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Frans Vanistendael, Prescient Prophet of Europe

by Stuart Gibson

Last month Frans Vanistendael, a regular contributor to Tax Notes International, wrote a thoughtful piece discussing how the growing refugee crisis in Europe could derail the EU’s efforts to coordinate tax policy and administration, and possibly jeopardize the existence of the union itself. (See Tax Notes Int’l, Oct. 5, 2015, p. 55.) He reluctantly forecast how — if leaders continue on their current path — the response of European countries in the Schengen zone to the flood of refugees from the Middle East could presage the end of the European Union. Recent events suggest he may have been more prescient than anyone thought.

Last week voters in Poland elected a new parliament. During its campaign, the Law and Justice party sounded populist themes that included some virulent anti-immigrant rhetoric. After the election, the new leadership turned its attention to raising the money needed to pay for its pre-election promises, including improving VAT enforcement and imposing special levies on supermarkets and banks (p. 410).

The victory of a party of eurosceptics in Poland might not, by itself, raise concerns about the future of the European Union. But other events in Europe suggest that Vanistendael’s predictions might not be far-fetched. Encouraged by the success of its neighbor Hungary’s border fence, Austria recently announced plans to build a fence along its border with its Schengen-zone neighbor Slovenia. Such a fence would violate one of the key terms of the Schengen agreement, which allows the free flow of people across borders of Schengen zone countries. That unexpected move has prompted Slovenia — which is only now beginning to feel the full impact of the refugee crisis — to threaten a fence along its border with non-Schengen-zone neighbor Croatia. According to Vanistendael, these are precisely the kinds of actions that could ultimately undermine the EU’s existence.

Despite these rumblings, the nations of Europe continue to improve tax coordination and transparency. Marking the end of an era of bank secrecy, Liechtenstein signed an agreement to exchange with the EU bank information on individual account holders beginning in 2017 (p. 400). That agreement follows a similar agreement reached with Switzerland in May and approved by the European Commission last week (p. 400).

Even with this progress, some in the European Parliament believe that Europe is moving too cautiously to stem cross-border tax abuse. Members criticized a recent decision of the Economic and Financial Affairs Council (ECOFIN) to weaken proposed rules on automatic exchange of tax rulings. In the meantime, the Special Committee on Tax Rulings and Other Measures Similar in Nature (TAXE Committee) approved a draft report recommending additional ways to improve tax coordination and transparency among member states. Before finalizing its report, the committee will give the large multinationals that had spurned earlier invitations one more chance to appear and explain their tax planning strategies. Google and Facebook have accepted this final invitation (p. 399).

Finally, when it comes to the treatment of bitcoin for tax purposes, the United States and Europe are miles (or kilometers) apart. Ajay Gupta discusses a recent ruling by the Court of Justice of the European Union holding that bitcoin is currency, and therefore exempt from European VAT. He contrasts that ruling with an IRS pronouncement that bitcoin is property — not currency — for U.S. tax purposes. Whether bitcoin is currency or property, many questions remain for U.S. taxpayers who gift or bequeath bitcoin. Gupta plans to address those questions next week (p. 384).

♦ Stuart Gibson is editor of Tax Notes International.
NEWS ANALYSIS

How Much Trouble Can Cash Management Be?

by Lee A. Sheppard

It’s hard to talk about football when the FIFA scandal is becoming gorier by the day. No soap opera in the Chelsea or Liverpool dressing rooms can match the daily drip feed of corruption from the sport’s governing body.

UEFA President Michel Platini’s hopes of distancing himself from his mentor Sepp Blatter and succeeding him have been dented by an undocumented $2 million payment he received from FIFA. Blatter said it was for accrued salary under a gentlemen’s agreement. Both men have been suspended from FIFA for 90 days while Swiss authorities investigate. The election of a FIFA president will still be February 26, 2016, and Platini may be disqualified.

