusts that operate in Canada.

Disallowed interest is treated as a dividend for WHT purposes.

Back-to-back loan arrangements

The Canadian Income Tax Act contains 'back-to-back loan' rules that prevent taxpayers from interposing a third party between a Canadian borrower and a foreign lender to avoid the application of rules that would otherwise apply if a loan were made directly between the two taxpayers. The back-to-back loan rules currently ensure that the amount of WHT on a cross-border interest payment cannot be reduced through the use of back-to-back loan arrangements. Legislation enacted in 2014 targeted certain back-to-back loan arrangements undertaken by taxpayers using an interposed third party by:

- amending an anti-avoidance provision in the thin capitalisation rules for taxation years that begin after 2014, and
- introducing a specific anti-avoidance rule relating to WHT on interest payments for amounts paid or credited after 2014.

Recently enacted legislation expands these back-to-back loan rules by:

- extending these rules to cross-border payments of rents, royalties, or similar payments made after 2016 (an exception is available for certain arm's-length royalty arrangements that do not have a main purpose of avoiding WHT)
- adding character substitution rules so the back-to-back loan rules cannot be avoided through the substitution of economically similar arrangements between the intermediary and another non-resident person, for interest and royalty payments made after 2016
- amending the shareholder loan rules to include rules that are similar to the back-to-back loan rules; this will apply to back-to-back shareholder loan arrangements that

are outstanding after 21 March 2016 (if there is only one intermediary) or after 31 December 2016 (if there are multiple intermediaries) (*see Shareholder loan rules in the Income determination section for more information*), and
- clarifying the application of these rules to back-to-back arrangements involving multiple intermediaries, for interest and royalty payments made after 2016, and for shareholder debts as of 1 January 2017.

Controlled foreign affiliates and foreign accrual property income (FAPI)
Under Canada's FAPI rules, Canadian corporations are taxed on certain income of controlled foreign affiliates (typically, certain income from property, income from a business other than active, income from a non-qualifying business, and certain taxable capital gains) as earned, whether or not distributed. A grossed-up deduction is available for foreign income or profits taxes and WHTs paid in respect thereof. In general, a foreign corporation is a foreign affiliate of a Canadian corporation if:

- the Canadian corporation owns, directly or indirectly, at least 1% of any class of the outstanding shares of the foreign corporation, and
- the Canadian corporation, alone or together with related persons, owns, directly or indirectly, at least 10% of any class of the outstanding shares of that foreign corporation.

The foreign affiliate will be a controlled foreign affiliate of the Canadian corporation if certain conditions are met (e.g. more than 50% of the voting shares are owned, directly or indirectly, by a combination of the Canadian corporation, persons at non-arm's length with the Canadian corporation, a limited number of Canadian-resident shareholders, and persons at non-arm's length with those Canadian-resident shareholders).

Tax credits and incentives

Foreign tax credits
Taxpayers that have foreign-source income and are resident in Canada at any time in the year are eligible for foreign tax credit relief. Separate foreign tax credit calculations are prescribed for business and non-business income on a country-by-country basis. All provinces and territories also allow a foreign tax credit, but only in respect of foreign non-business income taxes.

Income or profits taxes paid to foreign governments generally are eligible for credit against a taxpayer's Canadian income taxes payable. The credit in respect of taxes paid on foreign income is restricted to the amount of Canadian taxes otherwise payable on this income. Generally, foreign tax credits are available only to reduce Canadian tax on foreign-source income that is subject to tax in the foreign country.

Foreign business income or loss is computed for each foreign country in which a branch is located. Excess foreign business income tax credits may be carried back three years or forward ten. The foreign non-business income tax credit applies to all foreign taxes other than those classified as business income tax. No carryover is allowed with respect to the non-business income foreign tax credit. Unused foreign non-business income tax may be deducted in computing income.

Regional incentives

In specified regions of Canada (i.e. Atlantic provinces, the Gaspé region, and Atlantic offshore region), a 10% federal ITC is available for various forms of capital investment (generally, new buildings, machinery and equipment, and/or clean energy generation equipment to be used primarily in manufacturing or processing, logging, farming, or fishing). The ITC is fully claimed against a taxpayer's federal tax liability in a given year. Unused ITCs reduce federal taxes payable for the previous three years and the next 20, or may be 40% refundable to CCPCs.

The provinces and territories may also offer incentives to encourage corporations to locate in a specific region. Income tax holidays are available in Newfoundland and Labrador, Nova Scotia, Ontario, Prince Edward Island, and Quebec for certain corporations operating in specific industries (e.g. in Ontario and Quebec, commercialisation of intellectual property [IP]; in Prince Edward Island, aviation or marine technology) or meeting certain conditions (e.g. job creation for Newfoundland and Labrador).

Industry incentives

Canada offers many tax incentives at the federal, provincial, and territorial levels, for various industries and activities, including those related to:

- Research and development (*see below*).
- Film, media, computer animation and special effects, and multi-media productions.
- Manufacturing and processing.
- Environmental sustainability.

Scientific research and experimental development (SR&ED) credit

In addition to the SR&ED deduction, a taxpayer can benefit from an ITC, which is generally a 15% non-refundable credit on SR&ED expenditures that can be applied against taxes payable. Alternatively, this tax credit can be carried back three years or forward 20, to be applied against taxes owing.

A qualifying CCPC can qualify for a 35% refundable tax credit annually on its first CAD 3 million in expenditures. This enhanced credit is subject to certain income and capital limitations.

SR&ED ITCs have been extended to certain salary and wages (limited to 10% of salary and wages directly attributable to SR&ED carried on in Canada) incurred in respect of SR&ED carried on outside Canada.

In addition to the federal SR&ED incentives, all provinces (except Prince Edward Island), as well as the Yukon, provide tax incentives to taxpayers that carry on research and development (R&D) activities.

Withholding taxes

WHT at a rate of 25% is imposed on interest (other than most interest paid to arm's-length non-residents), dividends, rents, royalties, certain management and technical service fees, and similar payments made by a Canadian resident to a non-resident of Canada.

Canada

Canada is continually renegotiating and extending its network of treaties, some with retroactive effect. This table summarises WHT rates on payments arising in Canada. The applicable treaty should be consulted to determine the WHT rate that applies in a particular circumstance.

Recipient	Dividends (%)	Related-party interest (%) (1)	Royalties (%) (2)
Resident corporations and individuals	0	0	0
Non-resident corporations and individuals:			
Non-treaty	25	25	25
Treaty:			
Algeria	15	15	0/15
Argentina	10/15 (4)	12.5	3/5/10/15 (5)
Armenia	5/15 (4)	10	10
Australia	5/15 (4)	10	10
Austria	5/15 (4)	10	0/10
Azerbaijan (7)	10/15 (4)	10	5/10
Bangladesh	15	15	10
Barbados	15	15	0/10
Belgium	5/15 (4)	10	0/10
Brazil	15/25 (4)	15	15/25
Bulgaria	10/15 (4, 5)	10	0/10 (5)
Cameroon	15	15	15
Chile (5)	10/15 (4)	15	15
China, People's Republic of (6)	10/15 (4)	10	10
Colombia	5/15 (4)	10	10 (5)
Croatia	5/15 (4)	10	10
Cyprus	15	15	0/10
Czech Republic	5/15 (4)	10	10
Denmark	5/15 (4)	10	0/10
Dominican Republic	18	18	0/18
Ecuador	5/15 (4)	15	10/15 (5)
Egypt	15	15	15
Estonia (7)	5/15 (4)	10	0/10
Finland	5/15 (4)	10	0/10
France	5/15 (4)	10	0/10
Gabon	15	10	10
Germany	5/15 (4)	10	0/10
Greece	5/15 (4)	10	0/10
Guyana	15	15	10
Hong Kong (6)	5/15 (4)	10	10
Hungary	5/15 (4)	10	0/10
Iceland	5/15 (4)	10	0/10
India	15/25 (4)	15	10/15/20
Indonesia	10/15 (4)	10	10
Ireland, Republic of	5/15 (4)	10	0/10
Israel (8)	5/15 (4)	10	0/10
Italy	5/15 (4)	10	0/5/10
Ivory Coast	15	15	10
Jamaica	15	15	10

Recipient	Dividends (%)	Related-party interest (%) (1)	Royalties (%) (2)
Japan	5/15 (4)	10	10
Jordan	10/15 (4)	10	10
Kazakhstan (7)	5/15 (4)	10	10 (5)
Kenya	15/25 (4, 5)	15	15
Korea, Republic of	5/15 (4)	10	10
Kuwait	5/15 (4)	10	10
Kyrgyzstan (7)	15 (5)	15 (5)	0/10
Latvia (7)	5/15 (4)	10	10 (5)
Lebanon (3)	5/15 (4)	10	5/10
Lithuania (7)	5/15 (4)	10	10 (5)
Luxembourg	5/15 (4)	10	0/10
Madagascar (3)	5/15 (4)	10	5/10
Malaysia	15	15	15
Malta	15	15	0/10
Mexico	5/15 (4)	10	0/10
Moldova	5/15 (4)	10	10
Mongolia	5/15 (4)	10	5/10
Morocco	15	15	5/10
Namibia (3)	5/15 (4)	10	0/10
Netherlands	5/15 (4)	10	0/10
New Zealand	5/15 (4)	10	5/10
Nigeria	12.5/15 (4)	12.5	12.5
Norway	5/15 (4)	10	0/10
Oman	5/15 (4)	10 (5)	0/10
Pakistan	15	15	0/15
Papua New Guinea	15	10	10
Peru (5)	10/15 (4)	15	15
Philippines	15	15	10
Poland	5/15 (4)	10	5/10
Portugal	10/15 (4)	10	10
Romania	5/15 (4)	10	5/10
Russia (7)	10/15 (4)	10	0/10
Senegal	15	15	15
Serbia	5/15 (4)	10	10
Singapore	15	15	15
Slovak Republic	5/15 (4)	10	0/10
Slovenia	5/15 (4)	10	10
South Africa	5/15 (4)	10	6/10
Spain	5/15 (4)	10	0/10
Sri Lanka	15	15	0/10
Sweden	5/15 (4)	10	0/10
Switzerland	5/15 (4)	10	0/10
Taiwan (9)	10/15 (4)	10	10
Tanzania	20/25 (4)	15	20
Thailand	15	15	5/15
Trinidad and Tobago	5/15 (4)	10	0/10
Tunisia	15	15	0/15/20
Turkey	15/20 (4)	15	10
Ukraine (7)	5/15 (4)	10	0/10

Recipient	Dividends (%)	Related-party interest (%) (1)	Royalties (%) (2)
United Arab Emirates	5/15 (4)	10	0/10
United Kingdom	5/15 (4)	10	0/10
United States (10)	5/15 (4)	0	0/10
Uzbekistan (7)	5/15 (4)	10	5/10
Venezuela	10/15 (4, 5)	10	5/10
Vietnam	5/10/15 (4)	10	7.5/10 (5)
Zambia	15	15	15
Zimbabwe	10/15 (4)	15	10

Notes

1. Interest: Canada does not impose WHT on interest (except for 'participating debt interest') paid or credited to arm's-length non-residents. Most treaties have an explicit provision for higher WHT on interest in excess of FMV in non-arm's-length circumstances.
2. Royalties: A zero royalty rate generally applies to:
   - copyright royalties and payments for a literary, dramatic, musical, or other artistic work (but not royalties for motion picture films, work on film or videotape, or other means of reproduction for use in television), and/or
   - royalties for computer software, a patent, for information concerning industrial, commercial, or scientific experience (but not royalties for a rental or franchise agreement), or for broadcasting.

   Most treaties explicitly provide for higher WHT on royalties in excess of FMV in non-arm's-length circumstances. A zero rate of tax may apply in certain cases.

3. The treaty has been signed, but is not yet in force. In the absence of a treaty, Canada imposes a maximum WHT rate of 25% on dividends, interest, and royalties.
4. The lower (lowest two for Vietnam) rate applies if the beneficial owner of the dividend is a company that owns/controls a specified interest in the paying company. The nature of the ownership requirement, the necessary percentage (10%, 20%, 25%, or higher), and the relevant interest (e.g. capital, shares, voting power, equity percentage) vary by treaty.
5. If the other state (Canada for the treaty with Oman) concludes a treaty with another country providing for a lower WHT rate (higher rate for Kenya), the lower rate (higher rate for Kenya) will apply in respect of specific payments within limits, in some cases.
6. Canada's treaty with China does not apply to Hong Kong.
7. The treaty status of the republics that comprise the former USSR is as follows:
   - Azerbaijan, Estonia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Russia, Ukraine, and Uzbekistan: New treaties entered into force *(see table for rates)*.
   - Other republics: No negotiations are underway.

   Belarus, Tajikistan, and Turkmenistan will not honour the treaty with the former USSR. As a result, Canada will impose a maximum WHT rate of 25% on dividends, interest, and royalties until a new treaty enters into force. For other republics that comprise the former USSR, the status of the former treaty with the USSR is uncertain. Because the situation is subject to change, Canadian taxpayers are advised to consult with the CRA as transactions are carried out.

8. A new treaty with Israel entered into force on 21 December 2016. Its provisions apply in Canada:
   - for purposes of non-resident WHT, to amounts paid or credited after 31 December 2016, and
   - for other taxes, for taxation years beginning after 2016.

   The rates in the table are from the new treaty. Under the new treaty, the WHT rate is reduced from 15% to:
   - 5% on dividends paid to a company that directly holds at least 25% of the payor's capital (the rate will remain 15% on other dividends)
   - 10% on interest, but certain interest payments will be exempt, and
   - 10% on royalties, but certain royalties for the use of computer software, patents, and know-how, and certain copyright royalties, will be exempt.
9. A 'tax arrangement' between Canada and Taiwan was signed on 15 January 2016. Its provisions apply in Canada:
   - for purposes of non-resident WHT, to amounts paid or credited after 31 December 2016, and
   - for other taxes, for taxation years beginning after 2016.

   The rates in the table are from the tax arrangement. Under the tax arrangement, the WHT rate is reduced from 25% to:

- 10% on dividends paid to a company that directly or indirectly holds at least 20% of the payor's capital (the rate is 15% on other dividends)
- 10% on interest, but certain interest payments will be exempt, and
- 10% on royalties.

10. For the United States, the reduced treaty rates apply, subject to the Limitation on Benefits article.

Tax administration

Taxable period

The tax year of a corporation, which is normally the fiscal period it has adopted for accounting purposes, cannot exceed 53 weeks. The tax year need not be the calendar year. Once selected, the tax year cannot be changed without approval from the tax authorities.

Tax returns

Both the federal and the provincial/territorial corporation tax systems operate on an essentially self-assessing basis. All corporations must file federal income tax returns. Alberta and Quebec tax returns must also be filed by corporations that have PEs in those provinces, regardless of whether any tax is payable. Corporations with PEs in other provinces that levy capital tax must also file capital tax returns. Tax returns must be filed within six months of the corporation's tax year-end. No extensions are available.

Certain corporations with annual gross revenues exceeding CAD 1 million are required to electronically file (e-file) their federal CIT returns via the Internet. Also, information return filers that submit more than 50 information returns annually must e-file via the Internet. Penalties are assessed for failure to e-file.

Payment of tax

Corporate tax instalments are generally due on the last day of each month (although some CCPCs can remit quarterly instalments if certain conditions are met). Any balance payable is generally due on the last day of the second month following the end of the tax year.

Functional currency

The amount of income, taxable income, and taxes payable by a taxpayer is determined in Canadian dollars. However, certain corporations resident in Canada can elect to determine their Canadian tax amounts in the corporation's 'functional currency'.

Tax audit process

The tax authorities are required to issue an assessment notice within a reasonable time following the filing of a tax return. These original assessments usually are based on a limited review, if any, of the corporation's income tax return. However, the notice of assessment will identify any changes made (e.g. correcting discrepancies on any balances carried forward).

Traditionally, all corporations with gross income over CAD 250 million, and their affiliates, are assigned a large case file team and undergo an annual risk assessment. Corporations rated as high risk are generally audited annually. Medium-sized corporations (gross income between CAD 20 million and CAD 250 million) generally are selected based on a screening process and identified risks. Smaller corporations, which are usually CCPCs with gross income under CAD 20 million, have been subject to compliance or restricted audits, selected based on statistical

data and a screening process. Audits of CCPCs are generally restricted to covering the current and one previous taxation year.

In general, the CRA targets its resources on high-risk taxpayers, with minimal resources spent on lower-risk taxpayers.

Statute of limitations
A reassessment of the tax payable by a corporation that is not a CCPC may be made within four years from the date of mailing of the original notice of assessment, usually following a detailed field audit of the return and supporting information. The limitation period is three years for CCPCs. The three-year and four-year limits are extended a further three years in some cases (e.g. transactions with non-arm's-length non-residents). Reassessments generally are not permitted beyond these limits unless there has been misrepresentation or fraud. Different time limits may apply for provincial reassessments.

For taxation years ending after 2 October 2016, draft legislative proposals allow the CRA to reassess tax, after the end of the normal reassessment period, on a gain from the disposition of real or immovable property if the taxpayer does not initially report the disposition.

Appeals
A taxpayer that disagrees with a tax assessment or reassessment may appeal. The first step is to file a formal notice of objection within 90 days from the date of mailing of the notice of assessment or reassessment, setting out the reasons for the objection and other relevant information. Different time limits may apply for provincial reassessments. Corporations that qualify as 'large corporations' must file more detailed notices of objection. The CRA will review the notice of objection and vacate (cancel), amend, or confirm it. A taxpayer that still disagrees has 90 days to appeal the CRA's decision to the Tax Court of Canada, and, if necessary, to the Federal Court of Appeal and the Supreme Court of Canada. However, the Supreme Court hears very few income tax appeals.

Income tax objection process
The CRA intends to improve the income tax objection process in response to recommendations in the 2016 Fall Reports of the Auditor General of Canada. One report examined whether the CRA efficiently manages income tax objections. Report 2, 'Income Tax Objections', concludes that the CRA did not:

- process income tax objections in a timely manner
- adequately measure its performance results, and
- adequately analyse or review decisions on income tax objections and appeals, or share the results of these objections and court decisions within the CRA.

Topics of focus for tax authorities
Topics of interest to Canadian tax authorities include:

- Transfer pricing (inbound and outbound), including the quantum and deductibility of:
  - royalty payments made by Canadian corporations to non-arm's-length non-residents
  - goods and services

  - business restructuring expenses incurred by a group of corporations located in more than one country
  - interest rates and interest paid on loans if the funds derived from the loans are used offshore
  - guarantee fees paid by Canadian corporations to related non-resident corporations, and
  - management fees and general and administrative expenses.
- Offshoring of Canadian-source income by factoring the accounts receivable of Canadian corporations.
- Treaty shopping to reduce Canadian WHT and capital gains tax.
- Manipulation of tax attributes, including:
  - surplus stripping to reduce Canadian WHT by increasing a Canadian corporation's PUC and subsequently distributing the surplus as a return of capital
  - arrangements that manipulate the adjusted cost base of capital assets, and
  - the acquisition of tax losses realised by arm's-length entities.
- The requirement to withhold tax on certain payments made to a non-resident that relate to fees, commissions, or other amounts in respect of services rendered in Canada.
- Transaction costs, including professional fees, related to business restructuring.
- Deductibility of reserves (contingent or unsupported amounts).
- Foreign exchange gains and losses (current or capital).

General Anti-Avoidance Rule (GAAR)
The GAAR was first introduced in 1988 and was designed to challenge transactions or series of transactions that would directly or indirectly result in a tax benefit when:

- a taxpayer relies on specific provisions of the Income Tax Act to achieve an outcome that those provisions seek to prevent
- a transaction defeats the underlying rationale of the provisions that are relied upon, or
- an arrangement circumvents the application of certain provisions, such as specific anti-avoidance rules, in a manner that frustrates or defeats the object, spirit, or purpose of those provisions.

If GAAR applies, the CRA may deny any deduction, exemption, or exclusion in computing taxable income or the nature of any payment or other amount may be recharacterised to deny the tax benefit that would result from an avoidance transaction.

Foreign reporting
Reporting requirements apply to taxpayers with offshore investments. The rules impose a significant compliance burden for taxpayers with foreign affiliates. Failure to comply can result in substantial penalties.

Tax avoidance
An 'avoidance transaction' that meets certain conditions is a 'reportable transaction' and must be reported to the CRA. Ontario and Quebec also each have a provincial reporting regime for certain aggressive tax planning transactions. Other provinces are considering implementing similar disclosure rules for these transactions.

Tax evasion and aggressive tax avoidance
The 2016 federal budget announced that Canada will invest CAD 444 million 'to crack down on tax evasion and combat tax avoidance' and details how these funds will be allocated. The new initiatives include:

- hiring 100 additional auditors to investigate high-risk multinational corporations
- increasing the number of CRA annual examinations of high-risk wealthy taxpayers from 600 to 3,000
- increasing twelve-fold the number of transactions examined by the CRA
- creating a special CRA program to stop 'the organisations that create and promote tax schemes for the wealthy'
- using the latest investigative tools and technology, paired with larger CRA investigative teams, and
- creating an independent advisory committee to focus on offshore tax evasion and aggressive tax planning (the OCAC was established on 11 April 2016).

The 2017 federal budget invests an additional CAD 523.9 million over five years to prevent tax evasion and improve tax compliance. The CRA will:

- increase verification activities
- hire additional auditors and specialists with a focus on the underground economy
- develop robust business intelligence infrastructure and risk assessment systems to target high-risk international tax and abusive tax avoidance cases, and
- improve the quality of investigative work that targets criminal tax evaders.

The following measures have already been implemented to help the CRA combat international tax evasion and aggressive tax avoidance:

- Certain financial intermediaries are required to report to the CRA international electronic funds transfers (EFTs) of CAD 10,000 or more. The CRA has reviewed 20,000 EFTs related to the Isle of Man and the island of Guernsey, and has reviewed EFTs in two undisclosed jurisdictions; in 2017-2018, the CRA is planning to review approximately 100,000 EFTs in four other undisclosed jurisdictions.
- The 'Stop International Tax Evasion Program' compensates certain persons who provide information that leads to the assessment or reassessment of over CAD 100,000 in federal tax.
- If a taxpayer fails to report income from a specified foreign property on Form T1135 (Foreign Income Verification Statement), and the form was not filed on time or a specified foreign property was not, or not properly, identified on the form, the normal assessment period for this form is extended by three years.

The CRA has 850 ongoing audits and over 20 criminal investigations underway relating to offshore tax havens. The CRA had identified four jurisdictions of concern with over 41,000 transactions in review that are worth over CAD 12 billion.