Despite the objections of FIFA’s sponsors, Blatter refuses to resign from his post (he merely said that he will not stand for reelection). Sponsors Coca-Cola, McDonald’s, Visa, and Anheuser-Busch InBev have publicly asked Blatter to get out, with the beer company calling him an obstacle to FIFA reform. Both men have been suspended from FIFA for 90 days while Swiss authorities investigate. The election of a FIFA president will still be February 26, 2016, and Platini may be disqualified.

But we’re also getting closer to the answer to the question why the Europeans didn’t get rid of Blatter years ago and had to wait for the U.S. Department of Justice to start indicting his underlings. To put it succinctly, Blatter ain’t going down without taking everyone else down with him — perhaps even including the Kaiser.

That’s Germany national hero Franz Beckenbauer. Germany might have bought the 2006 World Cup — the bidding for which it won by a single vote. FIFA and the German football federation are investigating a €7 million payment by the latter to FIFA’s cultural program that may not have been used for its stated purpose (Spiegel, Oct. 16, 2015). The accusation is that the funds, lent by the head of Adidas, were used as a schwarze kasse with the full knowledge of the German bidding committee, headed by Beckenbauer.

“Without dirty tricks, Germany wouldn’t have had a chance of winning the bid to host the World Cup. But that’s no excuse . . . Decency must remain a core German value,” Spiegel intoned (Oct. 20, 2015).

FIFA has nothing on multinational companies when it comes to moving large sums of cash around the world. Around here, we’re used to a model of multinational behavior that says that all intragroup loans are phony, undertaken for the purpose of stripping income out of operating companies in countries with real tax systems. But multinationals really do need to get a lot of their cash into one place for business reasons and to satisfy outside lenders.

Obviously the one place that cash representing previously untaxed earnings cannot go is the United States, whose CFC rules are unique in treating inbound loans as repatriations. But for U.S.-parented multinationals, cash management outside the United States usually features a daily cash sweep and a tax haven group treasury company, in which some U.S. affiliates (but not parents or sub-parents) may participate.

Leaving U.S. law aside, what would base erosion and profit shifting changes in Europe mean for group cash management? Even though some governments made some effort to excuse group cash management operations from information reporting, they are not excused from other proposed rules for the simple reason that they are often amenable to income stripping.

Physical Cash Pooling

Multinationals like to have all their excess cash in one place, and their outside lenders like it that way too. The old-fashioned way to pool cash is physical — that is, a daily cash sweep from operating companies to a group treasury that creates interest-bearing intragroup loans booked as payables and receivables for tax purposes. Physical pooling has to be done currency-by-currency. The group treasury faces the outside for foreign exchange exposure.

If the group parent is a U.S. resident, it cannot be involved in cross-border physical pooling because a loan to it would be a subpart F inclusion (section 956).
The U.S. inbound loan rule is unique in its breadth. If the parent is Canadian, an inbound loan from an operating company is ordinary income unless it is either repaid within two years or paid out of active business income and the payer is resident in a treaty country. But physical pooling within the United States was widely practiced because of long-gone restrictions on interstate banking. Other tax questions involve back-to-back loans, transfer pricing, and thin capitalization. Some countries have withholding taxes on related-party payments or capital controls. Practitioners believe that BEPS will kill off physical pooling.

But physical pooling within the United States was widely practiced because of long-gone restrictions on interstate banking. Other tax questions involve back-to-back loans, transfer pricing, and thin capitalization. Some countries have withholding taxes on related-party payments or capital controls. Practitioners believe that BEPS will kill off physical pooling.

German companies use cash pooling around the world, according to Axel Bödefeld of Oppenhoff & Partner, who co-chaired a panel with Jack Bernstein of Aird & Berlis at the Vienna IBA. The EU interest and royalties directive (2003/49/EC) generally prevents withholding on interest payments. But this practice is becoming more difficult, because directors have to be given real power over the liquidity of subsidiaries, which cannot make deposits so large they would become insolvent. Tax authorities suspect that intragroup lending is just cover for income stripping, Bödefeld noted.