On 22 February 2017, Canada's Minister of National Revenue responded to the 14 recommendations in Canada's House of Commons Standing Committee on Finance report 'The Canada Revenue Agency, Tax Avoidance and Tax Evasion: Recommended Actions', dated 26 October 2016. The Minister accepted all the recommendations and stated that its response 'demonstrates the Government's commitment to crack down on aggressive tax avoidance and tax evasion'. The report reviewed the CRA's efforts to enhance tax compliance by individuals and corporations, and to address situations of non-compliance, and the development and use of offshore corporate structures. When implemented, several of the recommendations could increase both tax revenue and the cost of tax compliance.

Voluntary Disclosures Program (VDP)

On 8 December 2016, the CRA released 'Report on the Voluntary Disclosures Program', which sets out the 11 recommendations of the OCAC. The report states that the recommendations are designed to 'enhance and improve' the VDP. If implemented, the recommendations could significantly change the VDP. In particular:

- the program may be increasingly used as a tool to conduct more audits
- the result of a disclosure may be more discretionary and less certain, and
- the added discretion and uncertainty may lead to more tax disputes.

The CRA recently announced that persons identified in the 'Panama Papers' disclosure will not be permitted to use the VDP. It is expected that the CRA will further limit participants in the VDP relating to offshore non-compliance.

Base erosion and profit shifting (BEPS)

Canada has been an active participant in the BEPS Action Plan, a project of the OECD and the G20. BEPS refers to tax planning strategies that exploit gaps and mismatches in national tax laws to shift profits to low- or no-tax locations. The government will act on the recommendations from the BEPS Action Plan (final report issued 5 October 2015) relating to:

- CbC reporting (*see Country-by-country (CbC) reporting in the Group taxation section for more information*)
- transfer pricing guidance (*see Transfer pricing in the Group taxation section for more information*)
- treaty abuse (*see Treaty shopping below*), and
- the spontaneous exchange of tax rulings.

Spontaneous exchange of tax rulings

Effective 1 April 2016, the CRA began sharing select Canadian tax rulings with certain countries in accordance with BEPS Action 5. The types of tax rulings shared include cross-border rulings related to 'preferential regimes', transfer pricing legislation, and those providing a downward adjustment not directly reflected in the taxpayer's accounts, as well as PE rulings and related-party conduit rulings. Canada will share a summary of the applicable ruling with the countries of residence of the immediate parent company, the ultimate parent company, and certain other parties.

Treaty shopping

The government is committed to addressing treaty abuse in accordance with the minimum standard contained in the final OECD and the G20 BEPS report on treaty shopping (Action 6). The minimum standard requires countries to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements. The minimum standard also requires the adoption of one of two approaches in addressing treaty abuse, either the limitation-on-benefits approach or the limited principal purpose test. The federal government will evaluate both of these approaches, depending on the circumstances and discussions with Canada's tax treaty partners.

Other issues

Forms of business enterprise

Canadian law is based on the British common-law system, except in Quebec where a civil-law system prevails. The principal forms of business enterprise available in Canada are the following.

- Corporation: A legal entity distinct from its shareholders, whether public or private, incorporated federally, provincially, or territorially.
- Partnership: A business relationship between two or more 'persons' (i.e. individuals, corporations, trusts, or other partnerships) formed for the purpose of carrying on business in common. Not treated as a legal entity distinct from its partners.
- Sole proprietorship: An unincorporated business operated by an individual that is carried on under the individual's own name or a trade name.
- Trust: A relationship whereby property (including real, tangible, and intangible) is managed by one person (or persons, or organisations) for the benefit of another. May hold commercial enterprises.
- Joint venture: Generally, the pursuit of a specific business objective by two or more parties whose association will end once the objective is achieved or abandoned. Not treated as a legal entity distinct from the participants.

Foreign investors usually conduct business in Canada through one or more separate Canadian corporations, although operation as a branch of a profitable foreign corporation may be preferable during the start-up period. In addition, foreign investors may participate as partners in partnerships carrying on business in Canada or as joint venturers.

Cross-border tax compliance

Convention on Mutual Administrative Assistance in Tax Matters

Canada has ratified the Convention on Mutual Administrative Assistance in Tax Matters, which entered into force, in respect of Canada, on 1 March 2014 and into effect for taxable periods beginning after 2014. The member states of the Council of Europe and the member countries of the OECD are signatories of the convention. Under the convention, Canada will exchange tax information based on OECD standards, but is not required to collect taxes on behalf of another country, or provide assistance in the service of related documents. Canada will continue to negotiate a provision on helping to collect tax on a bilateral basis, and has agreed to include such a provision in some of its bilateral tax treaties.

Common Reporting Standard (CRS)

In November 2014, the G20 countries endorsed a new CRS for automatic information exchange developed by the OECD. Under the CRS, foreign tax authorities will provide information to the CRA relating to financial accounts in their jurisdictions held by Canadian residents. The CRA will, on a reciprocal basis, provide corresponding information to the foreign tax authorities on accounts held by residents of their jurisdictions in Canada.

Recently enacted legislation implements the CRS in Canada effective 1 July 2017, with a first exchange of information in 2018. As of 1 July 2017, Canadian financial institutions must have procedures to identify accounts held by residents of any country other than Canada and to report the required information to the CRA. Having satisfied itself that each jurisdiction has appropriate capacity and safeguards in place, the CRA

will formalise exchange arrangements with other jurisdictions leading to the exchange of information on a multilateral basis.

US Foreign Account Tax Compliance Act (FATCA)
An intergovernmental agreement (IGA) between Canada and the United States to improve international tax compliance and to implement the US FATCA entered into force on 27 June 2014. Canada began reporting the enhanced tax information in 2015.

Factual control
The Canadian Income Tax Act recognises two forms of control of a corporation: *de jure* (legal) control and *de facto* (factual) control. The concept of factual control is broader than legal control and is generally used to restrict access to certain corporate tax advantages. Legal control of a corporation is determined generally based on the right to elect the majority of the board of directors. Factual control is defined to exist where a person has directly or indirectly, in any manner whatever, influence that, if exercised, would result in control in fact of the corporation. Many court cases have discussed which specific factors may be useful in determining whether factual control exists.

However, a recent court decision held that for a factor to be considered in determining whether factual control exists, it must include a legally enforceable right and ability to effect a change to the board of directors or its powers, or to exercise influence over the shareholder or shareholders who have that right and ability. For taxation years beginning after 21 March 2017, the 2017 federal budget clarifies that a determination of factual control not be limited in the manner contemplated by the recent court decision.

Greenland

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Significant developments

The deadline for the corporate tax return has been extended to 15 June on the condition that the taxpayer submit the return via a new online portal. It is still possible to submit tax returns in paper format or via email, but in that case the deadline remains 1 May.

Taxes on corporate income

Greenlandic companies are taxable to Greenland on their worldwide income, except for income from real estate outside of Greenland, which is exempt. Non-resident companies are liable to tax in Greenland on business profits derived through a permanent establishment (PE) in Greenland. Further, non-resident companies are tax liable in Greenland for business profits derived in relation to the exploration for or exploitation of oil, gas, and minerals, regardless of the existence of a PE. Very few double tax treaties (DTTs) offer relief since Greenland only has full-fledged DTTs covering corporate tax with Denmark, the Faroe Islands, Iceland, and Norway.

The corporate tax rate is 30% for both Greenlandic and foreign companies. On top of the corporate tax, there is a 'surcharge' of 6% of the corporate tax payable; consequently, the effective corporate tax rate is 31.8%. Oil and mineral licence holders are exempt from the 6% surcharge according to current practice.

There are no industry-specific or special-tax regimes in Greenland. However, it is determined in all oil exploration licences that oil licensees pay a so-called 'surplus royalty' on top of the corporate tax.

Oil companies

All companies with mineral exploration licences (current and future) are required to pay a government royalty as a condition for grant of a production licence. The royalty terms form part of the licence conditions and vary with the age of the licence.

On licences issued prior to 2014, oil companies pay a 'surplus royalty' of 7.5%, 17.5%, and 30%, which should be paid when the internal rate of return exceeds, respectively, 21.75%, 29.25%, and 36.75% plus the official Danish discount rate, and carry the state-owned company with 12.5% (open door area 8%). Newer licences apply a gross royalty of 2.5% and a surplus royalty of 7.5%, 17.5%, and 30%, which should be paid when the accumulated turnover exceeds 35%, 45%, and 55%, respectively. Further, the state participation is reduced to 6.25% (carried).

Nonetheless, the model licence terms for upcoming rounds in Baffin Bay contain surplus royalty levels of 7.5%, 10%, and 12.5% at 35%, 45%, and 55% internal rates of

return, respectively. In other words, royalty levels are likely to differ between licences and should therefore be scrutinised.

Mining companies
There has been a policy of implementing royalty terms in mining licences as well. A Strategy Report for 2014 through 2018 stipulated that mining companies shall pay a gross royalty of up to 5.5% (depending on the type of mineral) based on turnover, plus, in the case of gemstones, a 'surplus royalty' on future licences. Apparently, this is not only for licences awarded in the future but also, to some extent, for mining companies with existing exploration licences in order for them to obtain a production licence.

Since these changes are implemented predominantly through licence terms rather than legislation, it is not entirely clear when and to what extent the changes will be finally implemented.

There is authority for according breaks in the corporate tax corresponding to the royalties contained in licence terms.

Hydroelectric energy
There has been a minor amendment that authorises that companies with a public licence to produce hydroelectric energy may be tax exempt to the extent this follows from the relevant licence. The purpose of this is to allow for replacement of corporate taxes with other payments stipulated by a licence grant, such as turnover based royalties or other forms of payment. This system duplicates the system already in place for licences under the Natural Resources Act (*råstofloven*), which comprises the exploitation of oil, gas, and minerals.

Local income taxes
There are no municipal or local corporate income taxes or similar charges in Greenland; however, withholding tax (WHT) rates differ by municipality (*see the Withholding taxes section*).

Corporate residence

A corporation is resident in Greenland for tax purposes if it is registered in the Danish Companies Register with its principal seat of business in Greenland or if it has its effective seat of management in Greenland. The effective seat of management is typically the place where the management decisions concerning the company's day-to-day operations are made.

Permanent establishment (PE)
Non-resident companies are liable to tax in Greenland on business profits derived through a PE in Greenland. Generally, Greenland may be assumed to rely on the principles of the Organisation for Economic Co-operation and Development (OECD) model tax treaty in the determination of whether a PE exists. There is virtually no published practice on the issue. Apart from income from a PE, foreign companies are tax liable on income in connection with the exploration and exploitation of oil, gas, and minerals, regardless of whether a PE exists. This includes all activity ultimately serving the extractive industries, including all kinds of subcontractors and service providers to the industry.

Other taxes

Value-added tax (VAT)
There is no VAT in Greenland.

Import duties
There are no general import duties on operating equipment in Greenland. However, if present in Greenland for more than an eight-month period, operating equipment has to be declared to the Greenlandic tax authorities for statistical purposes. There are import duties on some assets, such as cars, etc.

There are also import duties on alcohol, cigarettes, food products, etc. The fares vary depending on the exact goods in question.

Excise duties
There are Greenlandic excise duties on fishing of some fish species, alcohol produced in Greenland, lottery and gambling activities, motor vehicles, and various other excise taxes. The duties depend on the exact circumstances.

Property taxes
There are no property taxes in Greenland.

Stamp taxes
Stamp tax is payable on a few documents, such as a deed of transfer of real estate and ships (1.5% of the transfer sum), including on transfer of shares in companies that own ships.

Capital gains taxes
There are capital gains taxes on receivables, equity instruments, real estate, financial contracts (derivatives), and depreciable assets, including oil, gas, and mineral licences. The tax rate is identical to the general corporate tax rate, effectively 31.8% (30% for oil, gas, and mineral licence holders).

Losses on financial instruments may only be deducted from gains on financial assets.

Payroll taxes
Other that social security contributions (*see below*), no additional payroll taxes are applicable in Greenland.

Social security contributions
Employers are obligated to pay 0.9% of all paid wages and salaries as social security contribution.

All Danish, Greenlandic, and Faroese employers are subject to Danish social security payments (ATP). This applies to both foreign and Danish employees. However, foreign employees are exempt unless they are working in Greenland for more than six months.

Foreign employers are exempt from ATP unless they employ Danish employees who are not residents in Greenland.

Branch income

Greenlandic PEs of foreign companies, and taxable income connected to oil, gas, and mineral activities, are taxed under the same rules and rates as Greenlandic resident companies. There is no branch profits remittance tax or other similar tax on branch profits. As a branch is considered to be the same legal entity as the headquarters, interest paid from the branch to the headquarters is not tax deductible.

Unusually, if one foreign company has more than one location or PE in Greenland, these are treated as separate taxable entities with no possibility of consolidation.

Income determination

Taxable income is generally calculated as income determined for accounting purposes, which is adjusted and modified for several items as prescribed by the tax laws. One typical timing difference is depreciation.

Inventory valuation

There are no formal rules about inventory valuation in Greenland. Generally, inventory is valued at acquisition cost according to a first in first out (FIFO) principle.

Capital gains

Capital gains are subject to capital gains taxes. *See Capital gains taxes in the Other taxes section for more information*.

Dividend income

Income from dividends is generally included in taxable income. There is no relief, such as participation exemption or the like, meaning that any form of Greenlandic holding structure is generally inefficient. Dividends from foreign companies, however, are tax free, provided that the recipient holds at least 25% of the shares in the distributing company for at least one year.

Interest income

Interest income is generally included in taxable income.

Rental income

Rental income is generally taxable in Greenland; however, rental income from real estate located outside of Greenland is not taxable.

Royalty income

Royalty income is taxable in Greenland.

Partnership income

Partnership income is treated similarly to other income. Partnerships are generally fiscally transparent.

Unrealised gains/losses

Unrealised gains/losses are not taxable in Greenland. Greenland does not use a mark-to-market principle on capital gains.

Stock transactions

Gains and losses on equity transactions are taxable.

Foreign currency exchange gains/losses
Foreign exchange gains/losses are taxable in Greenland if realised; however, only foreign exchange gains/losses on receivables are taxable, not on debentures.

Foreign income
Greenlandic companies are taxable to Greenland on their worldwide income, except for certain income relative to foreign real estate; consequently, income from foreign PEs is taxable to Greenland.

The income of a foreign subsidiary may be taxed in the hands of its Greenlandic parent company if the subsidiary constitutes a controlled foreign company (CFC). *See Controlled foreign companies (CFCs) in the Group taxation section for more information*.

Deductions

The general deduction scheme is fairly standard, although the Greenlandic Tax Agency seems to have a restrictive view of the kinds of expenses that are deductible. One very unusual feature is that dividends paid are deductible for the distributing company.

Depreciation and amortisation
Tax depreciation is not required to be in coherence with book depreciation.

Operating assets can be depreciated by 30% a year on a declining-balance basis, ships and aeroplanes can be depreciated by 10% on a straight-line basis, and buildings and installations can be depreciated by 5% on a straight-line basis. Oil and mineral licences can be depreciated over ten years (oil) and four years (minerals) on a straight-line basis. If the lifetime of the licence is shorter than ten or four years, the licences are depreciated over the lifetime of the licence on a straight-line basis.

Depreciation allowances that are recaptured as part of a capital gain on the sale of an asset are generally fully taxable.

Unusually, companies are allowed a depreciation relief corresponding to gains on divested depreciable assets; however, this rule may not reduce the company's income to less than zero (or less than the balance of depreciable assets in the case of operating assets).

Goodwill
Goodwill can be depreciated as an operating asset (i.e. by 30% on a declining-balance basis).

Start-up expenses
No specific rules in Greenlandic tax law govern the treatment of start-up expenses. Instead, these expenses are treated according to general tax law.

Interest expenses
Interest expenses are generally deductible under Greenlandic tax law. However, there are some limitations (*see Thin capitalisation in the Group taxation section*).

Bad debt
Companies can deduct losses on bad debt for Greenlandic tax purposes only to the extent the losses are realised. Note that there is a high threshold for when a loss is deemed to be realised.

An exception to this rule is that financial institutions shall deduct provisions for bad debt and guarantee liabilities in accordance with the accounting rules applicable to them. The same applies to mortgage institutions, but only if they are domiciled in Greenland.

Charitable contributions
Contributions to charity are not deductible for Greenlandic tax purposes.

Pension expenses
Pension expenses are deductible as operating expenses.

Payments to directors
Payments to directors are deductible as operating expenses.

Research and development (R&D) expenses
R&D expenses may be deductible or not, depending on whether they are deemed operating expenses or capital expenses.

Bribes, kickbacks, and illegal payments
There is no published practice on the deductibility of bribes, kickbacks, return commissions, and the like. In Danish and Greenlandic practice, illegal payments are generally not deductible. Since 2008, any bribery payments, whether in or outside Greenland and whether towards a national or international authority, have been a criminal offence. Consequently, it may reasonably be inferred that no such payments are deductible.

Fines and penalties
Fines and penalties are not deductible for Greenlandic tax purposes.

Taxes
Income taxes are, in general, not deductible for corporate tax purposes. Excise duties are deductible.

Other significant items
A highly unusual item is that dividends distributed are deductible in the hands of the distributing company. If a decision to distribute is made before the deadline for filing the income tax return (1 May) on the basis of the preceding year's profits, the deduction may be carried back into the preceding year.

Net operating losses
Tax losses can be carried forward for up to five years. However, oil and mineral licence holders can carry losses forward indefinitely.

Tax losses may not be carried back and utilised in previous income years.

Tax losses are forfeited at 'significant' change of ownership or, unusually, activity of the company. Dispensation is available. 'Significant' is interpreted as 30% of ownership rights.

Payments to foreign affiliates

A Greenlandic corporation can claim a deduction for royalties, management fees, and similar payments made to foreign affiliates, provided that such amounts are made on an arm's-length basis and reflect services received. Interest at normal commercial rates paid to foreign affiliates generally will be allowed as a deduction but is subject to thin capitalisation (*see Thin capitalisation in the Group taxation section*).

Group taxation

Joint taxation is not possible in Greenland.

Transfer pricing

Greenlandic transfer pricing rules apply to transactions between related parties (e.g. intra-group transactions). The rules apply when a company or person directly or indirectly owns at least 50% of the share capital or 50% of the voting rights in another company.

Companies are obligated to disclose in the annual tax return certain information regarding type and volume of intra-group transactions. There is currently no practice regarding requirements for transfer pricing documentation.

Thin capitalisation

Greenland limits interest deductions according to the thin capitalisation rule. This rule works to disallow gross interest costs and capital losses on related-party debt to the extent the overall debt-to-equity ratio exceeds 2:1. Related-party debt is defined so as to include external bank debt if group member companies or shareholders have provided guarantees to the bank. This rule does not apply if the controlled debt is less than 5 million Danish kroner (DKK).

Controlled foreign companies (CFCs)

According to the Greenlandic CFC rules, a Greenlandic company has to include in its taxable income the CFC income of a foreign subsidiary if all of the following criteria are met:

- The Greenlandic company, alone or together with other group companies, individual owners, and/or their next of kin, controls the foreign company.
- During the income year, the subsidiary's financial assets, on average, make up more than 10% of the subsidiary's total assets.
- The foreign company is taxed 'substantially lower' than under Greenlandic taxation.

There is no black or white list that exempts subsidiaries resident in certain countries.

CFC income is defined in some detail and includes a broad spectrum of passive and financial income.

Tax credits and incentives

There are no tax credits or tax incentives in Greenland in general. However, current oil licence holders do, in their surplus royalty basis, qualify for an extra deduction in their capital and operating expenditure of 21.75%, 29.25%, and 36.75%, respectively,

plus the Danish discount rate, provided that the surplus royalty basis never has been positive. This is akin to the so-called 'uplift' known to other oil tax regimes.

Newer licences are subject to different royalty regimes, including different 'uplift' regimes. *Please refer to Oil companies in the Taxes on corporate income section*.

It is also possible for mineral licence holders to get a tax holiday from the corporate tax. However, this is only possible if the corporate tax is replaced entirely by other forms of fiscal levies or duties that provide the Greenlandic government with at least the same income as the corporate tax would have done.

Foreign tax credit

According to Greenlandic tax law, relief is generally available to credit foreign tax paid on non-Greenlandic source profits against the Greenlandic tax on the same profits. If relief is offered by treaty, the level of relief is capped at the level offered by the treaty. There are only treaty provisions to this effect with Canada, Denmark, the Faroe Islands, Iceland, and Norway.

Withholding taxes

Greenland has the following WHTs:

- Dividends: 36% to 44%, depending on the local municipality (may be reduced by treaty). It should be noted that paid dividends are deductible in the corporate tax base.
- Interest: There is no WHT on interest.
- Royalties: 30% (may be reduced due to treaty reduction).

Treaty rates are as follows:

Recipient	Dividends (%)	Interest (%)	Royalties (%)
Denmark	35	0	10
Faroe Islands	No relief (36% to 44%)	0	25
Iceland	35	0	15
Norway	35	0	10

Tax administration

Taxable period

The taxable period is the calendar year. Permission can be granted to use a 12-month period other than the calendar year, provided that the period starts on the first day of a calendar month.

Tax returns

Tax returns are completed on the basis of audited financial accounts with adjustments for tax. Tax returns should be filed no later than four months following the end of the income year, meaning 1 May for companies using the calendar year as the income year. However, if the company submits tax returns via the official web portal for tax return submissions, the deadline is 15 June.

The tax system, in practice, is based on self-assessment. Tax assessments are made by the tax authorities on the basis of the tax return.

Payment of tax
The corporate tax is due for payment by 20 November of the following year. Greenland does not have an on account tax system, so there are no advantages in paying the tax prior to this date.

Penalties
A tax surcharge of DKK 200 per day (maximum DKK 5,000) is levied for late submission of the tax return.

Tax audit process
Tax audit is a rather informal procedure, whereby questions for clarification and/ or documentation may be asked by the Greenlandic Tax Agency. There are few rules governing audit other than statutory limitation rules.

Statute of limitations
The general statute of limitations is 31 October in the fifth calendar year after that of the end of the relevant income year.

Topics of focus for tax authorities
There does not seem, presently, to be particular focus areas of the Greenlandic Tax Agency, and none have been publically announced.

Other issues

United States (US) Foreign Account Tax Compliance Act (FATCA)
In relation to the US FATCA, a Model 1 Intergovernmental Agreement (IGA) is treated as 'in effect' by the US Treasury as of 29 June 2014. The United States and Greenland have reached an agreement in substance, and Greenland has consented to disclose this status. In accordance with this status, the text of such IGA has not been released and financial institutions in Greenland are allowed to register on the FATCA registration website consistent with the treatment of having an IGA in effect, provided that the jurisdiction continues to demonstrate firm resolve to sign the IGA as soon as possible.

Mexico

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Significant developments

In October 2016, the Mexican Congress approved the 2017 Bill (the Law), which includes amendments to Mexican tax legislation. The Law has been published in the Mexican Official Gazette and is effective as of 1 January 2017.