Interest deductions are subject to German interest barrier rules limiting deductions to 30 percent of EBITDA (section 4h of the Income Tax Act). Receivables on intragroup loans cannot be written down (section 8b-3 of the Corporate Income Tax). Moreover, a write-down of a receivable may be treated as a distribution of hidden profits (built-in gain) under some circumstances, such as when an operating company is not compensated for a guarantee. Payments on intergroup guarantees are also nondeductible.

But a recent German federal fiscal court case permitted a write-down under old law because the question raised by intragroup loans was the pricing of the interest charge, not the validity of the loan (Tax Notes Int’l, Aug. 1, 2011, p. 373). That same court questioned the constitutionality of the interest barrier rule (Tax Notes Int’l, Apr. 28, 2014, p. 329).

Bödefeld explained that legislation in Germany proposed a year ago would extend the hybrid mismatch rule currently applicable to dividends to interest payments, so that no deduction would be permitted for interest payments that are not taxed at the receiving end or paid under an instrument that is not treated as debt (Tax Notes Int’l, Sept. 28, 2015, p. 1111). If an operating subsidiary sends cash to a group finance company, it must be compensated for the loan at an arm’s-length rate, a German court has held.

Austria has a plethora of rules, as Michaela Petritz-Klar of Schoenherr explained. Austrian subsidiaries of foreign parents often participate in cash pools. Their participation is scrutinized for proper transfer pricing, thin capitalization, and low levels of taxation for the group finance company. Interest deductions are denied if the payee is low-taxed, the borrower is too thinly capitalized, or the debt is used in the acquisition of the shares of a related party (debt push-down rule).

The Austrian rule denying deduction of payments to low-taxed payees was introduced as a BEPS response in 2014. Petritz-Klar noted that the concept of low taxation includes not just low nominal rates, but also dividend exemption for payments on hybrids and low effective tax liability resulting from special rules like fictitious expense deductions.

Austrian rules demonstrate the mismatch between cash management and transfer pricing. Petritz-Klar explained that Austrian tax authorities want documentation and arm’s-length pricing, usually at the parent’s rate rather than the affiliate’s higher stand-alone rate. Deposit interest should be at a market rate, and the resulting spread produced by Austrian transfer pricing rules has to be allocated around the group away from the finance company, which the tax authorities see as a service provider.

Analysis whether cash pooling is business-driven or tax-driven is required, especially when there is no net
positive leverage. If tax authorities do not respect the formal arrangements, payments could be recharacterized as dividends or contributions of capital. Petritz-Klar admitted that the rules were more complicated than necessary.

China is a tough country for pooling because it has capital controls. The renminbi is generally convertible only for trade in goods and services. Steven Nelson of VNS Tax & Legal explained that lending requires a banking license, so loans have to be run through licensed banks that charge fees for entrusted loans.

So companies could only do cash pooling within China until recently, when some multinationals were given permission for cross-border cash pooling. Regulations were issued. The Shanghai Free Trade Zone has a separate cash pooling scheme (Tax Notes Int’l, Oct. 7, 2013, p. 27).

Regulations issued in 2014 permit cash pooling between an operating company in the Shanghai Foreign Trade Zone and domestic affiliates (for renminbi) and foreign affiliates (for foreign currency). The operating company would have to be the cash pool leader, using a foreign trade account, according to Nelson. But there is no limit on the amount of borrowing or lending. The chief limitation is that the cash cannot come from outside lending; it must be generated from operation and investment by pool members. Nelson expressed skepticism that this limit could be enforced, given that pool members could be outside the zone.

More regulations issued in 2014 permit foreign exchange pooling with a Chinese pool leader, Nelson noted. Approval is required. There are limits on foreign exchange entering and leaving China. Foreign exchange can be converted into renminbi for genuine business purposes and invested in financial assets. Unrelated suppliers and customers can join the pool. Cross-border renminbi pooling requires approval from the People’s Bank of China. But there are quotas, and pool funds cannot be invested in financial assets (Circular 234).