The tax amendments principally affect Income Tax Law (i.e. deduction of electric vehicles, investments in hydrocarbons infrastructure, new rules to deduct outsourcing expenses), Value-added Tax (VAT) Law (i.e. subcontracted labour crediting requirements, pre-operating periods modifications), and the Federal Tax Code (i.e. filing an information return stating the tax status).

Further, the Mexican President introduced in June 2016 a beneficial tax Decree creating the so-called Mexican Special Economic Zones providing several benefits for taxpayers in regards of the Mexican Income Tax Law and VAT Law with the aim of promoting the development and investment in such regions. One of the main benefits is a 100% income tax exemption during the first ten years of operation, 50% in the next five years, among other incentives concerning VAT and customs. Note that currently the already established economic zones, such as Puerto Chiapas, Coatzacoalcos in Veracruz, Salina Cruz, Lazaro Cardenas, and Yucatan, are expecting investments from both national and foreign investors of different industry sectors (manufacturing sector, steel, food, textile, etc.). It is important to mention that other additional areas of the country are expected to be included in the Special Economic Zones list in the following stages of implementation. Investors interested in applying the Decree in one of the designated zones should first obtain an authorisation from the Mexican Ministry of Finance.

Lastly, another Mexican presidential Decree was published and is in force since January 2017 with the aim of promoting productive investment in Mexico and employment by facilitating the return of capital maintained abroad until 31 December 2016 by Mexican and non-Mexican resident permanent establishments (PEs) and taxing them at a reduced 8% rate (instead of 30% rate that should normally be applicable to Mexican legal entities receiving income from subsidiaries abroad), without adverse effects that would in some cases be otherwise applicable (i.e. surcharges). Note, however, that among other requirements, the returned capital must be invested in Mexico for at least a period of two years in specifically listed items (such as government bonds, shares of Mexican entities, acquisition of immovable property, investments in Mexico through Mexican banks or brokerage houses, among others). Also note that the Decree grants relief of all the informative returns and formalities in relation with the returned capital.

Relevant transactions disclosure
All taxpayers are subject to reporting relevant transactions on a quarterly basis. Relevant transactions are defined as share acquisitions or dispositions, extraordinary transactions with related parties, and corporate reorganisations, among others.

Taxes on corporate income

Federal corporate income tax (CIT)
CIT applies to Mexican resident taxpayers' income from worldwide sources, as well as to foreign residents on the income attributed to their PEs located in Mexico.

The federal CIT rate is 30%.

All corporate entities, including associations of a civil nature, branches, etc., are subject to the tax rules applicable to Mexican corporations (unless specifically ruled out, such as not-for-profit organisations).

Taxpayers engaged exclusively in agriculture, livestock, fishing, and forestry activities are subject to a reduction of 30% of their tax liability.

Provisions to recognise the effects of inflation for tax purposes in the areas of monetary assets and liabilities (annual monetary adjustment) and depreciable assets are provided in the income tax law, even though recent inflation rates have been stable at low levels.

Once a corporation has paid its CIT, after-tax earnings (i.e. earnings arising from the after-tax earnings account, *Cuenta de Utilidad Fiscal Neta* or CUFIN) may be distributed to the shareholders with no tax charge at the corporate level. A withholding tax (WHT) on dividend payments to individuals or foreign residents (including foreign corporations) applies at the rate of 10%; this WHT does not apply to distributions of profits subject to corporate-level tax prior to 2014. If a corporation makes a distribution out of earnings that for any reason have not been subject to CIT, such as distributions of book earnings (i.e. not yet recognised for tax purposes in Mexico), the corporation will also be subject to CIT on the grossed-up distributed earnings (gross-up factor is 1.4286).

Tax paid on dividends distributed in excess of CUFIN can be credited against the CIT of the year or in the two fiscal years following the year in which the tax on the non-CUFIN distributions was paid. The CUFIN of the tax years in which the credit is applied must be reduced by an amount equal to the grossed-up dividend distribution.

Local income tax
There are no state taxes on corporate net income.

Corporate residence

The federal tax code provides that corporations are deemed residents in Mexico if the principal centre of administration or the effective place of management is located in Mexico. A specific definition of 'tax resident' in any tax treaty overrides domestic law definitions, provided the taxpayer is eligible to apply the treaty.

When a company ceases to be a Mexican resident in terms of the Mexican federal tax code or any tax treaty, it is deemed to be liquidated for tax purposes. In such cases, a notification is required at least 15 days before the change, and the CIT return must be filed with the Mexican tax authorities within 15 working days following the date on which the change of tax residency takes place.

Permanent establishment (PE)

The income tax law considers a PE to be any place in Mexico where business activities or services are carried out or rendered by non-residents, such as agencies, offices, mining exploration sites, or any other place of exploration, extraction, or exploitation of natural resources, regardless of the length of time involved.

A foreign insurance company could also be considered as having a PE when it engages in activities consisting of insuring risk or collecting premiums (with the exception of reinsurance activities) in Mexico through a party other than an independent agent.

Sites used for display, storage, or purchasing facilities; inventories imported in-bond to be processed by a third party; short-term construction services; and offices to carry out auxiliary or preliminary activities and information gathering or scientific research are not considered to create a PE in Mexico. Non-residents may also keep merchandise in bonded warehouses (including merchandise delivered for importation into Mexico) without being considered as having a PE.

Based on the Hydrocarbons Law, foreign residents are deemed to have a PE when conducting certain oil and gas activities in Mexico for more than 30 days. This implies that the foreigner would need to satisfy all enrolment, compliance, documentation, withholding, and tax filing and payment obligations applicable to Mexican branches of foreign residents.

A non-resident is not considered to have a PE in Mexico as a result of the legal or economic relationships maintained with companies carrying out certain inventory processing activities (i.e. *Maquiladoras*) that process goods or merchandise maintained in Mexico by the non-resident by using assets provided by the non-resident or any related party, as long as certain requirements are met. The requirements include the conditions that the non-resident be resident in a tax treaty country and that the *Maquiladora* complies with the transfer pricing provisions ('safe harbour') to determine its tax profit, as provided in the Mexican income tax law, or secure an advance pricing agreement (APA) negotiated with the Mexican tax authorities.

Maquila operations are generally defined as those with the following characteristics:

- Raw materials are supplied by a foreign resident (with which a *Maquila* contract is in place) and are temporarily imported to be processed, transformed, or repaired and are subsequently exported, including, for these purposes, virtual import-export operations.
- The *Maquila* is also permitted to import goods in accordance with the permanent importation regime. Additionally, local purchases are allowed, as long as such goods are consumed in production and/or exported with the temporarily-imported inventory.
- The processing, transformation, or repair of goods must be performed with temporarily-imported machinery and equipment (M&E) that is the property of the foreign principal. In this regard, the foreign principal must own at least 30% of such

M&E. It is important to mention that this M&E may not have been previously owned by the *Maquila* or by any other Mexican-related party.

Parties resident abroad and engaged in *Maquila* operations through shelter *Maquila* companies may not be considered as creating a PE in Mexico when certain requirements are met and certain information is provided to the Mexican Tax Administration in relation to the gross revenues earned and income taxes paid by its non-Mexican-related party. This PE protection is limited to four years, but non-Mexican residents may opt to comply with their tax obligations through the shelter *Maquiladora* for an additional four-year period without triggering a PE, subject to the compliance of certain requirements. However, the eligible non-Mexican residents would be taxed under safe harbour provisions at a 30% CIT tax rate to determine their tax liability, which, under this scenario, would be determined by the Mexican shelter *Maquila*.

A definition of PE in any tax treaty overrides domestic law definitions where the taxpayer is eligible to apply the corresponding tax treaty.

Other taxes

Value-added tax (VAT)

VAT is payable at the general rate of 16% on sales of goods and services, as well as on lease payments and imports of goods and services. The sale of medicines, as well as the sale of most food products, is zero-rated. The principal VAT-exempt transactions are the sale of land, credit instruments (including equity shares), residential construction, interest paid by banks, medical services, education, salaries and wages, rentals of residential property, and the sale of non-amortisable participation certificates on real estate investment trusts (REITs), provided specific requirements are satisfied.

Temporary imports under IMMEX and similar programs are subject to the general 16% VAT rate. Such imports may qualify for VAT relief when obtaining special certification from the tax authorities related to the adequate control of such imports. The relief is applied in the form of an immediate VAT credit when clearing customs, which means that the temporary import is done on a cashless basis for VAT. Companies not covered by the certification may apply the same cashless treatment if they post a bond as payment guarantee.

The VAT law also taxes sales in Mexico of temporarily imported goods by non-residents to (i) other non-residents, (ii) *Maquiladoras*, or (iii) companies in the automotive industry.

The 0% VAT rate, which generally means that no VAT is payable, is applicable to a substantial number of transactions, including the sale of books, magazines, and newspapers published by the taxpayer, the exportation of goods and certain services (including some *Maquiladora* activities intended for exportation), the sale of certain basic foodstuffs, agricultural goods and services, sales and rentals of farm M&E, and other specified transactions.

VAT paid by business enterprises on their purchases and expenses related to VATable activities (including activities subject to the 0% VAT rate) may usually be credited against their liability for VAT they collect from customers on their own sales, services rendered, etc. The input VAT credit on goods or services of a general nature, or those not specially identified with either taxable or exempt activities for VAT purposes,

is computed based on a VAT ratio proportional to the VATable versus VAT activities (taxable and exempt) carried out by the taxpayer. Creditable VAT paid on purchases and expenses in excess of VAT collected from customers is recoverable via either a refund, offset against other Federal taxes, or a credit against subsequent VAT liabilities.

VAT is a 'cash basis' tax, with few exceptions (e.g. VAT on some types of interest must be paid on an accrued basis); consequently, only the receipt of payment for goods or services triggers the output VAT liability, and an input VAT credit may be claimed only when the taxpayer pays VAT to its providers of goods and services. VAT is calculated for each calendar month as a final tax. In addition, VAT overpayments may be used to offset the tax liabilities arising from other federal taxes.

VAT must generally be withheld by Mexican residents acquiring or leasing tangible goods from non-residents if such foreign residents do not have a PE in the country to which income is attributed. Mexican business entities are required to withhold VAT on payments to individuals or entities for services consisting of ground transportation of goods. Mexican corporations must also withhold VAT on commissions paid to individuals, as well as on independent services rendered by Mexican individuals, and on tangible goods leased from individuals.

An information return related to the VATable activities carried out by the taxpayer must be filed on a monthly basis. Definitive monthly VAT payments are required by the 17th day of the immediately following month.

Subcontracting
VAT paid for subcontracted labour will be creditable to the extent that the contractor obtains from the subcontractor (i) a copy of the VAT return showing VAT was remitted to the Mexican tax authorities, (ii) a copy of the acknowledgement of receipt issued by the tax authorities, and (iii) copies of any other information submitted to the tax authorities related to the VAT payment.

Pre-operating expenses
Under current VAT law, a VAT credit is granted in the pre-operating period (i.e. the period prior to the start of the taxable activities) based on an estimate of expected future activities subject to VAT. However, there is no adjustment mechanism if the actual activities subject to VAT differ from the estimated activities.

The new provision provides that VAT credits from expenses and certain investments in the pre-operating period can be used on the first VAT return for the month in which the company actually carries out activities subject to VAT, or in the month in which the company incurs the expense or makes the disbursement (in which case it can request a refund), provided that, in the latter case, the taxpayer provides information related to the VATable activities to be performed. In both cases, there will be a mandatory adjustment to the VAT credited once a 12-month period has elapsed from the date on which the credit was applied.

In addition, if the taxpayer does not perform taxable activities once the pre-operating period has ended, a reimbursement of any refund should be remitted to the tax authorities. This rule will not apply to taxpayers engaged in extraction activities, such as mining and oil.

Mexico

Customs duties/import tariffs

Mexico's commercial conditions provide an excellent business and investment opportunity. Mexico is a member of the World Trade Organization (WTO), the Asia-Pacific Economic Cooperation Mechanism (APEC), and the Organisation for Economic Co-operation and Development (OECD).

Mexico lies in a strategic geographical location for international trade, sharing borders with the United States (US) and representing an easy entry to the rest of Latin America, while also facing Europe and Asia.

Mexico has signed multiple Free Trade Agreements (FTAs), which provide for preferential duty rates on foreign trade operations with many more countries. FTAs signed by Mexico include the North American Free Trade Agreement (NAFTA) and agreements with the European Union (EU), the European Free Trade Association (EFTA), and Japan, among many other countries. Most FTAs provide 0% duty rates for almost 90% of the goods to be imported into Mexico.

General Import Duty rates range from 0% to 35%, but most imports fall within the range of 3% to 20% (exceptionally, certain food products, shoes, and textiles pay higher duties).

In general, temporary imports are exempt from customs duties (except for fixed assets in certain transactions). *For VAT payments on temporary imports, see above*.

Excise tax

The excise tax law (*Impuesto Especial Sobre Producción y Servicios* or IEPS) levies substantial federal excise rates on the importation and/or sale of certain taxable items, such as gasoline (% variable), beer (26.5%), wine (26.5% to 53%), spirits (53%), and cigarettes and other tobacco products (160% plus an additional quota), and on certain services related to these activities, such as commission, mediation, and distribution of excise taxable items, as well as services for raffles and gambling (30%). Excise tax is also applicable to certain telecommunications services (3%).

The excise tax law applies to soft drinks at 1 Mexican peso (MXN) per litre and to 'junk' food at an 8% rate. In both cases, the excise tax is payable by the producer or importer.

In general terms, goods are exempt from IEPS when exported. The input IEPS paid by exporters on their purchases is not creditable, and that tax becomes an additional cost.

IEPS is payable (output tax) and creditable (input tax) on a cash basis. It is payable on the date that the charge invoiced is collected from the client and can be credited when the respective payment is made to the supplier. On imports, IEPS is creditable when paid at the customs offices.

In certain cases, the IEPS legislation allows taxpayers that are not subject to this tax to credit IEPS paid on the acquisition and/or the importation of certain goods.

There is a specific procedure to calculate the tax for beer producers, bottlers, and importers; however, the tax can never be lower than 26.5%.

Among other obligations, IEPS taxpayers must file information returns before the Mexican Tax Administration periodically.

Property taxes
Annual taxes on real property are levied by Mexico City and all the states at widely varying rates applied to values shown in the property tax records. Assessed values have increased substantially recently in Mexico City and some other areas.

Title transfer taxes
The transfer of real estate is, almost without exception, subject to a variable transfer tax at rates averaging 2% to 4% on the highest of the value of the transaction, fair market value, or registered municipality value. The tax is levied by most states and Mexico City.

Stamp taxes
There are no stamp taxes in Mexico.

Payroll taxes
Most Mexican states levy a relatively low tax on salaries and other income earned by employees, which is payable by the employer (e.g. Mexico City imposes a 2% payroll tax payable by the employer).

Social security contributions
Employers and employees are required to make contributions to the social security system. These contributions are based on the daily salary plus any other compensation paid to the employee. There are various different rates that the employers are compelled to pay to the Mexican Social Security Ministry and or Housing Ministry that may vary in proportion of the so-called base salary of their Mexican employees and the type of concepts for which the compensation is given to the employee. For example, 2% on the base salary of the employee is paid by the employer for the concept of retirement, 5% on the employee base housing contribution salary for the concept of housing must be paid by the employer, among others.

Compulsory profit sharing
Although not a tax, every business unit with employees (irrespective of the type of organisation) is required to distribute a portion of its annual profits among all employees, except general directors and managers. The amount distributable to the employees is 10% of an adjusted taxable income. The main difference between the taxable income and the profit sharing base is that the tax losses cannot be applied against the profit sharing base.

No profit sharing is paid during the first year of operations. Also, special rules apply for personal service entities and for entities deriving their income from rental activities, both of which can limit their profit sharing payment to the equivalent of one month of regular salary.

The profit sharing amount paid out is a deductible item for CIT purposes, provided certain requirements are met.

Vehicle taxes
There is no federal tax on the ownership of vehicles; however, the states may impose a similar tax.

Tax is still levied on the acquisition of new vehicles. This tax is payable in addition to the VAT on the purchase. Note that some vehicles considered as 'hybrid' (e.g. battery assisted vehicles) are not subject to the new vehicle acquisition tax.

Branch income

Mexican branches of foreign corporations (i.e. PEs) are generally subject to the same tax rules as Mexican corporations, with some exceptions. Such exceptions include that branches may deduct *pro rata* allocations of head office expenses, provided certain requirements are satisfied (such as the existence of an applicable tax treaty and a comprehensive agreement for the exchange of tax information between the relevant territory and Mexico), but may not deduct remittances to their head offices, even when such remittances are classified as royalties, fees, commissions, services, or interest.

In general terms, profit distributions to the head office (other than those regarded as a return to the head office of the capital invested into the branch, which are reflected in their 'remittances accounts') either in cash or in kind from branches or other PEs are subject to the statutory CIT rate on the grossed-up distribution, unless the remittance is made from the CUFIN account balance (i.e. the after-tax earnings account).

Branches are also subject to the 10% WHT on profit distributions, which can be reduced or eliminated based on any applicable tax treaty provision.

Income determination

Recognition of income

Income is generally recognised on an accrual basis. However, the service revenues of civil entities that render professional services (e.g. law and accounting firms) and low-income entities (as defined in the Mexican Income Tax Law) are reported on a cash basis.

Inventory valuation

The costing system to be used will be the incurred cost system, based on historic costs or pre-determined costs. If the requirements provided in the regulations of the income tax law are met, the direct cost system (based on historical costs) may be used.

Inventory may be determined by any of the following methods:

- First in first out (FIFO).
- Identifiable costs.
- Average cost.
- Retail.

The FIFO method must be applied to each type of merchandise and each movement. The monetary FIFO method may not be used. Taxpayers selling goods that are identifiable by serial numbers, at a cost exceeding MXN 50,000, must determine their inventory by the identifiable cost method.

Once elected, a method is compulsory for five years and can be changed only if the requirements established in the regulations of the income tax law are fulfilled. The monetary results of the change in method are amortised over the following five years.

For accounting purposes, different methods and certain variations can be adopted. However, a record of the differences must be maintained, and such difference will not be taxable or deductible.

The cost of imported goods may be deducted (and included in the cost of goods sold) only if it can be supported that the goods were legally imported into the country.

Capital gains
Capital gains are taxed as follows.

Securities
Gains on securities are included in regular taxable income.

The tax basis of shares of Mexican corporations sold may be increased by the inflation adjustment applicable for the holding period.

When computing the tax basis of the shares, there are certain items to be considered, such as: (i) the movement in the after-tax earnings account (CUFIN) of the issuing company (including the possible negative CUFIN effects), as adjusted for inflation, (ii) the unamortised prior years' tax losses at the date of the sale, (iii) tax losses arising prior to the date on which the shares were acquired and amortised during the holding period, and (iv) any capital reductions of the issuing company.

When the sum of: (i) the CUFIN balance at the date of acquisition of the shares, (ii) the capital reductions paid, (iii) the unamortised prior years' tax losses at the date of the sale, and (iv) the negative CUFIN balance of the issuing corporation is higher than the sum of: (i) the CUFIN balance at the date of the sale and (ii) the tax losses arising prior to the date on which the shares were acquired, and amortised during the shares' holding period, the difference must be subtracted from the tax basis of the shares to be disposed of (potentially resulting in the shares' tax basis being equal to zero).

When the aforementioned difference exceeds the tax basis of the shares disposed of, this excess (restated by inflation) must be subtracted from the tax basis of the shares in any subsequent share sale by the same taxpayer, even if the shares are issued by a different company.

The aforementioned procedure allows the average cost (tax basis) of the shares to be determined, which is then updated and considered as the acquisition cost for future sales.

A different but simpler procedure is available (optionally) for computing the tax basis of shares held during a period of 12 months or less.

Deduction of losses arising from the sale of shares is limited to the value of gains from similar transactions in the same or the following ten fiscal years. Losses may not be deducted by non-residents selling shares.

A gain from the sale of shares is considered Mexican-source income when the transferred shares are issued by a Mexican resident or when more than 50% of their book value arises directly or indirectly from immovable property located in Mexico, including cases where the shareholding is structured in different levels.

In general terms, the sale by non-residents of shares issued by a Mexican company is subject to a 25% WHT applicable to the gross amount of the transaction (i.e. without deductions). However, there may be the option for gains realised by non-residents on the sale of shares issued by a Mexican company to be taxed by applying the 35% rate

to the net gain. The tax rate for these purposes is generally the same as the top bracket rate for individuals (currently 35%), unless a lower tax treaty rate is applicable.

This net income election is available only if the foreign shareholder income is not deemed to be subject to a regime considered as a 'preferred tax regime jurisdiction' (i.e. tax haven, which is deemed to exist when the non-Mexican resident income is not subject to taxation or taxed at a rate lower than 75% of the tax that would be paid in Mexico) or resides in a country with a territorial tax system. The non-resident seller must have previously appointed a representative in Mexico and have a public accountant assigned to issue a statutory tax audit report on the transfer of shares. The public accountant issuing the respective report must specify the accounting value of the shares sold and explain the factors used in determining the sales price and the market value of the shares if shares are sold between related parties.

The representative is jointly liable for the tax on the sale of shares, even when the statutory report is issued by a public accountant.

The tax authorities may authorise the deferral of taxes that would otherwise be triggered by the transfer of shares in a group reorganisation to the extent it is a share-for-share type of deal (the authorisation must be obtained prior to the share transfer). The price used on the transaction must be at arm's length. The tax deferred, adjusted for inflation, is due upon the sale of the originally transferred shares outside the same interest group. An interest group consists of shareholders that have over 50% common voting stock of the companies.

In principle, authorisations for tax deferral are not granted if the party acquiring or selling the shares is resident in a tax haven or is a resident of a country that has not signed a comprehensive exchange of information agreement with Mexico. However, in the latter case, an authorisation may still be granted if the taxpayer provides documentation to the Mexican tax authorities stating that the taxpayer has authorised the foreign tax authorities to provide information to the Mexican authorities regarding the operation in question.

If the share sale qualifies as an exempt reorganisation under tax treaty rules, the non-resident must appoint a legal representative in Mexico prior to the sale and file a notice with the Mexican Tax Administration informing them of such appointment and the details of the reorganisation process intended to be carried out. Additionally, certain formal requirements are established in the regulations of the Mexican income tax law that must be satisfied when carrying out this type of transaction.

Tax treaty rules (optionally) override domestic law rules when the seller resides in a tax treaty country.

Shares sold through the stock market
Capital gains realised on (i) the sale of shares issued by Mexican companies, (ii) securities exclusively representing such shares, (iii) shares issued by foreign companies quoted in the Mexican stock market, and (iv) derivative financial operations referenced to stock indexes and/or to the aforementioned shares, when the sale is conducted in stock markets or in derivative markets recognised under the Securities Market Law, are subject to a 10% income tax rate.

The applicable income tax on the gain obtained must be withheld by the broker/intermediary; however, there is no obligation to make this withholding if the investor

is a resident in a country with which Mexico has signed a tax treaty to avoid double taxation and provides the broker with a sworn statement explaining said situation and providing their registration number or tax ID issued by the proper authorities in their country. If this is not provided, the income tax must be withheld.

When a non-Mexican resident sells shares that do not satisfy the above requirements to be taxed at a 10% income tax rate, they must pay their tax by applying either 25% of the sale price or 35% of the net gain, complying with the requirements established for these purposes in the domestic law.

Real estate
In determining the taxable gain of real estate, the cost basis of land and buildings may be adjusted (i.e. increased) for tax purposes on the basis of the period of time for which the assets have been held. This adjustment is performed by applying inflation adjustment factors to the net undepreciated balance. Similar rules apply to non-residents electing to pay tax on net income by appointing a legal representative in Mexico. The rate of tax on the net gain is 35% (or lower treaty rate). Otherwise, the 25% final WHT on gross income applies to non-residents.

Machinery and equipment (M&E)
Gains or losses from the disposal of machinery, equipment, and other fixed assets are also calculated after adjusting the basis in these assets, by applying inflation factors to the net undepreciated balance.

Inflationary gain or loss
Taxpayers are required to calculate an adjustment for inflation (resulting in additional taxable income or deductible expense) on an annual basis by applying the percentage increases in the National Consumer Price Index (NCPI) to the value of essentially all liabilities, reduced by monetary assets, including bank balances, investments (except in shares), and some debt and receivables.

Dividend income
Dividends received by Mexican corporations from other Mexican corporations need not be included in gross income. Dividend income must be included within the recipient corporation's CUFIN.

No further corporate-level taxes apply on dividends distributed out of the CUFIN. However, non-CUFIN distributions (i.e. distributions that for any reason have not been subject to CIT) are subject to tax at the level of the distributing company at the general income tax rate on the grossed-up distribution at the effective rate of 42.86%. This tax is creditable in the year of payment or two subsequent years.

Interest income
Interest received by Mexican corporations is generally subject to tax on an accrual basis and included in gross income (*see also Inflationary gain or loss above*).

Royalty income
Royalties received by Mexican taxpayers are taxable income at the general corporate rate (i.e. 30%). Such revenue shall be accrued for tax purposes at the earliest of the due date for the royalty payment collection or the issuance of the corresponding invoice.

Governmental assistance

When the government grants economic or financial assistance to taxpayers through governmental budgetary programs, the cash received will not be treated as taxable revenue to the extent that (i) there is a public list of beneficiaries, (ii) the funds are wire-transferred to the beneficiaries' accounts, (iii) if applicable, the tax authorities issue a certificate of good tax standing to the beneficiary, and (iv) the assets or services the taxpayer acquires with the grant are not deducted.

Foreign income

A Mexican corporation is taxed on foreign-source income when earned. Double taxation is reduced, or possibly eliminated, by means of foreign tax credits. However, the undistributed profits of a foreign subsidiary are not subject to Mexican tax until dividends are paid, with the exception of companies with investments in entities with income subject to a preferred tax regime (tax haven or PTR) (*discussed below*), in which case income is generally taxable even if no distributions are received from those entities.

Investments in tax havens (income subject to PTRs)

Investments in tax havens include those made directly or indirectly in entities, branches, real property, shares, bank accounts, or investment accounts, and any kind of participation in entities, trusts, joint ventures, or investment funds, as well as in any other similar legal entities created or incorporated in accordance with foreign law and located in a tax haven, and including those that are carried out through an intermediary.

A business, entity, trust, or joint venture is considered to be located in a tax haven when it has a physical presence, an address, a post office box, or effective management in a tax haven, or when its bank account is held in or through financing entities located in a tax haven.

Unless it can be demonstrated that the taxpayer does not have management control of the foreign investments, the taxpayer must include the income generated through such entities or foreign vehicles in the proportion that corresponds to their direct or indirect participation in the capital of the entity or vehicle.

Income and profits subject to PTRs are taxed separately. This income cannot be combined with other taxable income or losses and it is not considered for purposes of making advance income tax payments. Tax applicable to this type of income is payable together with the annual CIT return.

The classification of a PTR is not based on the location of the investment but on the tax effectively paid on the income generated abroad. An investment is considered subject to a PTR if the income is not subject to tax or tax paid abroad is less than 75% of the income tax that would have been incurred and paid in Mexico if the income had been taxed under Mexican rules.

In general, interest income and the annual inflationary adjustment made to liabilities of the investment in the tax haven are included in taxable income without subtracting the annual inflationary adjustment on receivables. However, the annual inflationary adjustment on receivables may be subtracted from interest income earned, provided an information return is filed.

Tax on investments in a PTR is determined by applying the general CIT rate to taxable income (currently 30%). Additionally, net operating loss carryforwards associated with an investment in a PTR may be amortised against the tax profit of the following tax years arising from investments in a PTR, and tax deductions related to the investment may also be applied, as long as accounting records pertaining to those investments are available and the annual information return on the investments is filed on time.

Undistributed income from investments in entities located in a PTR need not be immediately included in taxable income (under the provisions discussed above) in certain particular cases (e.g. income arising from qualified active business activities in accordance with the applicable legislation and in the case of passive income from indirect investments in a tax haven when certain strict conditions are met).

Income earned in a PTR will be taxed until its distribution where the PTR income arises from a business activity. This treatment will not be applicable, however, if income such as interest, dividends, royalties, certain capital gains, and rents (i.e. passive income) represent more than 20% of the total income generated.

Other specific cases of income on which the tax may apply until distribution include the case of share transfers within the same group and for income derived from royalties and interest that do not represent a tax deduction for Mexican tax residents, to the extent that certain specific requirements are satisfied.

Maquiladoras

As discussed in the Corporate residence section, companies operating under an IMMEX program (*Maquiladoras/*in-bond processing companies) are considered to not have a PE in Mexico. This is the case for the non-resident principal that owns the M&E and inventory, to the extent it is a resident of a country that has a tax treaty in force with Mexico, complies with all the terms and requirements of the treaty, satisfies any mutual agreements between Mexico and its treaty partner, and complies with the transfer pricing provisions provided in the law.

Revenues associated with productive activities must be derived solely from *Maquila* activities. Additionally, the rules on M&E ownership are consistent with the IMMEX Decree definition (i.e. 30% or more of the M&E used in the *Maquila* operation must be owned by the foreign principal).

The effective income tax rate on *Maquila* profits is 30%.

In terms of transfer pricing, only the safe harbour and advance pricing agreement (APA) alternatives are applicable to *Maquilas*.

Under a Presidential Decree published in Mexico's Official Gazette, the following benefits are also granted to the *Maquiladora* industry:

- An additional deduction for 47% of tax-exempt benefits paid to employees involved in the relevant *Maquila* operation (since 2014, the Mexican tax law limits this deduction to 53% of tax-exempt benefits). *Maquiladoras* applying this benefit should inform the Mexican tax authorities of the amount of the benefit granted, and how it was determined, in a report due March of each taxable year.
- For sales of goods that are located in Mexico between a foreign resident and a *Maquiladora* that are taxed at the 16% VAT rate, the *Maquiladora* may credit the

VAT in the same month of the sale if certain certification requirements are met. This benefit applies if a certification is secured.

Additionally, among other rules, the Miscellaneous Tax Regulations (MTRs) include further guidance in connection with the *Maquiladora* industry, as follows:

- Revenues associated with productive activities must derive solely from *Maquila* activities. In this regard, this rule provides that such revenues may also include those obtained for other *Maquila* services rendered to related parties resident abroad and other miscellaneous income, provided that the *Maquila's* books clearly identify every type of income and related expenses.
- Income relating to the manufacture and distribution of finished goods for resale cannot be considered as 'solely derived from *Maquila* manufacturing activities'.
- The MTRs also provided that a foreign principal may still apply safe harbour protection relating to PE immunity contemplated in the 2013 Income Tax Law, provided that the foreign principal is resident in a country with which Mexico has a double tax treaty (DTT) and the principal is fully compliant with any treaty requirements applicable to its Mexican activities.

Deductions

The applicable deduction requirements must be complied with no later than the last day of the tax year to which the deduction applies, although the invoice supporting the expense may be provided up to the date on which the tax return for the period in question is filed (or comes due). An expense invoice must contain a date within the year for which the deduction is claimed.

Deductions for certain business expenses are limited in the case of business meals and use of company-owned cars.

Depreciation and amortisation

Straight-line depreciation is permitted at the rates specified in the law (i.e. estimated lives for assets are 20 years for buildings, 3.3 years for computers, 4 years for cars [the deductibility threshold for cars has been raised from MXN 130,000 to MXN 175,000, for electric cars the limit is MXN 250,000 starting from 2017], 10 years for certain M&E, etc.), and the deduction may be increased by applying the percentage increases in the NCPI from the month in which the asset was originally acquired. When an asset is disposed of or becomes useless, the remaining undepreciated historical cost may also be deducted, after application of the appropriate inflation adjustment factor to the undepreciated historical cost.

Starting from 2016, companies, including those dedicated to transportation infrastructure and those that invest in hydrocarbon-related activities and the generation of electricity, who have obtained revenues in the prior tax year up to MXN 100 million, can apply an accelerated depreciation (i.e. lump-sum deduction) for investments in new fixed assets that were acquired in the last quarter of the 2015 tax year, or in 2016 or 2017. The accelerated depreciation rate varies from around 60% to 90% depending on the type of assets and the year of acquisition (i.e. 2016 or 2017).

Intangible assets for the exploitation of goods that are in the public domain, or for rendering public services under concession, are considered deferred assets (i.e. not

deducted as incurred). Therefore, these assets are subject to amortisation for income tax purposes.

Specific annual depreciation rates are established for goods used in certain industries.

Goodwill
Goodwill is a non-deductible item for Mexican tax purposes, and the corresponding input VAT (if any) will not be creditable.

Start-up expenses
Start-up expenses incurred prior to the commencement of operations may be amortised at the rate of 10% per year, after applying the adjustment factors.

Interest expenses
In general terms, interest expenses are deductible items if, among others, the principal is invested in the main activity of the Mexican taxpayer, withholding obligations are complied with, informative returns disclosing information related to the loan and transactions carried out with related parties are filed, thin capitalisation rules (3:1 debt-to-equity ratio) are satisfied, the transaction is at arm's length, and the interest does not fall into the deemed dividend criteria (*see the rules for the deductibility of interest payments at the end of this section*).

Bad debts
Bad debts may be deducted on the earlier of the date on which the debt prescribes or the date on which the taxpayer substantiates the practical impossibility of collection, as defined by the law, among other detailed rules.

Charitable contributions
The maximum amount for deductible donations is limited to 7% of the taxable income of the previous year.

Fines and penalties
In general terms, fines and penalties are non-deductible items for income tax purposes, except interest for underpayment of taxes.

Taxes
In general, all federal, state, and local taxes levied on a company (not including those required to be withheld from other parties) represent deductible expenses for CIT purposes, with the following exceptions:

- CIT.
- Federal VAT and excise tax when the company is entitled to credit the tax.
- Taxes on acquisitions of fixed assets and real estate, which must be capitalised and deducted as part of the total cost of such assets to be depreciated.

Subcontracting
Payments derived from labour subcontracting will be deductible when, among other requirements, the contractor obtains from the subcontractor (i) copies of the tax receipts for salary payments made to the employees performing the outsourced services, (ii) a copy of the acknowledgement of receipt, and (iii) a copy of the tax return showing that the income tax withholding and contributions to the Mexican Social Security Institute were paid.

Net operating losses

Subject to certain limitations, losses incurred in prior years by a business may be carried forward and deducted from income earned over a subsequent ten-year period. Net operating loss carrybacks are not allowed.

Losses carried forward may be increased by the percentage increase in the NCPI between the seventh and 12th months of the fiscal year in which they are incurred and thereafter up to the sixth month of the fiscal year in which they are applied.

In the case of entities engaged in activities related to the exploration and production of hydrocarbons in maritime waters at depths of 500 metres or more, net operating losses (following the same adjustment rules mentioned above) may be used to reduce their taxable income within the following 15 years.

Tax loss carryforwards are non-transferable, not even by virtue of a merger. However, the tax losses the surviving entity had prior to the merger may continue to be used to offset the income derived from the same business activities that originated them and, with certain restrictions, may also be used to offset income that derives from new business activities. In the case of a spin-off, tax loss carryforwards should be divided between the surviving entity and the spun-off entities in accordance with their main business activity, prior to the spin-off, as follows:

- Commercial main business activity: In proportion to inventory and accounts receivable.
- Other non-commercial entrepreneurial activities: In proportion to fixed assets.

Current tax legislation may limit the offsetting of tax loss carryforwards upon direct or indirect changes in ownership that imply a change in control of the Mexican entity in certain situations (i.e. whenever the revenue of the last three years is less than the tax loss carryforwards updated for inflation balance of the year prior to the change in control, among other situations). The limitation, if applicable, would limit the netting of tax loss carryforwards available prior to the change in control against the income derived from the same business activities that originated them.

Payments to foreign affiliates

Taxable income and authorised deductions must be determined on the basis of prices that would be agreed with independent parties in comparable transactions (arm's-length values).

For this purpose, taxpayers must secure and maintain contemporaneous documentation supporting transactions with related parties residing abroad, supporting that income and deductions are based on fair market values in accordance with Mexican transfer pricing principles. The documentation must be prepared per type of transaction and must include all operations carried out with related parties.

Domestic transactions with affiliates must also be supported by the application of a recognised transfer pricing method selected in accordance with the Mexican tax legislation in connection with the particularities of the transactions.

Payments made to entities whose income is deemed to be subject to a PTR are considered non-deductible unless it is possible to support that the price of the transaction is substantially the same to the one that would have been used among non-related parties in comparable transactions. Unless otherwise supported, it is assumed

that operations with companies, entities, or trusts whose income is subject to a PTR are carried out between or among related parties and that the transactions are not at arm's length.

The sale price of shares (other than publicly traded shares) sold to a related party must be set at market value in accordance with Mexican transfer pricing provisions, and the transaction must be supported by the corresponding contemporaneous transfer pricing documentation.

Payments to non-residents of a prorated portion of expenses (i.e. allocations of expenses) are, in principle, not deductible for Mexican corporations. However, per current administrative tax rules, they may be deductible if a comprehensive set of requirements is complied with.

Payments made by Mexican residents to domestic or foreign related parties, which are in the hands of such related parties also deductible, are not deductible for the Mexican resident unless the corresponding income is included in the related party taxable income in the same or in a subsequent tax year.

Technical assistance, royalties, and interest payments
In order to be deductible, payments related to technical assistance, the transfer of technology, or royalties must be made directly to companies with the required technical capabilities to provide the corresponding service and should correspond to services actually received. In some situations, the payments may be made to a third party to the extent the relevant agreement expressly includes it.

A deduction for technical assistance, interest, or royalty payments (including those treated as royalties related to industrial M&E leases) is disallowed when paid to a foreign related party entity that controls or is controlled by the Mexican taxpayer and at least one of the following scenarios is applicable:

- The recipient of the income item is a fiscally transparent entity in its residency jurisdiction, unless its shareholders or members are subject to tax for income received by such transparent entity and the payment made by the Mexican resident to the foreign entity is at arm's length.
- The recipient entity considers the payment to be disregarded for tax purposes in its residency jurisdiction.
- The recipient does not include the payment as part of its taxable income in its residency jurisdiction.

Group taxation

The income tax law previously included a chapter that allowed certain holding companies to file a consolidated income tax return with their majority-owned subsidiaries. Tax consolidation was applicable for CIT purposes but not for other taxes (e.g. VAT) or compulsory employee profit sharing.

Companies that, until 2013, consolidated with their subsidiaries for tax purposes were entitled to reduce their deferred tax by crediting against the consolidated tax the tax on dividends paid between members of the group, and to reduce by up to 50% the consolidated tax by applying losses (valued at 15%) incurred by the controlled entities.

Mexico

The tax consolidation regime was repealed starting in 2014, and a new simplified tax consolidation (deferral) regime was introduced.

Due to the repeal of the former tax consolidation regime, the new Income Tax Law provides three options for computing the deferred consolidated income tax benefit, which will be payable over a five-year period.

The main requirements for applying the current tax consolidation (deferral) regime are as follows:

- That the Mexican tax resident holding entity holds, directly or indirectly (through other Mexican entities), 80% or more of the shares of the entities that would form part of the consolidation regime.
- That the Mexican holding entity is not held in more than 80% of other entities, unless such other entities are resident of a jurisdiction having an in force broad exchange information agreement with Mexico.

Shares that qualify as placed among the general investing public and non-voting shares are not considered for the purposes of determining the proportions described above.

As of May 2016, Albania, Argentina, Aruba, Australia, Austria, Bahamas, Bahrain, Barbados, Belgium, Belize, Bermuda, Brazil, Canada, Cayman Islands, Chile, China, Colombia, Cook Islands, Costa Rica, the Czech Republic, Denmark, Ecuador, Estonia, Finland, France, Georgia, Germany, Ghana, Gibraltar, Greece, Guernsey, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Isle of Man, Italy, Japan, Jersey, the Republic of Korea, Kuwait, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Moldova, the Netherlands, the Netherlands Antilles, New Zealand, Norway, Panama, Poland, Portugal, Qatar, Romania, Russia, Samoa, Singapore, Slovak Republic, South Africa, Spain, St. Lucia, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom, the United States, and Uruguay are considered to have broad exchange information agreements on tax matters with Mexico; other agreements or tax treaties that might include an information exchange agreement on tax matters are awaiting ratification or being negotiated.

The Mexican Tax Administration must authorise the application of the consolidation regime, and written consent of the legal representative of each of the companies that would be participating must be filed before 15 August of the year prior to the first year of consolidation to request the proper authorisation. Special tax accounts should be kept by each of the companies of the group.

There are some types of entities that would not qualify for the consolidation regime, among others, non-profit entities, credit institutions, insurance corporations, trusts, auxiliary credit institutions, stock exchange entities, foreign exchange houses and capital investment companies, non-resident companies, companies in liquidation, civil or social associations, cooperatives, and *maquiladoras*.

In general terms, the current consolidation regime allows an individual company to offset losses against profits of other companies in the same group during a three-year deferral period.

The deferred income tax must be paid by each of the entities of the group on the same date on which they are required to file their annual income tax return for the year following that in which the three-year deferral period concludes. The deferred income

tax will be paid updated with the accumulated inflation adjustment from the month in which the tax was deferred to the month in which the tax is paid.

The deferral benefit must be paid before the three-year deferral period if:

- a member leaves the consolidated group
- the ownership percentage is reduced, or
- the group is deconsolidated.

Transfer pricing

Mexican transfer pricing legislation is based on the OECD principles. This has resulted in the implementation of transfer pricing guidelines that are in line with the global economy and trade.

In general terms, from a Mexican transfer pricing perspective, all related-party transactions (including certain joint-venture relationships) must be performed at arm's length.

Those taxpayers who are required to present an informative return with respect to their tax status (a DISIF for its acronym in Spanish) are required to present information relating to transactions carried out with related parties and foreign related parties for each tax year. The DISIF must be filed, when applicable, as part of the annual corporate tax return of Mexican legal entities.

Local legislation allows the selection of both traditional methods and profit-based methods consistent with the OECD guidelines. However, the legislation provides a strict ordering criteria for the application of a method, starting with the comparable uncontrolled price (CUP) method. Other methods different from the CUP may only be applied if the CUP method is justifiably not applicable based on the specific facts and circumstances of each transaction.

Mexican legislation is generally 'form over substance' oriented; consequently, contractual terms remain relevant when defining the economic substance of the transactions subject to the transfer pricing analysis.

Reliable financial information is not always publicly available for Mexican entities. Hence, reliance is often placed on foreign information, which is then adjusted to properly reflect local market conditions and render the transactions in question more comparable.

Thin capitalisation

Interest generated by excess debt lent by a foreign related party to a Mexican resident is non-deductible for CIT purposes. Excess debt is defined as that exceeding three times the value of shareholders' equity (i.e. a 3:1 debt-to-equity ratio) as per the taxpayer's Mexican Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS) balance sheet.

In principle, all interest-bearing debts are considered in determining the annual average debt for purposes of calculating the ratio and thereby the disallowed interest expense amount. However, certain debts incurred for construction, operation, or maintenance of productive infrastructure associated with Mexico's strategic areas or to generate electricity may be excluded from the computation.

Taxpayers may also be able to obtain a ruling from the Mexican Tax Administration in order to apply a higher financial leverage (i.e. not the 3:1 debt-to-equity ratio) if they support with the Mexican tax authorities that the particularities of their business activities required a higher leverage. Also, the thin capitalisation rules do not apply to entities that are part of the Mexican financial sector for the realisation of their business activities.

In addition, taxpayers may be entitled to use the sum of the average balances of their capital contributions account (CUCA) and their (CUFIN) to determine the 3:1 debt-to-equity ratio instead of shareholders' equity. Taxpayers that opt to apply this alternative for the thin capitalisation computation must continue to use it for at least five years. Note that the alternative computation is mandatory for those taxpayers that do not apply Mexican GAAP.

Specific provisions dealing with the disallowance of interest expenses for debt financing structured though back-to-back loans should also be closely observed.

Controlled foreign companies (CFCs)

See Foreign income in the Income determination section for a description of the taxation of undistributed profits of foreign subsidiaries.

Tax credits and incentives

Foreign tax credit

The Mexican Income Tax law allows Mexican corporations and individuals to credit for Mexican income tax purposes the income tax paid abroad in connection with non-Mexican source income. The tax credit would only be applicable if the relevant income item from non-Mexican source is deemed as taxable for Mexican tax purposes in respect to the full amount (i.e. including the income tax paid abroad).

In general, creditability is available in respect of foreign income taxes withheld from foreign-source income or paid with a tax return filed in the foreign country in the name of the Mexican resident or by a foreign branch of a Mexican corporation. However, in the case of profit or dividend distributions by non-Mexican resident legal entities to Mexican resident legal entities, the proportional income tax paid by the non-Mexican resident distributors would may be creditable in Mexico. Note that the Mexican Income Tax Law provides a specific computation to determine the proportional income tax paid abroad.

Furthermore, the creditability of the proportional income tax paid abroad in respect of dividend or profit distributions mentioned in the preceding paragraph would only be applicable if the Mexican resident entity receiving the dividend or profits holds at least 10% of the equity of the foreign distributing entity during a six-month period prior to the distribution.