China has a slug of withholding taxes on interest and guarantee fees, and there has been no word about any special treatment of cash pooling, according to Nelson. Interest deductions would not be a problem as long as transfer pricing rules were obeyed. Some rates have been challenged. Net interest income is subject to business tax, which is being converted to VAT.

Meanwhile, Hong Kong and Singapore compete with each other with tax benefits for regional treasury centers. Neither withholds on outbound interest. Both have lots of treaties and low rates. But Singapore has a big edge in this competition on lifestyle considerations, Hong Kong-based Nelson noted.

Canadian rules are very complex. The Canadian affiliate is usually a lender, in the experience of Alain Ranger of Fasken Martineau DuMoulin, who spoke at an IBA conference in London earlier this year. If a Canadian company makes a loan to a sister foreign group finance company, it is treated as a constructive dividend to the group parent, includable in its income, if the loan is left outstanding for a year after the tax year when it was made.

The deemed dividend is subject to 15 percent withholding, which is refundable when the loan is repaid. The Canadian lender will be deemed to receive interest at a prescribed rate. But this rule can be avoided if the parties elect to include interest income at a penalty rate, Ranger explained.

What if the Canadian company was not making its own decisions — as is likely to be the case in a cash pool? Canada’s foreign affiliate dumping rules could treat that loan as a dividend to the parent followed by on-loan to the finance company. These hurdles explain why much Canadian cash pooling is notional.

**Notional Cash Pooling**

Notional pooling involves an outside bank. All members of the cash pool make deposits and withdrawals at the bank’s branches. One affiliate functions as cash pool leader. Cash movements across borders are minimized because each bank branch participates. No intragroup loans are created for tax purposes because all the borrowing and lending are by the bank (although some tax administrators may take a different view).

Each member has an individual bank account. The funds in each account are virtually, but not legally, consolidated to form a group balance for purposes of cash management. No cash pool member’s contractual relationship with the bank is affected by the virtual consolidation (a bank deposit is a contract, not a bailment).

Another way of looking at the virtual system is that the bank creates a shadow account for the group. At the behest of the cash pool leader, the bank debits and credits the shadow account for each member. Interest is debited and credited to and from the bank, and is respected for tax purposes. The cash pool leader gives instructions to the bank about where to deploy money that both the bank and the operating companies have on deposit or borrow.

Any member of the pool may be in the posture of borrower or lender depending on its net position with the pool. The bank typically limits the group’s total borrowings to the sum of the group’s outside lending limit plus total group members’ deposits. So deposits effectively serve as collateral for payment of bank loans to the group’s net borrowers. There may be negative balances if the group borrows a lot, on which all pool members would be jointly liable.

No intragroup debt is created because all the borrowing and lending are by the bank, according to Ranger. Because a cash pool arrangement is usually set up for business reasons, tax advisers may not be present at creation or monitoring.
If specific entities should not be net borrowers, this constant fluctuation can cause tax advisers to tear their hair out. Notional pooling requires a lot of daily, weekly, monthly, and annual monitoring for tax purposes, even though it was set up for business purposes, according to Ranger. If, at the end of a day, there is more debit than credit, the parent may be required to inject cash into the pool.

The bank treats individual virtual loans and deposits as netted, so that the bank may be acting as an agent, Sam Kaywood of Alston & Bird suggested at the London IBA. Ranger responded that the agency problem may be exacerbated because the bank is often merely charging a fee for services of managing the virtual pool, rather than the normal spread between deposits and loans. If the bank is an agent, then some or all of the pool members would have a PE in the bank's country of residence.