In the case of dividend or profit distributions from a foreign legal entity that are in turn distributed to another foreign legal entity that then distributes the dividend to the Mexican legal entity, Mexican income tax credit for the proportional income taxes paid by both foreign legal entities may be allowed, in accordance with a specific computation provided by the Mexican Income Tax Law. Note that the creditability is strictly limited to two foreign corporate levels. In addition, the creditability in such cases would only be applicable if the entity distributing the dividends on the

second corporate level resides in a jurisdiction having an in force broad exchange of information agreement with Mexico and the Mexican entity holds an indirect 5% participation in such non-Mexican resident entity equity during the six-month period prior to the dividend distribution.

The foreign tax credit will be allowed up to the effective Mexican rate of tax on the taxable income (tax result) shown by the annual return on a country-by-country basis and per income type limitation. Taxpayers who are not in a position to take full credit for the taxes paid to a foreign country on foreign-source income are allowed a ten-year carryforward of such excess foreign taxes, provided certain compliance requirements are met and the credit would be limited to the corporate tax rate in Mexico of 30%.

The Mexican tax authorities have published internal criterion to determine whether or not a foreign tax should be considered as an income tax for purposes of applying the aforementioned creditability provisions. Such criteria provides, among other situations, that the main qualifying feature to be met is that the relevant tax is levied on income (i.e. revenue subtracted by authorised deductions in similar moments to those established by the Mexican Income Tax Law). Note that such criterion is not binding to taxpayers and refers to a law that was amended in 2014; however, it is still consulted in practice as it provides insight on the Mexican tax authorities view on such topic.

Duty-deferral programs

A deferral program is an authorisation provided by the Mexican Ministry of Economy to those companies importing raw materials or fixed assets to manufacture finished products within Mexico for export.

In addition to the benefits described for CIT purposes in the *Income determination* section, *Maquiladoras* under the IMMEX program are entitled to the following customs benefits:

- No payment of import duties for temporarily imported raw materials, as long as they are exported.
- Temporarily imported raw materials and fixed assets will not be subject to VAT when the Mexican entity importing the goods obtains a VAT certification (*see VAT in the Other taxes section*) from the tax authorities related to the adequate control of such imports or posts a bond guaranteeing the VAT payment until the goods are exported.

Another program allowing preferential duty rates is the Sectorial Relief Program (known as PROSEC), which allows manufacturers to apply lower duty rates on the import of raw materials and machinery required for their productive processes, regardless of their country of origin and regardless of if they are for the Mexican market or for export. These programs were created by the federal government in order to establish competitive tariff conditions for Mexican manufacturers needing to import raw materials and fixed assets from non-NAFTA or trade partner countries.

Companies in Mexico that carry out import operations with values of MXN 300 million per semester, or IMMEX companies, can take advantage of significant customs and administrative benefits if registered into the 'Certified Company Registry' (authorised by the Ministry of Finance). In addition, companies that comply with certain requirements regarding controls and security within their supply chain, regardless of the MXN 300 million obligation, can also obtain the 'Certified Company Registry'; this specific type of registry is known as New Scheme of Certified Companies (NEEC for its

acronym in Spanish), which is different from the newer VAT certification for IMMEX companies mentioned before.

In general terms, the main benefits provided by the Certified Company Registry allows simplified procedures to process imports and exports, including the reduction in time and number of reviews when clearing goods at customs facilities.

Research and development (R&D) incentives
The Mexican Income Tax Law provides a 30% tax credit for R&D expenses, including investments in R&D. The tax credit will be equal to current-year R&D expenses in excess of the average R&D expenses incurred in the previous three years. This incentive cannot be combined with other tax incentives. The government will set up a committee to analyse and approve R&D credits. Further, taxpayers will have to file an information return each February with details of the R&D expenses to be validated by the authorities. Additional rules for the R&D tax credit were published in the Mexican Official Gazette in February 2017 and are in force since 17 March 2017. The given rules provide clarity on the procedural requirements to apply for such tax incentive, some limitations, and a list of expenses that are deemed as qualifying for purposes of obtaining the tax incentive benefits (e.g. fees paid to third party investigators, expenses incurred in testing, tools for testing, specialised equipment necessary for the development of the project, laboratory equipment, among others).

Employment incentives
An incentive offers a credit equivalent to 100% of the income tax corresponding to the salary paid to workers/employees with certain types of disabilities.

An additional deduction, equivalent to 25% of the salary paid to such workers/employees, is also available.

Both benefits cannot be applied in the same fiscal year.

Incentives for investments in movie production
A limited credit is applicable for investments in movie production activities through an immediate tax credit, which is capped at 10% of the total income tax of the prior year, provided certain requirements are met.

Incentives for investments in theatre production
A limited credit is applicable for investments in theatre production activities through an immediate tax credit, which is capped at 10% of the total income tax of the prior year, provided certain requirements are met.

Real estate investment incentives
Some tax benefits exist for qualifying real estate investment trusts (i.e. REITs or the so-called FIBRAS for its acronym in Spanish) in Mexico.

Capital investment
There are certain incentives to encourage risk capital investments in Mexico.

Other incentives
Certain other specific and limited tax incentives are available for taxpayers engaged in certain activities (e.g. those engaged in air or sea transportation of goods or passengers with respect to aircraft and ships with a federal government commercial concession or permit; in the agricultural and forestry sectors; and in-bond warehouses with

respect to real property used for the storage, safeguarding, or conservation of goods or merchandise).

Taxpayers dedicated exclusively to the generation of energy from renewable sources or efficient energy through co-generation systems and that have fully deducted their investments shall establish an account designated as a 'Tax Profit Account for Investments in Renewable Energy', which will allow for the distribution of dividends without payment of CIT.

Individual shareholders of companies that reinvest profits generated from 2014 to 2016 are entitled to a reduction in tax on dividends of up to 5% to the extent such profits are distributed beginning in 2019.

Withholding taxes

Payments to Mexican residents

Payments to resident corporations and PEs in Mexico are generally not subject to WHT.

Payments by resident corporations to resident individuals are subject to WHT as follows:

Payment	WHT (%)
Wages, salaries, and other remuneration	0 to 35
Fees:	
Members of boards of directors and advisory boards	35.0
Other professional fees	10.0
Lease payments on real property	10.0
Interest on securities (1)	0.6
Interest on non-qualified securities	20.0
Dividends	10.0
Miscellaneous types of income of individuals, usually sporadic payments	20.0

Note

1. WHT on interest paid by financial institutions to Mexican resident investors is generally set at 0.6% of the invested capital.

Payments to non-residents

Income tax must usually be withheld from payments to non-resident corporations and individuals. In the case of non-tax treaty countries, the statutory withholding rates are as noted below.

Income tax of 40%, with no deductions, must be withheld on most payments made to foreign-related parties whose income is deemed to be subject to a PTR, in lieu of the tax provided in the domestic law for non-PTR foreign resident entities. This is not applicable in certain cases, such as on income not subject to Mexican taxation in accordance with the regular provisions for income earned by non-residents from a source of wealth located in Mexico, income from dividends, and certain types of interest, including interest payments made to foreign banks. In these cases, the regular provisions of the domestic law should be applied to determine the income tax withholding.

Additionally, revenues for intermediation services, including commissions for brokerage, agents, distribution, and assignment, and generally all income from the negotiation of third-party interests, are also subject to 40% WHT when paid to residents whose income is subject to a PTR. The 40% may be reduced if the foreign related party beneficiary resides in a country with which Mexico has signed a comprehensive exchange of information agreement.

Non-residents' wages and salaries are taxed on the basis of a 12-month earnings period at the following income tax withholding rates:

Taxable income (MXN)		
From	**To**	**WHT (%)**
0	125,900	0
125,901	1,000,000	15
1,000,001	and above	30

The above mentioned rates are also applicable to retirement fund payouts.

However, no tax arises on compensation (wages, salaries, or fees other than board fees) paid by a non-resident with no establishment in Mexico (even if not subject to tax) to which the services relate, provided the individual remains in Mexico for fewer than 183 days (consecutive or not) in any 12-month period.

The tax, when applicable, is withheld if the income is paid by a resident (or a non-resident PE located in Mexico). Otherwise, the tax is generally payable within 15 working days of the associated payment, by the foreign party earning the Mexican-sourced income.

Statutory withholding rates (not mentioned above) under local legislation are as follows:

Payment	**WHT (%)**
Professional fees for services rendered in Mexico	25
Lease payments:	
Lease of real property	25
Lease of containers imported on a temporary basis, airplanes, and ships authorised by the Mexican Government to be commercially exploited in the transportation of goods or persons	5
Lease of personal property	25
Time-sharing services (1)	25
Charter agreements	10
Sales:	
Real property located in Mexico (1)	25
Shares of Mexican companies (1, 2)	25
Transfers of ownership of Mexican public debt by other than the original creditors (intended to cover debt-for-equity swaps) (1)	25
Derivative transactions:	
On capital (1)	25
On debt (3)	Same rates applicable to interest

Payment	WHT (%)
Interest (4):	
Paid to foreign government financing entities, to duly registered foreign banks and other entities that provide financing with funds obtained by issuing publicly traded debt instruments abroad, registered with the Ministry of Finance (5)	10
Interest on debt instruments placed abroad (6)	4.9
Interest payments to specific foreign financial institutions (7)	4.9
Other interest payments (not otherwise included above) paid by Mexican financial institutions to residents abroad	21
Paid to foreign suppliers of M&E, to others to finance purchases of such assets or inventory or working capital loans if the lender is duly registered	21
Paid to reinsurance entities	15
Other interest payments	35
Financial leases (on the portion deemed to qualify as interest or finance charge)	15
Dividends (12)	10
Royalties (8):	
For the use of railroad cars	5
For the use of copyrights on scientific, literary, or art works, including motion pictures and radio and television recordings, as well as software and payments for the transmission of video and audio signals via satellite, cable, optic fibre, and similar media	25
On patents, invention or improvement certificates, trademarks, brand names, and advertising	35
For the use of drawings or models, plans, formulas, or procedures, and of scientific, commercial, and industrial equipment; on amounts paid for information regarding scientific, commercial, and industrial experience; and for technical assistance	25
Short-term construction and the respective installation, maintenance, technical direction, or supervision (9)	25
Reinsurance premiums	2
Income obtained by athletes and artists (1)	25
Income derived from prizes (e.g. lottery tickets or raffles) (10)	1/21
Other income (forgiven debts, indemnifications, rights to participate in business, investments, etc.)	35

Notes

1. The non-resident may elect to pay tax at a rate of 35% (*see Note 11 below for the rate applicable thereafter*) on the net taxable profit in the case of (i) time-sharing services, (ii) share sales, (iii) sales of real property, (iv) activities of sportsmen/artists, and (v) derivative stock and debt transactions, provided that the non-resident recipient of the income has a legal representative resident in Mexico and to the extent that the following specific requirements are met:
   - For time-sharing services, the resident legal representative must keep the audited financial statements of the foreign resident, or the financial statements included in the foreign resident taxpayer's informative return on their tax status, available for inspection by the Mexican tax authorities.
   - For share sales, a tax opinion issued by a registered public accountant is required (not applicable to foreign residents whose income is subject to a PTR or resides in a territorial tax regime).
   - For shares and debt-for-equity swap transactions, this election is available only where the foreign taxpayer whose income is not subject to a PTR or resides in a country with a territorial tax system. It should be noted that there is an option to defer Mexican income tax arising from the sale of shares on a share-for-share basis within the same group due to a corporate reorganisation, provided certain conditions are met.
2. The sale of shares through the Mexican Stock Exchange is subject to a 10% WHT. When the investor is a resident in a country with which Mexico has signed a tax treaty, such withholding will not apply if certain requirements are satisfied.
3. The applicable WHT rate (based on the WHT rates for interest) for debt-derivative transactions is applied on a net basis. However, if the transaction is liquidated in kind, the applicable WHT rate (on the same net basis) is 10%.

4. Interest payments to non-residents are exempt from Mexican income tax when they are paid on the following:
   - Loans to the federal government or to the Bank of Mexico (Central Bank) or bonds issued by the latter organisation to be acquired and paid abroad.
   - Loans for three or more years granted or guaranteed by duly registered financial entities that promote exports through special financing.
   - Preferential loans granted or guaranteed by foreign financial entities to institutions authorised to receive tax-deductible donations in Mexico, provided these institutions are properly registered and use the funds for purposes consistent with their status.
   - Loans derived from bonds issued by the federal government or the Bank of Mexico placed on a recognised national stock exchange, to the extent the beneficial owner is a foreign resident.
5. A 4.9% WHT rate is applicable when the interest is paid to banks resident in countries with which Mexico has signed a tax treaty.
6. The 4.9% WHT rate applies, provided the placement is handled through banks or brokerage firms resident in a country with which Mexico has signed a tax treaty if there is compliance with the information requirements established in the general rules issued by the Ministry of Finance. If there is failure to comply with these requirements, the 10% WHT rate applies. The 4.9% and 10% WHT rates mentioned in the preceding paragraphs do not apply, and instead a 35% WHT rate is applicable to interest, when the direct or indirect beneficiaries of the interest, either individually or jointly with related parties, receive more than 5% of the interest arising from the instrument in question, and are either (i) holders of more than 10% of the voting shares of the issuing company, either directly or indirectly, either individually or jointly with related parties, or (ii) business entities holding more than 20% of their shares, either directly or indirectly, either individually or jointly with parties related to the issuer.
7. The 4.9% WHT rate is applicable to interest payments made to foreign financial institutions in which the Mexican federal government or the Mexican Central Bank has equity participation.
8. The WHT rate is applied to the gross amount of the payment.
9. The non-resident taxpayer may elect to pay 35% tax on the net profit if the taxpayer has a resident legal representative and so informs the customer, who then makes no withholding. When business activities last for more than 183 days, the foreign taxpayer is deemed to have a PE in Mexico for tax purposes and is taxed in the same manner and subject to the same rules as a local resident corporation or branch.
10. The 21% federal rate is applied only in the case of non-qualifying prizes (i.e. income derived from prizes that is subject to a state tax that exceeds a rate of 6%).
11. The statutory WHT rates mentioned above may be reduced by applying tax treaty provisions. During the last two decades, Mexico has embarked on a policy of negotiating a network of tax treaties with its main trading and investment partners (*see table below*).
12. The 10% WHT on dividend payments to foreign residents does not apply to distributions of profits subject to corporate-level tax prior to 2014. If a corporation makes a distribution out of earnings that for any reason have not been subject to CIT, such as distributions of book earnings (i.e. not yet recognised for tax purposes in Mexico), the corporation will also be subject to CIT on the grossed-up distributed earnings (gross-up factor is 1.4286).

As of January 2017, the treaties with the following countries are pending ratification while waiting for the completion of specific formalities by the respective governments in order to become effective, have not been published yet in the Official Gazette, or are under negotiation: Argentina, Costa Rica, Egypt, Guatemala, Iran, Jamaica, Lebanon, Malaysia, Morocco, Nicaragua, Oman, Pakistan, Philippines, Saudi Arabia, Slovenia, Thailand, and Venezuela.

As of January 2016, tax treaties with the countries listed in the following table have been published in the Official Gazette and are in force.

The WHT rates negotiated under the tax treaties are as follows:

	Dividends (%)			
Recipient	**Portfolio**	**Substantial holdings**	**Interest (%)**	**Royalties (%)**
Australia	15	0 (1)	10/15 (25)	10
Austria	10	5 (4)	10	10
Bahrain	0	0	4.9/10 (20)	10
Barbados	10	5 (1)	10	10
Belgium (37)	15	5 (2)	10/15 (16)	10
Brazil	15	10 (6)	15	10/15 (27, 29)

Recipient	Dividends (%) Portfolio	Substantial holdings	Interest (%)	Royalties (%)
Canada	15	5 (4)	10	10
Chile	10	5 (6)	5/15 (26)	5/10 (29, 30)
China	5 (7)	5 (7)	10	10
Colombia	0	0	5/10 (17)	10
Czech Republic	10 (7)	10 (7)	10	10
Denmark	15	0 (3)	5/15 (17)	10
Ecuador	5 (7)	5 (7)	10/15 (16)	10
Estonia	0	0	4.9/10 (38)	10
Finland	0	0	10/15 (24)	10
France	0/5 (9)	0/5 (9)	5/10 (17, 29)	10 (29)
Germany	15	5 (1)	5/10 (18)	10
Greece	10 (7)	10 (7)	10	10
Hong Kong	0	0	4.9/10 (20)	10
Hungary	15	5 (1)	10	10
Iceland	15	5 (1)	10	10
India	10 (7)	10 (7)	10	10 (31)
Indonesia	10 (7)	10 (7)	10	10
Ireland, Republic of (36)	10	5 (4)	5/10 (17, 29)	10
Israel	10	5 (10)	10	10
Italy (37)	15 (7)	15 (7)	10 (29)	15
Japan	15	5 (8)	10/15 (25)	10
Korea, Republic of	15	0 (1)	5/15 (17)	10
Kuwait	0	0	4.9/10 (20)	10
Latvia	10	5	5/10 (39)	10
Lithuania	15	0	10	10
Luxembourg	15	8 (11)	10	10
Malta	0	0	5/10 (17)	10
Netherlands	15	0 (12)	5/10 (21)	10 (28)
New Zealand	15 (7, 13)	15 (7, 13)	10	10
Norway	15	0 (3)	10/15 (16)	10
Panama	7.5	5 (32)	5/10 (17)	10 (33)
Peru	15	10 (2)	15	15
Poland	15	5 (3)	10/15 (19)	10
Portugal	10 (7)	10 (7)	10	10
Qatar	0	0	5/10 (40)	10
Romania	10 (7)	10 (7)	15	15
Russia	10 (7)	10 (7)	10	10
Singapore	0	0	5/15 (17)	10
Slovak Republic	0 (14)	0 (14)	10	10
South Africa	10	5 (1)	10	10
Spain (36)	15	5 (3)	5/10/15 (21, 22, 29)	10
Sweden	15	5 (5)	10/15 (16)	10
Switzerland	15	0 (34)	5/10 (35)	10
Turkey	15	5	10/15 (41)	10
Ukraine	15	5	10	10
United Arab Emirates	0	0	4.9/10 (20)	10
United Kingdom	0	0	5/10/15 (21, 23)	10

Mexico

Recipient	Dividends (%) Portfolio	Substantial holdings	Interest (%)	Royalties (%)
United States	10	5 (4, 15)	4.9/10/15 (20, 23)	10
Uruguay	5 (7)	5 (7)	10	10

Notes

The applicable tax rates on dividends paid abroad in accordance with the tax treaties executed by Mexico are detailed below; however, under domestic law, no withholding is applied on distributions of profits subject to corporate-level tax generated prior to 2014, when the 10% dividend WHT started applying.

There are certain specific cases of interest paid to parties resident abroad that might be exempted by certain tax treaties (e.g. interest paid to a pension fund or paid by a bank, interest paid on certain loans granted or guaranteed by certain entities for exports under preferable conditions), which are not detailed in the information below.

The Tax Reform gives the Mexican tax authorities the ability to require that the foreign-related party provide a sworn statement through its legal representative confirming that the item of income for which a treaty benefit is claimed would otherwise be subject to double taxation.

1. This rate applies when the recipient corporation that is the beneficial owner of the dividend (except for civil partnerships) directly owns at least 10% of the capital of the distributing corporation. In the case of Barbados, Hungary, and South Africa, the specific exclusion of civil partnerships is not included.
2. This rate applies where the company that is the beneficial owner of the dividends directly or indirectly owns at least 25% of the capital of the distributing company.
3. This rate applies where the company that is the beneficial owner of the dividends (except for civil partnerships) directly owns at least 25% of the capital of the company distributing the dividends. In the case of Norway, taxation is limited to the country of residence of the party receiving the dividends, provided the aforementioned substantial holding rule is satisfied.
4. This rate applies where the recipient corporation that is the beneficial owner of the dividend owns at least 10% of the voting shares of the paying corporation. The Mexico-US tax treaty contains a most-favoured nation clause.
5. This rate applies where a company that is the beneficial owner of the dividends (except for civil partnerships, although limited liability partnerships are included) directly owns at least 10% of the voting shares of the company distributing the dividends.
6. This rate applies where a company that is the beneficial owner of the dividends owns at least 20% of the voting shares of the company paying the dividends.
7. This is the maximum WHT rate for dividends, with no distinction for substantial holdings. In the case of Ecuador and India, the tax payable on dividends paid to residents in Mexico must not exceed a limit established in the treaty.
8. The 5% rate applies when a company that is the beneficial owner of the dividends owns at least 25% of the voting shares of the company paying dividends during the six months prior to the end of the tax period in which dividends are paid. Under certain particular rules and provided this ownership requirement is satisfied, dividend payments are only subject to tax in the country of residence of the recipient of the dividends.
9. No withholding applies when more than 50% of the shares of the recipient corporation are owned by residents of France or Mexico or when the beneficial owner of the dividend is a resident individual. Accordingly, the WHT applies to dividends when more than 50% of the recipient corporation's shares are owned by residents of other countries. However, the WHT must not exceed 5% when the party receiving the dividend is the effective beneficiary of said dividend. Dividends paid by a company resident in France to a resident of Mexico, other than a company that directly or indirectly holds at least 10% of the capital stock of the first-mentioned company, may also be taxed in France, in accordance with the law of France, but if the recipient of the dividends is the beneficial owner, the tax thus charged must not exceed 15% of the gross amount of the dividends.
10. The 5% rate applies where the company that is the beneficial owner of dividends directly or indirectly owns at least 10% of the capital of the company distributing the dividends. There is a 10% tax rate that applies when these same ownership requirements are satisfied, but the company paying dividends is a resident of Israel (provided dividends are paid from earnings taxed in Israel at a tax rate lower than the regular corporate tax rate in Israel).
11. The applicable tax rate on the gross amount of the dividends when the recipient company (beneficial owner) (except for civil partnerships) directly holds at least 10% of the capital of the corporation paying the dividend must not exceed 5% in the case of Luxembourg and 8% in the case of Mexico. The protocol of the Mexico-Luxembourg tax treaty states that this rate might be reviewed in the future by the contracting states if the WHT is not fully creditable, and can be adjusted under the principle of avoiding double taxation, provided the adjusted WHT rate is not lower than 5%.
12. Dividends paid by a company resident in Mexico to a company resident in the Netherlands (which is the beneficiary of said dividends) are subject to a maximum tax of 5% on the gross amount of

the dividends if the beneficial owner is a company that directly or indirectly owns at least 10% of the capital of the company paying said dividends. However, as long as a company resident in the Netherlands is not subject to Dutch income tax on dividends received from a company resident in Mexico under the terms of the Dutch income tax law and any future amendments thereto, the dividends mentioned in the preceding paragraph may only be taxed in the Netherlands (not in Mexico).

13. The Mexico-New Zealand tax treaty contains a most-favoured nation clause that may be applicable in the future.
14. The exemption on dividend WHT is not applicable in the case of deemed dividends.
15. To the extent certain requirements provided in the Protocol are met, the WHT may be reduced to 0%.
16. The 10% rate applies to loans from banks.
17. The 5% WHT rate is applicable to interest paid to banks.
18. The 5% rate applies to interest on loans from banks, insurance companies, and retirement and pension plans.
19. The 10% rate applies to interest on loans from banks, insurance companies, and securities regularly and substantially traded on a recognised national stock exchange.
20. The 4.9% rate applies to interest on loans from banks and insurance companies and to interest on securities regularly and substantially traded on a recognised national stock exchange.
21. In the case of the Netherlands, the 5% rate applies to interest on loans from banks and to interest on securities regularly and substantially traded on a recognised national stock exchange. In the case of Spain and the United Kingdom, the 5% rate extends to interest paid to insurance companies.
22. The 10% rate applies to interest paid by financial institutions and interest paid to the original seller of M&E.
23. The 10% rate on interest applies in the case of interest paid to the original seller of M&E and interest paid by banks.
24. The 10% rate applies to interest on loans from banks and to interest derived from bonds or securities that are regularly and substantially traded on a recognised securities market, as well as to interest paid by the purchaser of M&E to a beneficial owner that is the seller of the M&E.
25. The 10% rate applies to interest on loans from banks and insurance companies, to interest on securities regularly and substantially traded on a recognised national stock exchange, to interest paid to the original seller of M&E in a sale on credit, and to interest paid by banks.
26. The 5% rate is applicable to interest on loans granted by banks and insurance companies, securities traded on a recognised securities market, and the sale on credit of M&E.
27. It is understood that the definition of royalties applies to any type of payment received for the provision of technical assistance services. The 15% rate applies to royalties arising from the use of, or the right to use, trademarks.
28. The original rate is 15% but has been reduced to 10% as long as the Netherlands does not impose a WHT.
29. The reduced WHT rate results from the application of the most-favoured nation clause.
30. The 5% rate applies to industrial, commercial, and scientific equipment.
31. The 10% rate also applies to fees for technical assistance, which are payments of any kind, other than those mentioned in Articles 14 and 15 of the treaty as consideration for managerial or technical or consultancy services, including the provision of services of technical or other personnel.
32. This rate applies where the company that is the beneficial owner of the dividends directly owns at least 25% of the capital of the distributing company.
33. The treaty broadly defines royalties and includes payments related to certain software.
34. This rate applies where the company that is the beneficial owner of the dividends directly or indirectly owns at least 10% of the capital of the distributing company.
35. The 5% rate applies on the gross amount of the interest paid to, among others, banks and insurance institutions.
36. Treaty being renegotiated.
37. The protocol of this treaty has already been renegotiated, but is not yet enforced.
38. The 4.9% rate applies on the gross amount of the interest paid to banks and pension funds or pension schemes; the 10% rate applies on the gross amount of the interest paid in any other case.
39. The 5% rate applies on the gross amount of the interest paid to and by banks; the 10% rate applies on the gross amount of the interest in all other cases.
40. The 5% rate applies on the gross amount of the interest if the beneficial owner of the interest is a bank; the 10% rate applies on the gross amount of the interest in all other cases.
41. The 10% rate applies on the gross amount of the interest if it is paid to a bank; the 15% rate applies on the gross amount of the interest in all other cases.

Tax administration

Taxable period

In general terms, the taxable period in Mexico is the calendar year.

Tax returns

Corporate taxpayers are required to file annual CIT returns for the preceding calendar year by 31 March of the following year.

Thereafter, taxpayers meeting certain size criteria or belonging to a group that, as a whole, meets these criteria must submit a tax-compliance informative return along with the preceding calendar year annual CIT return (i.e. 31 March of the following year).

In lieu of submitting the tax-compliance informative return, business taxpayers meeting certain size criteria may elect to file a tax-compliance audit report on an annual basis with the Mexican Audit Administration. This audit report covers all federal taxes other than customs duties and consists of audited financial statements and detailed schedules, together with a report by the auditor stating that no irregularities were observed in respect of the taxpayer's compliance with its federal tax liabilities. This report must be filled electronically, and the auditor must be an independent certified public accountant (CPA) registered with the Mexican Audit Administration. The amount of detailed information required to be filed, and the auditor's responsibility in connection therewith, is significant.

Employees' profit sharing payments are generally due by 31 May of the year following that in which the corresponding profit was obtained.

Information returns must also be filed not later than 15 February each year, reporting on, amongst others, the following activities performed in the immediately preceding year:

- Payments made to parties resident abroad.
- Loans received from or guaranteed by non-residents.
- Transactions conducted through a business trust.
- Parties to which the taxpayer makes payments and withholds income tax.
- Parties to which the taxpayer has made donations.
- Parties to which the taxpayer has paid dividends, and the value of such payments.
- Transactions carried out with suppliers and clients, either local or overseas.

Taxpayers making salary payments are also required to file information returns reporting salaries paid and salary credit paid in the immediately preceding calendar year.

An annual information return must be filed on investments made or held in a tax haven. This must be filed in February of the immediately following year.

An information return on transactions carried out with non-resident-related parties must be filed together with the annual CIT return (no later than March of the following year).

Taxpayers must file an information return stating their tax status with their annual CIT return. For tax year 2016, the information return due date remains 30 June 2017; however, due to particular provisions of the Mexican Federal tax code for computing terms, it is possible to file it until 3 July 2017. The obligation to file the informative tax status return corresponding to fiscal year 2017 must be filed in 2018 on the same date the annual corporate tax return is filed.

Taxpayers allowed to elect to file the tax report will not be obligated to file the information return stating their tax status.

Payment of tax

Corporate taxpayers are required to make estimated payments of CIT by the 17th day of each month based on their estimated taxable income at the end of the previous month and calculated principally by applying the profit factor to the cumulative monthly gross income. The profit factor is determined by dividing the taxable profit by gross income shown in the annual return for the preceding year, or, if no profit factor is to be found in that annual return, the factor appearing in the year preceding that and so on, up to five years, with certain adjustments. For this purpose, gross income includes nominal income, excluding inflationary adjustments. The balance of CIT for the year is due at the same time as the annual return.

Special procedures are provided for computing advance CIT payments and for obtaining authorisation to reduce the amounts of monthly advances after the sixth month of the year. No advance payments or adjustments thereto are required in the first year of operations.

Tax audit process

In general terms, for taxpayers that elected to file a tax-compliance audit report, the tax audit (tax inspection) may start with a review of the audit report prepared by the independent CPA. At this point, the tax authorities may finish the audit if they are satisfied with the information provided by the CPA; otherwise, tax authorities may initiate a direct review on the taxpayer either at the tax authority's offices or at the taxpayer's facilities. Tax authorities may request several documents from the taxpayer and third parties that carried out transactions with the audited taxpayer.

Tax audits should be concluded within the following 12 months after the audit was initiated. The period to conclude tax audits for taxpayers that are either part of the financial system or consolidated for tax purposes is 18 months. In cases where the Mexican tax authorities request information to tax authorities from foreign jurisdictions, the period to conclude the audit is two years. The above periods might be suspended under certain circumstances (e.g. a judicial recourse or appeal initiated by the taxpayer against the tax authorities). Upon conclusion of the audit, the tax authorities should issue either a notification explaining tax underpayments observed during the audit process or a notification of conclusion if no issues remain open at the end of the inspection.

Finally, tax authorities should issue a notification of assessment within the six months after the conclusion of the tax audit. At this point, all underpayments claimed by the tax authorities become due.

Concluding Agreements

The Prodecon is a decentralised Mexican government organisation that acts as the Ombudsman of Mexican taxpayers, providing advice and issuing recommendations to the tax authorities. In recent years, Prodecon's Concluding Agreements have become more common and have had a positive impact for taxpayers when it comes to reconciling differences with the tax authority in regards to an audit and controversial assessments.

The agreement applies when a taxpayer is dissatisfied with the authority's tax assessment as a result of an audit. The taxpayer then should file a petition to the Prodecon, noting the facts, omissions, and support elements to expose its defending arguments. The Prodecon then notifies the authority and proposes an agreement to settle the difference and conclude the audit without further procedures. The authority

has 20 days to indicate whether or not it accepts the terms that arise in the Conclusive Agreement.

Statute of limitations

In general, the right of the tax authorities to collect taxes, review tax returns, or claim additional tax expires five years after the date the respective return is filed. However, in cases where the taxpayer has not secured a federal tax registration number, has no accounting records, has failed to keep accounting records for the required five-year period, or has not filed a tax return, the statute of limitations expires in ten years. Similarly, the period for claiming a refund of overpaid tax expires after five years.

Topics of focus for tax authorities

Although there are no formal written communications from the tax authorities dealing with their topics of focus, in recent years the tax authorities have focused audits on transactions with non-residents, inter-company transactions, transfer pricing, social security contributions, and customs duties, among other areas.

Other issues

Relevant transactions disclosure

The Mexican Supreme Court ruled against the rule in which taxpayers are subject to report relevant transactions on a quarterly basis, however, it is not automatically applicable to all taxpayers, which means that Mexican taxpayers would still need to go to court in case they are sanctioned for not complying with such obligation. Additionally, the Mexican tax authorities are working on amending the return to incorporate it to the text of the Law, which is one of the main reasons the court ruled against it in the first place. According to the Mexican tax authorities, relevant transactions include share acquisitions or dispositions, extraordinary transaction with related parties, and corporate reorganisations, among others. The Mexican Supreme Court states that the rule is against the principle of legal security for the taxpayers.

Cash deposits reporting

Financial institutions are required to report, by 15 February of each year, to the Revenue Administration Service (*Servicio de Administracion Tributaria* or SAT) the information on customers making monthly cash deposits in excess of MXN 15,000.

International Financial Reporting Standards (IFRS) adoption

All companies listed on the Mexican Stock Exchange are required to submit annual consolidated financial statements accompanied by the opinion of a Mexican independent CPA. These financial statements must be prepared in conformity with IFRS and cover three years. Financial institutions and insurance companies must also file audited financial statements with the appropriate regulatory agency.

The elective adoption of IFRS in Mexico for other companies presents great challenges and opportunities. Changing from Mexican Financial Reporting Standards (MFRS) to IFRS requires companies to review their financial reporting procedures and criteria. Major changes in the requirements often have a ripple effect, impacting many aspects of a company's information reporting organisation.

Nevertheless, the benefits to Mexican companies in reporting under IFRS are numerous. Among the greatest of these is the opening up of the Mexican Stock Market to overseas investors. By adopting IFRS, investors are able to compare two companies

on different sides of the world with greater ease, and thus it is hoped that the change will encourage investment in Mexican companies.

Adoption of IFRS is not a straightforward process, and it will require time and effort on the part of the adopting entities to be able to ensure a smooth transition from MFRS to IFRS and ensure that the changes and benefits from this transition are duly implemented.

Foreign Account Tax Compliance Act (FATCA) intergovernmental agreement (IGA)

FATCA was enacted in 2010 by the US Congress to target non-compliance by US taxpayers using foreign accounts. FATCA requires foreign financial institutions (FFIs) to report to the US Internal Revenue Service (IRS) information about financial accounts held by US taxpayers or by foreign entities in which US taxpayers hold a substantial ownership interest.

Mexico signed an IGA with the US Treasury on 19 November 2012 under which Mexican financial institutions are required to report US-owned account information directly to the Mexican tax authority, rather than to the US IRS. The Mexican tax authority will then share that information with the US IRS.

The IGA provides that the United States will reciprocate with the sharing of information.

Mexican tax authorities have issued a set of administrative rules for banks and other financial and related entities to comply with the FATCA IGA.

Country-by-country (CbC) reporting

In 2016, the Mexican government enacted the requirement to file a master information return (Master file), local information return (Local file), and CbC report on a calendar-year basis, staring in FY 2016 and due by 31 December 2017. The provisions of the Mexican Income Tax Law on this obligation are consistent with the OECD's Base Erosion and Profit Shifting (BEPS) with respect to Action Plan 13: Guidance on the Implementation of Transfer Pricing Documentation and Country by Country Reporting. Note that the filing of Master and Local files is required by Mexican taxpayers exceeding the established threshold, while the CbC report is required only for Mexican multinational groups meeting certain group revenue thresholds. However, Mexican tax authorities may also request a CbC report concerning foreign multinational groups. In both cases, specific thresholds for presenting documentation is established.

Failure to file the reports is subject to fines and disqualification of the taxpayer from entering into contracts with the Mexican public sector.

United States

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Significant developments

In 2016, the Treasury Department released final and temporary regulations under Section 385, addressing whether certain instruments between relate parties are treated as debt or equity, and final regulations under Section 987, providing tax accounting rules for a branch or other qualified business unit (QBU) that conducts business using a functional currency that is different from that of its owner.

President Trump signed an executive order on 21 April 2017, directing Treasury to identify significant tax regulations that "impose an undue financial burden on United States taxpayers; add undue complexity to the federal tax laws; or exceed the statutory authority of the Internal Revenue Service" issued on or after 1 January 2016. Anti-corporate-inversion regulations will be examined as part of this executive order, including final and temporary regulations issued under sections 385. At the time this summary was published, there have been no changes to the regulations.

Taxes on corporate income

In the United States, resident corporations are taxed based on worldwide income. Generally, a foreign corporation engaged in a US trade or business is taxed at regular US corporate tax rates on income from US sources that is effectively connected with that business and at 30% on US-source income not effectively connected with that business.

The US corporate income tax (CIT) rate is based on a progressive rate schedule; however, an alternative minimum tax (AMT) provides for a flat rate with fewer deductions.

2017 taxable income		CIT		
Over (USD*)	But not over (USD)	Pay (USD) +	% on excess	of the amount over (USD)
0	50,000	0	15	0
50,000	75,000	7,500	25	50,000
75,000	100,000	13,750	34	75,000
100,000	335,000	22,250	39	100,000
335,000	10,000,000	113,900	34	335,000
10,000,000	15,000,000	3,400,000	35	10,000,000
15,000,000	18,333,333	5,150,000	38	15,000,000
18,333,333			35	0

* United States dollars

The 39% tax rate applies to taxable income between USD 100,000 and USD 335,000 to eliminate the benefit of the 15% and 25% rates, and the 38% tax rate applies to taxable income between USD 15,000,000 and USD 18,333,333 to eliminate the benefit of the 34% rate. Special rules apply to personal service corporations and personal holding companies.

Alternative minimum tax (AMT)
An AMT is imposed on corporations other than S corporations (*see below*) and small C corporations (generally those with no three year average annual gross receipts exceeding USD 7.5 million). The tax is 20% of alternative minimum taxable income (AMTI) in excess of a USD 40,000 exemption amount (subject to a phase out). AMTI is computed by adjusting the corporation's regular taxable income by specified adjustments and 'tax preference' items. Tax preference or adjustment items could arise, for example, if a corporation has substantial accelerated depreciation, percentage depletion, intangible drilling costs, or non-taxable income.

S corporations
Corporations with 100 or fewer shareholders, none of whom may be corporations, that meet certain other requirements may elect to be taxed under Subchapter S of the Internal Revenue Code (IRC or 'the Code') and are thus known as S corporations. S corporations are taxed in a manner similar, but not identical, to partnerships (i.e. all tax items [e.g. income, deductions] flow through to the owners of the entity). Thus, S corporations generally are not subject to US federal income tax.

Gross transportation income taxes
Foreign corporations and non-resident alien individuals are subject to a yearly 4% tax on their US-source gross transportation income (USSGTI) that is not effectively connected with a US trade or business. Transportation income is any income derived from, or in connection with, (i) the use (or hiring or leasing) of any vessel or aircraft, or (ii) the performance of services directly related to the use of any vessel or aircraft.

Local income taxes
CIT rates vary from state to state and generally range from 1% to 12% (although some states impose no income tax). The most common taxable base is federal taxable income, which is modified by state provisions and generally is allocated to a state on the basis of a three-factor formula: tangible assets and rental expense, sales and other receipts, and payroll. State and municipal taxes are deductible expenses for federal income tax purposes.

Corporate residence

A corporation organised or created in the United States under the law of the United States or of any state is a domestic corporation. A domestic corporation is a resident corporation even though it does no business or owns no property in the United States.

Permanent establishment (PE)
A PE generally is defined as a fixed place of business.

Other taxes

Sales taxes

No provisions exist for a sales tax or value-added tax (VAT) at the federal level. However, sales and use taxes constitute a major revenue source for the 45 states that impose such taxes and the District of Columbia. Sales and use tax rates vary from state to state and generally range from 2.9% to 7.25% at the state level. Most states also allow a 'local option' that permits local jurisdictions, such as cities and counties, to impose an additional percentage on top of the state-level tax and to keep the related revenues.

In general, a sales tax is a tax applied to the retail sale of tangible personal property and certain services. Although the form of the tax may vary, it is usually imposed either directly upon the retail sale of the taxable item, on the gross receipts from the sales of taxable items, or on the person engaged in the business of making retail sales of taxable items. The use tax compliments the sales tax and is usually assessed on purchases made out of state and brought into the jurisdiction for use, storage, or consumption. Typically, either a sales tax or a use tax can be assessed on a transaction, but not both.

Customs duties and import tariffs

All goods imported into the United States are subject to entry and are dutiable or duty-free in accordance with their classification under the applicable items in the Harmonized Tariff Schedule of the United States. The classification also identifies eligibility for special programs and free trade agreement preferential duty rates.

When goods are dutiable, *ad valorem*, specific, or compound duty rates may be assessed. An *ad valorem* rate, which is the type of rate most often applied, is a percentage of the value of the merchandise, such as 7% *ad valorem*. A specific rate is a specified amount per unit of weight or other quantity, such as 6.8 cents per dozen. A compound rate is a combination of both an *ad valorem* rate and a specific rate, such as 0.8 cents per kilo plus 8% *ad valorem*. Customs requires that the value of the goods be properly declared regardless of the dutiable status of the merchandise.

Liability for the payment of duty becomes fixed at the time an entry is filed with US Customs and Border Protection (CBP). The obligation for payment is upon the person or firm in whose name the entry is filed, the importer of record.

Excise taxes

Excise taxes are generally imposed by the federal and state governments on a wide range of goods and activities, including gasoline and diesel fuel used for transportation, air travel, manufacturing of specified goods, and indoor tanning services.

The excise tax rates are as varied as the goods and activities upon which they are levied. For example, the excise imposed on indoor tanning services is 10% of the amount paid for the services while the excise imposed on the sale of coal mined in the United States is the lower of USD 1.10 per ton or 4.4% of the sale price.

Property taxes

Most states, and some cities, impose a variety of property taxes on both real and personal property.

Stamp taxes
No provisions exist for a stamp tax at the federal level. However, state and local governments frequently impose stamp taxes at the time of officially recording a transaction based upon the value of real estate. The sales tax on real estate may be a stamp tax on the documents recording the transfer of the real estate.

Capital gain taxes
On current transactions, the long-term capital gains tax rate is the same as the tax rates applicable to ordinary income. Thus, the maximum rate is 35%, excluding the additional phase out rates. However, differences may arise where AMT is imposed.

Accumulated earnings tax
Corporations (other than S corporations, domestic and foreign personal holding companies, corporations exempt from tax under Subchapter F of the Code, and passive foreign investment companies) accumulating earnings and profits for the purpose of avoiding shareholder personal income tax (PIT) are subject to a penalty tax in addition to any other tax that may be applicable. The accumulated earnings tax is equal to 20% of 'accumulated taxable income'. Generally, accumulated taxable income is the excess of taxable income with certain adjustments, including a deduction for regular income taxes, over the dividends paid deduction and the accumulated earnings credit. Note that a corporation can justify the accumulation of income, and avoid tax, based on its reasonable business needs.

Personal holding company tax
US corporations and certain foreign corporations that receive substantial 'passive income' and are 'closely held' may be subject to personal holding company tax. The personal holding company tax is 15% of undistributed personal holding company income and is levied in addition to the regular tax.

Payroll taxes
Employers are subject to federal unemployment insurance tax (FUTA) of 6.2% on the first USD 7,000 of wages paid to employees meeting certain criteria. In addition, states impose workers' compensation insurance tax at varying rates depending on state law and the nature of employees' activities. For 2017, employers also are subject to social security contributions tax of 7.65% (including 1.45% Medicare tax) on the first USD 127,200 (up from USD 118,500 in 2016) of wages paid to employees and 1.45% of Medicare tax on any wages in excess of USD 127,200 (up from USD 118,500 in 2016).

Environmental tax
Importers, manufacturers, and sellers of petroleum or other ozone-depleting chemicals (ODC) are subject to an environmental tax calculated per weight of the ODC used in the manufacture of the product. The tax is determined under an exact or table method provided in the instructions to Form 6667. If the weight cannot be determined, the tax is 1% of the entry value of the product.

Other state and municipal taxes
Other taxes that states may impose, in lieu of or in addition to taxes based on income, include franchise taxes and taxes on the capital of a corporation. State and municipal taxes are deductible expenses for federal income tax purposes.

Branch income

Tax rates on branch profits are the same as on corporate profits. The law also imposes a 30% branch profits tax in addition to US corporate level income taxes on a foreign corporation's US branch earnings and profits for the year that are effectively connected with a US business. The taxable base for the branch profits tax is increased (decreased) by any decrease (increase) in the US net equity of the branch. The branch profits tax on profits may be reduced or eliminated entirely if a relevant treaty so provides (subject to strict 'treaty shopping' rules). The purpose of the branch profits tax is to treat US operations of foreign corporations in much the same manner as US corporations owned by foreign persons.

With certain exceptions, a 30% (or lower treaty rate) branch profits tax also will be imposed on interest payments by the US branch to foreign lenders. In addition, the tax will apply if the amount of interest deducted by the branch on its US tax return exceeds the amount of interest actually paid during the year.

Income determination

Inventory valuation

Inventories generally are stated at the lower of cost or market on a first in first out (FIFO) basis. Last in first out (LIFO) may be elected for tax purposes on a cost basis only and generally requires book and tax conformity.

The tax law requires capitalisation for tax purposes of several costs allocable to the manufacturing process that frequently are expensed as current operating costs for financial reporting (e.g. the excess of tax depreciation over financial statement depreciation).

Capital gains

Gains or losses on the sale or exchange of capital assets held for more than 12 months are treated as long-term capital gains or losses. Gains or losses on the sale or exchange of capital assets held for 12 months or less are treated as short-term capital gains or losses. The excess of net long-term capital gain over net short-term capital loss is considered net capital gain. Capital losses are allowed only as an offset to capital gains. An excess of capital losses over capital gains in a tax year may be carried back three years and carried forward five years to be used against (offset) capital gains.