Canadian companies often use notional pooling because physical pooling is difficult, according to Ranger. The multinational guarantees its outside debt with the bank deposits. Usually the group members on the credit side give guarantees to the group members on the debit side. Effectively the parent guarantees all borrowing. Ranger explained that the guarantees need to be priced reasonably so that losses on the loans can be tax deductible (General Electric Capital Canada Inc. v. The Queen, TCC 563 (Dec. 4, 2009)). There may be corporate law restrictions on guarantees.

Some multinationals are not in the habit of charging for intragroup guarantees. Kaywood noted. Ranger responded that there could be a deemed dividend if no guarantee fee was charged on a parent guarantee.

Notional cash pooling avoids a lot of problems raised by physical pooling. But in the minds of some tax authorities, it may not be notional at all. When it adopted German-style interest barrier rules, Italy restricted deduction of net interest arising in notional cash pooling (Tax Notes Int'l, May 11, 2009, p. 481).

Austrian tax authorities see notional pooling as mere service provision, for which cash management fees are appropriate, according to Petritz-Klar. That is, a nice, fat bank-like spread cannot be attributed to a group finance company doing notional pooling.

According to a recent ruling by the Canada Revenue Agency, the Canadian general antiabuse rule may apply to notional pooling because it may be an avoidance transaction, Ranger explained. The CRA’s theory appears to be that notional pooling is the equivalent of physical pooling. According to proposed legislation for back-to-back loan rules, deposits to the bank would be intermediary debt or a tainted right to use property. (Prior analysis: Tax Notes Int'l, Nov. 10, 2014, p. 529.)

A recent Portuguese transfer pricing case provided a window on notional cash pooling through the Netherlands. The subsidiary was always a net creditor and its parent was always a net debtor in their notional cash pool. Using the bank's regular interest rates, the difference between the pool's debt and credit rates was 121 basis points. The parent had outside borrowing. The tax authority argued that the subsidiary's constant credit position effectively guaranteed the parent's outside loans, so it should be better compensated at 159 basis points (Tax Notes Int'l, June 3, 2013, p. 999).

The arbitrators went for a profit split instead, rejecting the tax authority’s argument for a comparable uncontrolled price. Two aspects of this case are notable. First, the tax administrator argued that a virtual lending relationship created a real lending relationship because of the parties’ constant postures. Second, the European Commission appears to be arguing for a comparable uncontrolled price in the Fiat state aid case.

There could be a VAT issue for a group treasury. A group treasury that sits above operating companies, as is usually the case, would be combined with them for VAT purposes (VAT filing group). Physical cash pooling is an exempt activity akin to banking. But the operating companies’ combination with the group treasury could result in the denial of recovery of input VAT for the former. Petritz-Klar noted that notional cash pooling, by contrast, is a service subject to VAT.

“It's not clear how a notional shadow bank account in a foreign country works under U.S. law,” said Michael Jacoby of EY at the Vienna IBA. Notional pooling is not free from questions about interest deductibility, intragroup guarantees, thin capitalization and repatriation of operating company earnings.

**Substance Requirements**

At the London IBA, Pano Pliotis of GE explained that notional cash pooling nonetheless requires a Netherlands or Luxembourg entity that is a cash pool leader and has a customer relationship with an unrelated bank.

A group finance company need not involve any personnel. It can be on autopilot. Often companies want it that way because they don’t want to have to get a banking license. The Netherlands and Luxembourg are favored jurisdictions for group treasuries, but disfavored for sending personnel.

Cash pooling using the Netherlands is usually notional, according to Ewout van Asbeck of Van Doorne NV, who spoke at the London IBA. Cash pooling is usually done with a single currency for simplicity, but multiple currencies can be used. Van Asbeck explained that Dutch tax authorities are not pursuing compensation for guarantees, but are thinking about whether to require charges for guarantees. His view was that fees should be charged for guarantees.