For dispositions of personal property and certain non-residential real property used in a trade or business, net gains are first taxable as ordinary income to the extent of the depreciation/cost recovery, with any remainder generally treated as capital gain. For other trade or business real property, net gains generally are taxed as ordinary income to the extent that the depreciation or cost recovery claimed exceeds the straight-line amount, with any remainder treated as capital gain.

An exception to capital gain treatment exists to the extent that losses on business assets were recognised in prior years. A net loss from the sale of business assets is treated as an ordinary loss. Future gains, however, will be treated as ordinary income to the extent of such losses recognised in the five immediately preceding years.

Dividend income
A US corporation generally may deduct 70% of dividends received from other US corporations in determining taxable income. The dividends received deduction is increased from 70% to 80% if the recipient of the dividend distribution owns at least 20% but less than 80% of the distributing corporation. Generally, dividend payments between US corporations that are members of the same affiliated group (*see the Group taxation section*) are deferred or eliminated until a transaction with a third party occurs. With minor exceptions, a US corporation may not deduct dividends it receives from a foreign corporation.

Stock dividends
A US corporation can distribute a tax-free dividend of common stock proportionately to all common stock shareholders. If the right to elect cash is given, all distributions to all shareholders are taxable as dividend income whether cash or stock is taken. There are exceptions to these rules, and extreme caution must be observed before making such distributions.

Interest income
Interest income is generally includible in the determination of taxable income.

Rental income
Rental income is generally includible in the determination of taxable income.

Royalty income
Royalty income is generally includible in the determination of taxable income.

Partnership income
The income (loss) of a partnership passes through to its partners so that the partnership itself is not subject to tax. Thus, each partner generally accounts for their distributive share of the partnership's taxable income.

Foreign income (Subpart F income) of US taxpayers
Generally, a US corporation is taxed on its worldwide income, including foreign branch income earned and foreign dividends when received. Double taxation is avoided by means of foreign tax credits. Alternatively, a deduction may be claimed for actual foreign taxes that are paid. In the case of foreign subsidiaries that are more than 50% owned (by vote or value) by US shareholders (commonly known as controlled foreign companies or CFCs), certain types of undistributed income will be taxed currently to the US shareholders (Subpart F income). Generally, Subpart F income includes income that is easily transferred to a low-tax jurisdiction.

Income from certain passive foreign investment companies (where 75% or more of the income is passive or at least 50% of the assets held produce passive income) also is subject to current taxation. Current taxation occurs if the corporation elects to be a qualified electing fund (QEF) or there are actual distributions. If a QEF election is not made and the corporation makes an actual distribution, the distribution will be treated as an excess distribution to the extent it exceeds 125% of the average of the distributions made with respect to the stock over the three immediately preceding years. The excess distribution is spread over the taxpayer's holding period, and the amount allocated to each year in the holding period is subject to tax at the highest marginal tax rate in effect for that year. This deferred tax amount also is subject to an interest charge. The interest charge is designed to pay the benefit of the tax deferral that arises out of having an overseas investment that pays no US income taxes.

Deductions

Depreciation and amortisation

Depreciation deductions are allowances that may be taken for capital outlays for tangible property. For property placed in service after 1986, capital costs must be recovered by using the modified accelerated cost recovery system (MACRS) method. Depending on the type of tangible property, the general cost recovery periods are three, five, seven, ten, 15, 20, 27.5, and 39 years (31.5 years for property placed in service before 13 May 1993). The cost recovery methods and periods are the same for both new and used property. Most tangible personal property is in the three, five, or seven year class. Property placed in the three, five, seven, or ten year class is depreciated by first applying the 200% declining-balance method and then switching to the straight-line method at such a time as when use of the straight-line method maximises the depreciation deduction. Property in the 15 or 20 year class is depreciated by using the 150% declining-balance method and later switching to the straight-line method. An election may be made to use the alternative depreciation system (basically, the straight-line method over prescribed lives). Residential rental property generally is depreciated by the straight-line method over 27.5 years. Non-residential real property is depreciated by the straight-line method over 39 years (31.5 years for property placed in service before 13 May 1993).

An election to use the straight-line method over the regular recovery period or a longer recovery period also is available. Alternatively, taxpayers may elect to use the 150% declining-balance method over the regular recovery period for all property other than real property. This method is required for AMT purposes.

For most tangible personal and real property placed in service in the United States after 1980 but before 1 January 1987, capital costs were recovered using the accelerated cost recovery system (ACRS), which applied accelerated methods of cost recovery over periods specified by statute. The general ACRS recovery periods were three, five, ten, 15, 18, and 19 years.

Special rules apply to automobiles and certain other 'listed' property. Accelerated depreciation deductions can be claimed only if the automobile is used 50% or more for qualified business use as defined in related regulations. Further, for automobiles placed in service after 1986, the allowable yearly depreciation deduction cannot exceed specific dollar limitations.

Separate methods and periods of cost recovery are specified by statute for certain tangible personal and real property used outside the United States.

Rapid amortisation may be allowable for certain pollution control facilities.

Tax depreciation is not required to conform to book depreciation. Tax depreciation generally is subject to recapture on the sale or disposition of certain property, to the extent of gain, which is subject to tax as ordinary income.

The cost of most intangible assets is generally capitalised and amortisable rateably over 15 years.

Section 179 deduction
Corporations can elect to expense, up to a statutory amount per year, the cost of certain eligible property used in the active conduct of a trade or business. This is commonly referred to as the Section 179 deduction.

The 2003 tax cuts temporarily increased the maximum dollar amount that may be deducted under Section 179 from USD 25,000 to USD 100,000. The 2003 tax cuts also increased the phase-out amount from USD 200,000 to USD 400,000. These amounts have been further modified and extended several times on a temporary basis, increasing up to a high of USD 500,000 and USD 2 million, respectively, for tax years beginning in 2010 and 2011, and then to USD 125,000 and USD 500,000, respectively, for tax years beginning in 2012, before reverting to the permanent amounts of USD 25,000 and USD 200,000, respectively, for tax years beginning in 2013 and thereafter. The American Taxpayer Relief Act of 2012, signed into law on 2 January 2013, increased the maximum amount and phase-out threshold in 2012 and 2013 to the levels in effect in 2010 and 2011 (USD 500,000 and USD 2 million, respectively). The Tax Increase Prevention Act of 2014, signed into law on 19 December 2014, extended the USD 500,000 and USD 2 million amounts to tax years beginning in 2014. The Consolidated Appropriations Act, 2016, signed into law on 18 December 2015, extended the USD 500,000 and USD 2 million amounts permanently, retroactive to 1 January 2015; beginning in 2016, the limitation amount is indexed for inflation.

In addition, the deduction under this election is limited to the taxable income of the business.

Bonus depreciation
A 50% special first year depreciation allowance (i.e. bonus depreciation) applies (unless an election out is made) for new MACRS property with a recovery period of 20 years or less, certain computer software, water utility property, and certain leasehold improvements acquired after 31 December 2007. The special allowance applies for regular income tax and AMT purposes. No AMT adjustment is made if the special allowance is used. The special allowance does not apply to property that must be depreciated using the alternative depreciation system or to 'listed property' not used predominantly for business. The special allowance reduces basis before regular depreciation is figured. Additionally, claiming bonus depreciation on automobiles may affect the first year depreciation limits on such automobiles.

The Tax Increase Prevention Act of 2014, signed into law on 19 December 2014, extended 50% bonus depreciation through 31 December 2014 (31 December 2015 for long-production-period property [LPPP] and certain aircraft).

The Act extended for one year, to property placed in service before 1 January 2015 (1 January 2016 in the case of certain longer-lived property and transportation property), the provision allowing a corporation to elect to accelerate AMT credits in lieu of bonus depreciation.

The Consolidated Appropriations Act, 2016, signed into law on 18 December 2015, extended bonus depreciation as follows:

- 30% for property acquired and place in service during 2015, 2016, and 2017.
- 40% for property acquired and place in service during 2018.
- 30% for property acquired and place in service during 2019.

The Act also modified the AMT rules beginning in 2016 by increasing the amount of unused AMT credits that may be claimed in lieu of bonus depreciation.

Depletion
For natural resource properties other than timber and certain oil and gas properties, depletion may be computed on a cost or a percentage basis.

Cost depletion is a method of depletion applied to exhaustible natural resources, including timber, which is based on the adjusted basis of the property. Each year, the adjusted basis of the property is reduced, but not below zero, by the amount of depletion calculated for that year. The current year cost depletion deduction is based on an estimate of the number of units that make up the deposit and the number of units extracted and sold during the year.

Percentage depletion is a method of depletion applied to most minerals and geothermal deposits, and, to a more limited extent, oil and gas. Percentage depletion is deductible at rates varying from 5% to 25% of gross income, depending on the mineral and certain other conditions. Percentage depletion may be deducted even after the total depletion deductions have exceeded the cost basis. However, percentage depletion is limited to 50% (100% for oil and gas properties) of taxable income from the property (computed without allowance for depletion). Generally, percentage depletion is not available for oil or gas wells. However, exceptions exist for natural gas from geopressurised brine and for independent producers of oil and gas.

Goodwill
The cost of goodwill generally is capitalised and amortisable rateably over 15 years.

Start-up expenses
Generally, start-up expenditures must be amortised over a 15-year period; however, certain taxpayers may elect to deduct some expenses in the tax year in which the trade or business begins.

US manufacturing deduction
Over the last several decades, various tax incentive systems have been enacted in the United States to encourage exports and were later repealed, including the extraterritorial income (ETI) regime, which was repealed as a result of a World Trade Organization (WTO) ruling that the ETI regime favoured US goods and violated the national treatment provisions of the General Agreement on Tariffs and Trade. In response, the United States enacted the American Jobs Creation Act of 2004, which introduced a phase-out repeal of ETI and introduced the domestic production activities deduction under Section 199, seeking to compensate US manufacturers for the loss of ETI benefits.

Under Section 199, taxpayers are allowed a 9% deduction for qualified production activities (QPA) income (subject to a taxable income limitation). The deduction is available to all taxpayers actively engaged in QPA. For corporate taxpayers, the deduction generally will mean a federal income tax rate of 31.85% on QPA income. Importantly, the deduction also applies in calculating the AMT. There is a limit on the amount of the deduction equal to 50% of W-2 wages allocable to QPA (subject to a specific effective date), and the deduction is not allowed for taxpayers that incur a loss from their production activities or have an overall loss (including a carryover loss) from all activities.

A taxpayer's QPA income is calculated using the following formula: domestic production gross receipts less the sum of cost of goods sold allocable to such receipts and other expenses, losses, or deduction that are properly allocable to such receipts.

Interest expenses
Interest expenses generally are deductible but may be limited by thin capitalisation rules (*see Thin capitalisation in the Group taxation section*).

Bad debt
Bad debt resulting from a trade or business may be deducted in the year the debt becomes worthless. Determining the date the debt becomes worthless may present difficulty.

Charitable contributions
Deductions for allowable charitable contributions may not exceed 10% of taxable income computed without regard to certain deductions, including charitable contributions themselves. Deductions for contributions so limited may be carried over to the five succeeding years, subject to the 10% limitation annually.

Employee benefit plans (pension plans and expenses)
Through the Code, the government provides incentives for employers to provide retirement benefits to workers, including employee benefit, qualifying profit-sharing, or stock bonus plans. Usually, the employer will be allowed a current deduction for any contributions made to the fund, and the employee's tax liability will be deferred until the benefit is paid. For-profit, non-government employers generally have two types of available plans, which generally are subject to the reporting and disclosure requirements set forth under the Employee Retirement Income Security Act of 1974 (ERISA).

The first category of employee benefit plans is the defined benefit plan, or more commonly known as a pension plan, to which an employer contributes money, on an ongoing basis, to cover the amount of retirement income owed to retired employees under the plan (which will vary based on years of service, average salary, and/or other factors). Any investment gains or losses will not affect the amount of benefits paid to participants but will affect the amount an employer needs to contribute in order to cover its obligation.

The second category of employee benefit plans is the defined contribution plan, or more commonly known in the United States as a '401(k) plan', to which an employer's contributions (if any) are allocated amongst the separate accounts of participating employees, who also may contribute to their respective accounts. Investment gains or losses and the history of contributions will affect the value of a participant's account at retirement but will not affect an employer's contributions since the employer is not obligated to ensure any specified level of benefit in the plan.

Non-profits, including churches and government entities, have similar employee benefit plans, except different requirements apply. Small employers and self-employed individuals also have similar options available but are subject to different requirements.

Fines and penalties
No deduction generally is allowed for fines or penalties paid to the government for violation of any law.

Bribes, kickbacks, and illegal payments
An amount paid, directly or indirectly, to any person that is a bribe, kickback, or other illegal payment is not deductible.

Taxes
State and municipal taxes are deductible expenses for federal income tax purposes.

Other significant items

- No deduction generally is allowed for a contingent liability until such liability is fixed and determinable.
- Costs incurred for entertainment must meet strict tests in order to be deductible. The deduction for business meal and entertainment expenses is 50% of the expenses incurred. There are also limitations on the deductibility of international and domestic business travel expenses.
- Royalty payments, circulation costs, mine exploration and development costs, and other miscellaneous costs of carrying on a business are deductible, subject to certain conditions and limits.
- Depending on the taxpayer's tax accounting method, research and experimental (R&E) expenditures may be deducted as incurred or treated as deferred expenses and amortised over a period of not less than 60 months; however, in general, the method used must be consistently applied.

Net operating losses (NOLs)
An NOL is generated when business deductions exceed gross income in a particular tax year. Depending on current tax law, an NOL may be carried back to offset past income and possibly obtain a refund or carried forward to offset future income. Generally, a loss may be carried back two years and, if not fully used, carried forward 20 years. For state tax purposes, carryback and carryforward provisions are often similar to the federal provisions, except that several states do not permit any carrybacks or carryforwards.

Special rules surrounding NOLs may apply if a taxpayer is located in a qualified disaster area.

Special rules also apply relating to specified liability losses.

Complex rules may limit the use of NOLs after a reorganisation or other change in corporate ownership. Generally, if the ownership of more than 50% in value of the stock of a loss corporation changes, a limit is placed on the amount of future income that may be offset by losses carried forward.

Payments to foreign affiliates
A US corporation generally may claim a deduction for royalties, management service fees, and interest charges paid to foreign affiliates to the extent the amounts are actually paid and are not in excess of what it would pay an unrelated entity (i.e. are at arm's length). In addition, US withholding on these payments may be required.

Group taxation

An affiliated group of US 'includible' corporations, consisting of a parent and subsidiaries directly or indirectly 80% owned, generally may offset the profits of one

affiliate against the losses of another affiliate within the group by electing to file a consolidated federal income tax return. A foreign incorporated subsidiary may not be consolidated into the US group, except for certain Mexican and Canadian incorporated entities. A partnership may not be included in a consolidated return, even if it is 100% owned by members of an affiliated group, since a partnership is not a corporation. However, a member's earnings that flow through from a partnership are included as part of the consolidated group's taxable income or loss. Filing on a consolidated (combined) basis is also allowed (or may be required or prohibited) in certain states.

Sales, dividends, and other transactions between corporations that are members of the same group generally are deferred or eliminated until such time as a transaction occurs with a non-member of the group. Losses incurred on the sale of members of the group are disallowed under certain circumstances.

Transfer pricing

Transfer pricing regulations govern how related entities set internal prices for the transfers of goods, intangible assets, services, and loans in both domestic and international contexts. The regulations are designed to prevent tax avoidance among related entities and place a controlled party on par with an uncontrolled taxpayer by requiring an arm's-length standard. The arm's-length standard generally is met if the results of a controlled transaction are consistent with results that would have been realised if uncontrolled taxpayers had engaged in a similar transaction under similar circumstances. If a company is not in compliance with the arm's-length standard, the Internal Revenue Service (IRS) may raise taxable income and tax payable in the United States. After a transfer pricing adjustment, a multinational company may face double tax, paying tax twice on the same income in two countries. Multinational companies may request competent authority relief from double taxation through a tax treaty.

In order to avoid potential transfer pricing penalties, one avenue available to companies may be to obtain an advance pricing agreement (APA) with the IRS, unilaterally, or with the IRS and another tax authority, bilaterally, covering inter-company pricing.

Thin capitalisation

Thin capitalisation rules may apply to disallow interest payments related to excess debt and to re-characterise such payments as dividends. The interest expense deduction can be limited and suspended if more than 50% of the adjusted taxable income of a thinly-capitalised corporation (with similar rules for a corporate partner in a partnership) is sheltered by interest paid to a related party (or paid to a third-party but guaranteed by the related party) who is not subject to US tax on the income.

Controlled foreign companies (CFCs)

Under the Subpart F regime, a CFC is any foreign corporation with respect to which more than 50% of either the voting power of all classes of stock entitled to vote or the total value of all classes of the corporation's stock is owned by US shareholders on any day during the foreign corporation's tax year.

Tax credits and incentives

Foreign tax credit (FTC)

Generally, in any year, a taxpayer can choose whether to take as a credit (subject to limitation) or as a deduction foreign income, war profits, and excess profit taxes paid or accrued during the tax year to any foreign country or US possession. An FTC reduces

US income tax liability dollar for dollar, while a deduction reduces the US income tax liability at the marginal rate of the taxpayer. For taxpayers with NOLs, the FTC is of no value in such year. However, a benefit might be received either in an earlier year (through a refund of previously paid taxes) or a later year (through a reduction of future taxes). It also should be noted that a taxpayer has an ability to switch from credit to deduction (or from deduction to credit) at any time in a ten-year period commencing when the foreign taxes were paid or accrued. Generally, an FTC may be carried back one year and, if not fully used, carried forward ten years.

In addition, the FTC goes beyond direct taxes to include foreign taxes paid 'in lieu of' a tax upon income, war profits, or excess profits, which would otherwise generally be imposed. It also includes deemed-paid (indirect) taxes paid for certain US corporate shareholders of non-portfolio foreign corporations when actual or deemed dividends are received. Furthermore, the FTC system has numerous limitations to mitigate the potential abuses of the credit by the taxpayer.

General business credit

Various business credits are available to provide special incentives for the achievement of certain economic objectives. In general, these credits are combined into one 'general business credit' for purposes of determining each credit's allowance limitation for the tax year. The general business credit that may be used for a tax year is limited to a tax-based amount. In general, the current year's credit that cannot be used in a given year because of the credit's allowance limitation may be carried back to the tax year preceding the current year and carried forward to each of the 20 years following the current year.

In general, the current year business credit is a combination of the following credits, some of which were extended, retroactively to 1 January 2015, for two years, five years, or permanently as part of the Consolidated Appropriations Act, 2016, and others of which expired at the end of 2014, but still may be renewed retroactively by Congress:

- Investment credit.
- Work opportunity credit.
- Alcohol fuels credit.
- Research credit.
- Low-income housing credit.
- Enhanced oil recovery credit.
- Disabled access credit for certain eligible small businesses.
- Renewable electricity production credit.
- Empowerment zone employment credit.
- Indian employment credit.
- Employer social security credit.
- Orphan drug credit.
- New markets tax credit.
- Small employer pension plan start-up cost credit for eligible employers.
- Employer-provided child care credit.
- Railroad track maintenance credit.
- Biodiesel fuels credit.
- Low sulphur diesel fuel production credit.
- Marginal oil and gas well production credit.
- Distilled spirits credit.
- Advanced nuclear power facility production credit.
- Non-conventional source production credit.

- New energy efficient home credit.
- Energy efficient appliance credit.
- A portion of the alternative motor vehicle credit.
- A portion of the alternative fuel vehicle refuelling property credit.
- Hurricane Katrina housing credit.
- Hurricane Katrina employee retention credit.
- Hurricane Rita employee retention credit.
- Hurricane Wilma employee retention credit.
- Mine rescue team training credit.
- Agricultural chemicals security credit for eligible businesses.
- Differential wage payment credit.
- Carbon dioxide sequestration credit.
- A portion of the new qualified plug-in electric drive motor vehicle credit for vehicles that will vary based on the date of purchase.

Employment credits

A 'work opportunity tax credit' is available through 2019 for employment of certain types of workers. 'Creditable' wages generally are the first USD 6,000 of wages paid to each qualified employee for the year. The credit is 40% of creditable wages, for a maximum credit of USD 2,400.

Research credit

The research credit under Section 41 is available for companies that make qualified research expenditures (QREs) to develop new or improved products, manufacturing processes, or software in the United States. The credit was enacted in 1981 on a temporary basis to help increase R&E spending in the United States. Since then, the research credit has been extended on a temporary basis about 16 times, but was extended, retroactively to 1 January 2015, on a permanent basis as part of the Consolidated Appropriations Act, 2016.

The research credit generally is computed by calculating current-year QRE over a base. The base is calculated using either the regular research credit (RRC) method or the alternative simplified credit (ASC) method. Under the RRC method, the credit equals 20% of QREs for the tax year over a base amount established by the taxpayer in 1984 to 1988 or by another method for companies that began operations after that period.

The ASC equals 14% (for the 2009 tax year and thereafter) of QREs over 50% of the average annual QREs in the three immediately preceding tax years. If the taxpayer has no QREs in any of the three preceding tax years, the ASC may be 6% of the tax year's QREs. The taxpayer must make a timely ASC election on Form 6765 attached to an originally filed return filed by the due date for that return (including extensions), or, pursuant to final regulations published in February 2015, an amended return (subject to certain limitations).

Taxpayers using the RRC also may take a 20% credit for incremental payments made to qualified organisations for basic research. For tax years ending after 8 August 2005, taxpayers also may take the Energy Research Consortium Credit, which provides a 20% credit for expenditures on qualified energy research undertaken by an energy research consortium.

The deduction for R&E expenditures under Section 174 must be reduced by the entire amount of the credit unless an election is made to reduce the amount of the credit.

Inbound investment incentives

There generally are no specific incentives related to inbound investment at the federal level, other than certain portfolio debt and bank deposit exceptions. The portfolio debt exception enables non-residents and foreign corporations to invest in certain obligations (which must meet certain statutory requirements to qualify as 'portfolio debt') in the United States without being subject to US income (or withholding) tax on the interest income. Certain state and local benefits may also be available.

Qualified private activity bonds

Interest income received on certain qualified private activity bonds generally is exempt from federal income tax. This enables a business enterprise to issue the bonds at a lower interest rate.

Other tax incentives

State and local governments provide numerous incentives to encourage business and, thus, employment in their jurisdictions.

Withholding taxes

Under US domestic tax laws, a foreign person generally is subject to 30% US tax on its US-source income. US persons making payments ('withholding agents') to foreign persons generally must withhold 30% of the payment amount as tax withheld at source on payments, such as dividends and royalties, made to foreign persons. In other situations, withholding agents may apply reduced rates or be exempted from withholding tax (WHT) at source when there is a tax treaty between the foreign person's country of residence and the United States.

The United States has entered into various income tax treaties with countries in order to avoid double taxation of the same income and to prevent tax evasion. The table below, *from the IRS website*, summarises the benefits resulting from these treaties.

Recipient	Dividends paid by US corporations in general (%) (1)	Dividends qualifying for direct dividend rate (%) (1, 2)	Interest paid by US obligors in general (%)	Royalties* (%)
Non-treaty	30	30	30	30/30/30/30/30
Treaty rates:				
Australia (3)	15 (22)	5 (22, 24)	10 (5, 6, 15, 21)	NA/5/5/5/5
Austria (3)	15 (9)	5 (9)	0 (15, 19)	NA/0/0/10/0
Bangladesh (3)	15 (22)	10 (22)	10 (11, 15, 19)	NA/10/10/10/10
Barbados (3)	15 (9)	5 (9)	5	NA/5/5/5/5
Belgium (3)	15 (22, 27)	5 (22, 24, 27)	0 (15, 19)	NA/0/0/0/0
Bulgaria (3)	10 (22, 27)	5 (22, 27)	5 (15, 19, 21, 27)	NA/5/5/5/5
Canada (3)	15 (22)	5 (22)	0 (15, 19)	10/0/0/10/0
China, People's Republic of (3)	10	10	10	7/10/10/10/10
Commonwealth of Independent States (CIS) (8)	30	30	0 (7)	0/0/0/0/0
Cyprus (3)	15	5	10 (21)	NA/0/0/0/0
Czech Republic (3)	15 (9)	5 (9)	0 (15)	10/10/10/0/0
Denmark (3)	15 (22, 27)	5 (22, 24, 27)	0 (15, 20)	NA/0/0/0/0

Recipient	Dividends paid by US corporations in general (%) (1)	Dividends qualifying for direct dividend rate (%) (1, 2)	Interest paid by US obligors in general (%)	Royalties* (%)
Egypt	15 (4)	5 (4)	15 (4)	NA/30/15/NA/15 (3)
Estonia (3)	15 (9)	5 (9)	10 (15, 20)	5/10/10/10/10
Finland (3)	15 (22, 27)	5 (22, 24, 27)	0 (15, 20)	NA/0/0/0/0
France (3)	15 (22)	5 (22, 24)	0 (5, 15)	NA/0/0/0/0
Germany (3)	15 (22, 27)	5 (22, 24, 27)	0 (15, 19)	NA/0/0/0/0
Greece (4)	30	30	0	0/0/0/30/0
Hungary (3)	15	5	0	NA/0/0/0/0
Iceland (3)	15 (22, 27)	5 (22, 27)	0 (15, 20)	NA/5/0/5/0
India (3)	25 (9)	15 (9)	15 (12)	10/15/15/15/15
Indonesia (3)	15	10	10	10/10/10/10/10
Ireland (3)	15 (22)	5 (22)	0 (15)	NA/0/0/0/0
Israel (3)	25 (9)	12.5 (9)	17.5 (12, 17)	NA/15/15/10/10
Italy (3)	15 (22)	5 (22)	10 (15, 23)	5/8/8/8/0
Jamaica (3)	15	10	12.5	NA/10/10/10/10
Japan (3, 25)	10 (22, 25, 27)	5 (22, 24, 25, 27)	10 (15, 25, 26, 27)	NA/0/0/0/0
Kazakhstan (3)	15 (16)	5 (16)	10 (15)	10/10/10/10/10
Korea, South (3)	15	10	12	NA/15/15/10/10
Latvia (3)	15 (9)	5 (9)	10 (15, 20)	5/10/10/10/10
Lithuania (3)	15 (9)	5 (9)	10 (15, 20)	5/10/10/10/10
Luxembourg (3)	15 (9, 28)	5 (9)	0 (4, 5, 15)	NA/0/0/0/0
Malta (3)	15 (22, 27)	5 (22, 27)	10 (15, 19)	NA/10/10/10/10
Mexico (3)	10 (22, 27)	5 (22, 24, 27)	15 (15, 18, 25, 27)	10/10/10/10/10
Morocco (3)	15	10	15	NA/10/10/10/10
Netherlands (3)	15	5 (24, 29)	0 (6)	NA/0/0/0/0
New Zealand (3)	15 (22)	5 (22, 24)	10 (15, 19, 21)	NA/5/5/5/5
Norway (3)	15	15	10	NA/0/0/NA/0
Pakistan (4)	30	15	30	NA/0/0/NA/0
Philippines (3)	25	20	15	NA/15/15/15/15
Poland (3)	15	5	0	NA/10/10/10/10
Portugal (3)	15 (9)	5 (9)	10 (5, 15)	10/10/10/10/10
Romania (3)	10	10	10	NA/15/15/10/10
Russia (3)	10 (16)	5 (16)	0 (15)	NA/0/0/0/0
Slovak Republic (3)	15 (9)	5 (9)	0 (15)	10/10/10/0/0
Slovenia (3)	15 (22)	5 (22)	5 (15)	NA/5/5/5/5
South Africa (3)	15 (9)	5 (9)	0 (15, 19)	NA/0/0/0/0
Spain (3)	15 (9)	10 (9)	15	8/10/10/8/5 (10)
Sri Lanka (3)	15 (29)	15 (29)	10 (15, 19)	5/10/10/10/10
Sweden (3)	15 (22, 27)	5 (22, 24, 27)	0 (15)	NA/0/0/0/0
Switzerland (3)	15 (9)	5 (9)	0 (15, 19)	NA/0/0/NA/0
Thailand (3)	15 (9)	10 (9)	15 (12, 15)	8/15/15/5/5
Trinidad & Tobago (3)	30	30	30	NA/15/15/NA/0 (14)
Tunisia (3)	20 (9)	14 (9)	15	10 (13)/15/15/15/15
Turkey (3)	20 (9)	15 (9)	15 (6, 12, 15)	5/10/10/10/10
Ukraine (3)	15 (16)	5 (16)	0	NA/10/10/10/10
United Kingdom (3)	15 (22, 25)	5 (22, 24, 25)	0 (15, 20, 25)	NA/0/0/0/0
Venezuela (3)	15 (22)	5 (22)	10 (15, 20, 21)	5/10/10/10/10

Notes

* Please note the tax rates and associated footnotes appearing in the 'Royalties' column in the table address five types of royalties, as denoted in the most recent IRS publication. These five are industrial equipment royalties, know-how/other industrial royalties, patent royalties, motion picture and television royalties, and copyright royalties. The slashes '/' between each figure and associated footnote(s) are meant to demarcate these five types of royalties, respectively. For rates indicated as 'NA', if the enterprise earns income from the leasing of equipment in the conduct of a trade or business, it is covered by the Business Profits article. For passive income from the leasing of equipment, and not in the Royalty article, it is covered by the Other Income article, if any.

1. No US tax is imposed on a dividend paid by a US corporation that received at least 80% of its gross income from an active foreign business for the three-year period before the dividend is declared.
2. The reduced rate applies to dividends paid by a subsidiary to a foreign parent corporation that has the required percentage of stock ownership. In some cases, the income of the subsidiary must meet certain requirements (e.g. a certain percentage of its total income must consist of income other than dividends and interest). For Italy, the reduced rate is 10% if the foreign corporation owns 10% to 50% of the voting stock (for a 12-month period) of the company paying the dividends. For Japan, dividends received from a more than 50% owned corporate subsidiary are exempt if certain conditions are met.
3. The exemption or reduction in rate does not apply if the recipient has a PE in the United States and the property giving rise to the income is effectively connected with this PE. Under certain treaties, the exemption or reduction in rate also does not apply if the property producing the income is effectively connected with a fixed base in the United States from which the recipient performs independent personal services. Even with the treaty, if the income is not effectively connected with a trade or business in the United States by the recipient, the recipient will be considered as not having a PE in the United States under IRC Section 894(b).
4. The exemption or reduction in rate does not apply if the recipient is engaged in a trade or business in the United States through a PE that is in the United States. However, if the income is not effectively connected with a trade or business in the United States by the recipient, the recipient will be considered as not having a PE in the United States to apply the reduced treaty rate to that item of income.
5. Interest determined with reference to the profits of the issuer or one of its associated enterprises is taxed at 15%.
6. Contingent interest that does not qualify as portfolio interest is treated as a dividend and is subject to the rates under those columns, as appropriate.
7. The exemption applies only to interest on credits, loans, and other indebtedness connected with the financing of trade between the United States and the CIS member. It does not include interest from the conduct of a general banking business.
8. The tax rates in the US treaty with the former USSR still apply to the following countries: Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan.
9. The rate in column 2 applies to dividends paid by a regulated investment company (RIC) or a real estate investment trust (REIT). However, that rate applies to dividends paid by a REIT only if the beneficial owner of the dividends is an individual holding less than a 10% interest (25% in the case of Portugal, Spain, and Tunisia) in the REIT.
10. The rate is 8% for copyrights of scientific work.
11. The rate is 5% for interest (i) beneficially owned by a bank or other financial institution (including an insurance company) or (ii) paid due to a sale on credit of any industrial, commercial, or scientific equipment, or of any merchandise to an enterprise.
12. The rate is 10% if the interest is paid on a loan granted by a bank or similar financial institution. For Thailand, the 10% rate also applies to interest from an arm's-length sale on credit of equipment, merchandise, or services.
13. This is the rate for royalties for the use of, or the right to use, industrial, commercial, and scientific equipment. The rate for royalties for information concerning industrial, commercial, and scientific know-how is subject to the rate in column 5 ('other royalties').
14. The rate is 15% for copyrights of scientific work.
15. Exemption or reduced rate does not apply to an excess inclusion for a residual interest in a real estate mortgage investment conduit (REMIC).
16. The rate in column 2 applies to dividends paid by a RIC. Dividends paid by a REIT are subject to a 30% rate.
17. An election can be made to treat this interest income as if it were industrial and commercial profits taxable under article 8 of this treaty.
18. The rate is 4.9% for interest derived from (i) loans granted by banks and insurance companies and (ii) bonds or securities that are regularly and substantially traded on a recognised securities market. The rate is 10% for interest not described in the preceding sentence and paid (i) by banks or (ii) by the buyer of machinery and equipment to the seller due to a sale on credit.
19. The rate is 15% (10% for Bulgaria; 30% for Austria, Germany, and Switzerland) for contingent interest that does not qualify as portfolio interest.
20. The rate is 15% for interest determined with reference to (i) receipts, sales, income, profits, or other cash flow of the debtor or a related person, (ii) any change in the value of any property of the debtor or a related person, or (iii) any dividend, partnership distribution, or similar payment made by the debtor to a related person.
21. Interest received by a financial institution is tax exempt. For Venezuela, the rate is 4.95% if the interest is beneficially owned by a financial institution (including an insurance company).

22. The rate in column 2 applies to dividends paid by a RIC or REIT. However, that rate applies to dividends paid by a REIT only if the beneficial owner of the dividends is (i) an individual (or pension fund, in the case of France or New Zealand) holding not more than a 10% interest in the REIT, (ii) a person holding not more than 5% of any class of the REIT's stock and the dividends are paid on stock that is publicly traded, or (iii) a person holding not more than a 10% interest in the REIT and the REIT is diversified.
23. Interest paid or accrued on the sale of goods, merchandise, or services between enterprises is exempt. Interest paid or accrued on the sale on credit of industrial, commercial, or scientific equipment is exempt.
24. Dividends received from an 80%-owned corporate subsidiary are exempt if certain conditions are met.
25. Exemption does not apply to amount paid under, or as part of, a conduit arrangement.
26. Interest is exempt if (i) paid to certain financial institutions, or (ii) paid on indebtedness from the sale on credit of equipment or merchandise.
27. Amounts paid to a pension fund that are not derived from the carrying on of a business, directly or indirectly, by the fund are exempt. This includes amounts paid by a REIT only if the conditions in footnote 22 are met. For Sweden, to be entitled to the exemption, the pension fund must not sell or make a contract to sell the holding from which the dividend is derived within two months of the date the pension fund acquired the holding.
28. The exemption does not apply if the recipient of the gain is an individual who is present in the United States for more than 119 days during the year.
29. The rate applies to dividends paid by a REIT only if the beneficial owner of the dividends is (i) an individual holding less than a 10% interest in the REIT, (ii) a person holding not more than 5% of any class of the REIT's stock and the dividends are paid on stock that is publicly traded, or (iii) a person holding not more than a 10% interest in the REIT and the REIT is diversified.

Tax administration

Taxable period

US corporate taxpayers are taxed on an annual basis. Corporate taxpayers may choose a tax year that is different from the calendar year. New corporations may use a short tax year for their first tax period, and corporations may also use a short tax year when changing tax years.

Tax returns

The US tax system is based on the principle of self-assessment. A corporate taxpayer is required to file an annual tax return (generally Form 1120) by the 15th day of the fourth month following the close of its tax year. A taxpayer can obtain an additional six month extension of time to file its tax return. Failure to timely file may result in penalties.

Important tax return due dates

Form No.	Title	Purpose	Due date
W-2	Wage and Tax Statement	Employers must provide employees with statements regarding total compensation and amounts withheld during year.	Must be sent to employees on or before 31 January.
1099 series	Various	Information returns to be provided to recipients of dividends and distributions, interest income, miscellaneous income, etc.	Must be sent on or before 31 January.
1120 series, including 1120S (for S Corps)	US Corporation Income Tax Return	Income tax returns for domestic corporations or foreign corporations with US offices.	15 April for C corporations, 15 March for S corporations (Form 7004 may be filed to obtain an automatic six-month extension)

Form No.	Title	Purpose	Due date
Schedule K-1	Partner's Share of Income (Loss) from an Electing Large Partnership	Information returns to be provided to partners by large partnerships.	15 March
1065	US Return of Partnership Income	Information returns to be filed by large partnerships.	15 March (Form 7004 may be filed to obtain an automatic six-month extension)
State tax returns	Various	Income tax returns for states where corporation carries on trade/business.	Varies, often 15 April

Payment of tax

A taxpayer's tax liability generally is required to be prepaid throughout the year in four equal estimated payments and fully paid by the date the tax return is initially due for that year. However, because a corporation that expects its tax liability for the tax year to exceed the small sum of USD 500 (based on its tax liability for the preceding year), almost all corporations are required to pay their full estimated tax liability for the year in their four estimated tax payments. For calendar year corporations, the four estimated payments are due by the 15th day of April, June, September, and December. For fiscal year corporations, the four estimated payments are due by the 15th day of the fourth, sixth, ninth, and 12th month of the tax year. Generally, no extensions to pay are allowed. Failure to pay the tax by the due dates as indicated above can result in estimated tax and late payment penalties and interest charges.

The instalment payments must include estimates of regular CIT, AMT, environmental tax, and, for foreign corporations, the tax on gross transportation income. To avoid a penalty, corporations must calculate the instalment payments based on at least 25% of the lesser of (i) the tax shown on the current tax return or (ii) the prior year's tax liability, provided that the tax liability was a positive amount in the prior year and that such year consisted of 12 months. However, corporations with taxable income of at least USD 1 million (before use of NOLs or capital loss carryforwards) in any of the three preceding years are not permitted to calculate the instalment based payment on the prior year's tax liability, except in determining the first instalment payment. Instead, such corporations must calculate the instalment payments based on the tax shown on the current tax return.

Penalties

Civil and criminal penalties may be imposed for failing to follow the Code when paying US taxes. The civil penalty provisions may be divided into four categories: delinquency penalties; accuracy-related penalties; information reporting penalties; and preparer, promoter, and protester penalties. Many, but not all, have exception provisions to cover reasonable cause. In addition, many have provisions directing how the penalties interact with the other penalties.

These four main civil penalty categories may further be divided. First, the delinquency penalties may be divided into failure to file, failure to pay, and failure to make timely deposits of tax. Failure to make timely deposits of tax applies to taxpayers required to make instalment payments and WHT payments.

Second, the penalties relating to the accuracy of tax returns are divided into the negligence penalty, the substantial understatement penalty, substantial overstatement

of pension liabilities, substantial estate or gift tax valuation underestimate, and the valuation penalties. These penalties are also coordinated with the fraud penalty to eliminate any stacking of the penalties. Again, like other provisions, the fraud penalty is not intended to be imposed as a stacked penalty.

The third category of penalties is the information reporting penalties. These penalties may be imposed upon those who only have a duty to report information to the IRS.

The fourth and final major categories of civil penalties are the preparer, promoter, and protester penalties. Currently, the most notable of these is the return preparer penalty for which there is a penalty for a position on a return for which the preparer did not have substantial authority. Also included in this provision is a penalty for wilful or reckless attempt to understate the tax liability of another person. Additionally, return preparer penalties may be imposed for failure to furnish a copy of a return or claim for refund to the taxpayer, sign the return or claim for refund, furnish one's identifying number, or file a correct information return.

Other promoter and protestor penalties include a penalty for promoting abusive tax shelters, aiding and abetting the understatement of tax liability, and filing frivolous income tax returns. Additionally, a court may award sanctions and costs if a person institutes or maintains a proceeding primarily for delay, takes a position that is frivolous, or unreasonably fails to pursue available administrative remedies.

In addition to these major civil penalties, international tax-related penalties for failures other than timely and accurate filing (e.g. wilful failure to report international boycott activity, failure of an agent to furnish a notice of a false affidavit relating to the WHT on dispositions of US real property interests, failure of a US person to furnish information relating to CFCs and controlled foreign partnerships, failure of a US person to report foreign bank accounts) exist. Pension and employee benefit related tax penalties exist that protect the policy reasons for the tax incentives, including, most notably, early withdrawal of pension funds. Another group of specialised penalties apply to exempt organisations.

Criminal penalties exist for situations when the failures to stay within the tax system are more egregious. Although applicable to corporate taxpayers, they are applied more frequently to individuals.

In addition to the penalty provisions, interest at statutory rates generally applies to underpayments of tax.

Tax audit process

Generally, the US tax system is based on self-assessment; however, many large and mid-size businesses are under continuous audit by the IRS and state tax authorities. The audits may include the entire list of taxes for which the business is liable. Smaller business and persons with lower incomes are generally subject to audit on a random basis.

Statute of limitations

The IRS generally has three years after an original return is filed to assess income taxes. A return will be deemed to have been filed on its due date, even if the return is actually filed on an earlier date.

Topics of focus for tax authorities
Currently, the IRS is focused on abusive payments related to contribution to capital of a corporation, domestic manufacturing deduction, foreign earnings repatriation, FTC generators, repairs vs. capitalisation change in accounting method, research credit claims, transfer of intangibles/offshore cost sharing, WHTs, and employee classification.

Tax shelter
Treasury regulations require taxpayers to disclose transactions determined to be abusive or possibly abusive. Current information on these transactions, known as listed and reportable transactions, is available from the IRS website (*www.irs.gov*).

Accounting for income taxes
For US federal tax purposes, the two most important characteristics of a tax method of accounting are (i) timing and (ii) consistency. If the method does not affect the timing for including items of income or claiming deductions, it is not an accounting method and generally IRS approval is not needed to change it. In order to affect timing, the accounting method must determine the year in which an income or expense item is to be reported.

In general, in order to establish an accounting method, the method must be consistently applied. Once an accounting method has been adopted for federal tax purposes, any change must be requested by the taxpayer and approved by the IRS. Changes in accounting methods cannot be made through amending returns. The two most common methods of accounting are the accrual basis and cash basis methods.

Other issues

Tax accounting and internal controls
Accounting Standards Codification (ASC) 740, Income Taxes (formerly known as Financial Accounting Standards Board [FASB] Statement No. 109, Accounting for Income Taxes) addresses how companies should account for and report the effects of taxes based on income. ASC 740's principles and requirements apply to domestic and foreign entities in preparing financial statements in accordance with US generally accepted accounting principles (GAAP), including not-for-profit entities with activities that are subject to income taxes. This scope includes: (i) domestic federal (national) income taxes (US federal income taxes for US enterprises) and foreign, state, and local (including franchise) taxes based on income; and (ii) an enterprise's domestic and foreign operations that are consolidated, combined, or accounted for by the equity method.

In recent years, controls around the accounting for income taxes have been a critical source of material weaknesses in companies' internal controls over financial reporting. Accounting for income taxes also has been a primary reason for restating financial statements. Management should ensure that its judgments and estimates are reasonable (e.g. assessing the need for a valuation allowance on deferred taxes) and that the underlying internal control processes are reliable.

The adoption of International Financial Reporting Standards (IFRS) in the United States is set by the Securities and Exchange Commission (SEC). The timeline included in the SEC's roadmap provides for adoption of IFRS in the United States between 2014 and 2016.

Corporate reorganisations

In general, a corporate reorganisation involving a merger, acquisition, or consolidation is a taxable event under the general recognition provisions of the Code. However, a corporate reorganisation that meets certain statutory and judicial requirements may qualify as a tax-free transaction, with gain or loss generally not recognised or deferred to a later date.

Foreign Account Tax Compliance Act (FATCA)

FATCA was enacted in 2010 to prevent and detect offshore tax evasion. While the name may imply that FATCA is directed at financial institutions, many global companies outside the financial services industry may be affected if they have entities in their worldwide network falling under the purview of FATCA, or have operational areas that make or receive payments subject to FATCA.

Multinational enterprises that are withholding agents were already obligated to report, withhold on payments, and document payees, but FATCA requires changes to these activities. FATCA mandates that multinational businesses evaluate entity payees differently, engage in withholding on certain gross proceeds transactions (a change from historic processes), as well as report different information to the IRS.

The withholding provisions of FATCA began 1 July 2014. Compliance with FATCA may require changes to existing systems and processes across business units and regions, the renewal of policies and day-to-day practices, and new tasks, such as registering with the IRS.

To mitigate certain foreign legal impediments to FATCA compliance, intergovernmental agreements (IGAs) also have been negotiated (with more to come) between the US Treasury and foreign governments. Under certain IGAs, including most of the IGAs signed thus far, information will be exchanged directly between the IRS and local governments. This obligates entities in IGA jurisdictions to report information to their government that may not have been required or permitted in the past.

Assessing FATCA's impact will require identifying whether an IGA may apply to the entity or payment stream at issue. Provisions in the final FATCA regulations or, if applicable, an IGA that provides more favourable results may be utilised. This likely will increase the complexity of the process, due in part to the multiple paths to compliance (e.g. regulations or an IGA). The regulators have focused on having consistent requirements in each IGA, but there are noticeable differences in the agreements signed to date.

US possessions

Puerto Rico, American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, and the US Virgin Islands have their own independent tax departments. Accordingly, they have their own rules. *See the Puerto Rico summary for more information about Puerto Rico taxation*.

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