A lot of EU cash pooling is run through Luxembourg and the Netherlands, where the work is done, because of advantageous treaty networks, according to
van Asbeck. Banks in both countries have good systems for cash pooling. A Dutch ruling frees the recipient from many burdens. No operating company participating in pooling would be deemed to have a PE in the Netherlands, which has no thin capitalization rules, withholding tax on intragroup interest, or stamp duties.

Dutch law requires a group treasury to have sufficient capital to carry out its functions in order to be considered the beneficial owner of the interest paid to it. Otherwise it would be considered a service provider, according to van Asbeck. It must have equity at risk equal to 1 percent of its loan book up to a maximum of €2 million equity. Profit-participating loans are used to remove profits from the Netherlands.

A Dutch group treasury is allowed to operate cost-plus basis. The Dutch tax rate is 20 to 25 percent, but being allowed to run an intragroup financial intermediary on a cost-plus basis reduces the tax base greatly. The Dutch practice permits the small spread to be split evenly between the group finance subsidiary and the headquarters treasury department (Decree IFZ2004/126M and Decree IFZ2004/127M of Aug. 11, 2004).

Both countries will continue to issue rulings because they believe that they have done nothing wrong, according to van Asbeck. The commission ruled that Fiat received prohibited state aid in the form of a selective advantage that reduced its Luxembourg tax liability by €20 million to €30 million (IP/15/5880). Luxembourg griped that the criteria used were unprecedented.

The commission ruled that because Fiat Finance and Trade Ltd (FTT) was comparable to a bank, it should have earned comparable profits. The commission accused the Luxembourgian authorities of using a complex transfer pricing method to artificially lower the FTT’s tax liabilities. Specifically, the chosen method used a capital base that was too low, so that the rate of return on this capital was below market. FTT should have had adequate capital, and should have earned a market return on it.

That is, Luxembourg ruling policy required too small a spread in group finance companies. When the standard 25-basis-point cost-plus margin was subjected to Luxembourg’s regular 29 percent rate, the result was a tax base lower than actual financial income. Moreover, the tax base did not vary with FTT’s actual performance.

Luxembourg group finance company rules are substantially similar to Dutch finance company rules. So every multinational that has a Dutch or Luxembourg group finance company has to worry about the commission ruling. (Prior analysis: Tax Notes Intl’, Oct. 13, 2014, p. 106.)

FTT is not unique. Every Luxembourg group finance company got the same ruling — to the point that Luxembourg practitioners argue that there was no selectivity. (Multinationals are a select group according to Commission v. Gibraltar, C-106/09 and C-107/09.)

So what happens when one of these hollow entities runs up against substance requirements? Dutch law does have some minimal substance requirements (Decrees DGB 2014/3098, DGB 2014/3099, DGB 2014/3101, DGB 2014/3102, and DGB 2014/296M of June 3, 2014). Qualified personnel are required for substance, but they do not have to be employees of the company. But its board meetings, bank accounts, and books must be in the Netherlands. Practitioners advise putting warm bodies in group finance companies.

(Prior analysis: Tax Notes Intl’, May 19, 2014, p. 645.)

German CFC rules claw back interest income earned in a low-tax jurisdiction unless the group finance company has substance (section 7 et seq. of the Foreign Tax Act). EU CFC rules are required to permit flight to low-tax jurisdictions when there is substance (Cadbury Schweppes PLC and CSO Ltd. v. Commissioners of Inland Revenue, C-196/04).

Petritz-Klar explained that Austrian tax law has substance requirements to respect the payee of interest as the beneficial owner, so there may be questions when interest is paid to a group finance company. There must be bodies and office space and real decision-making as to the disposition of funds.

Conduits are ignored; the focus is on the ultimate payee. Petritz-Klar said that this inquiry could be perversely circular, with taxpayers arguing that a payee has no substance to get a result. Back-to-back loans are disfavored and guarantees are scrutinized.

Hybrids

At the London IBA, Kaywood explained that preferred equity certificates (PECs) and convertible preferred equity certificates (CPECs) are used to shelter income earned by a Luxembourg group treasury, which is usually opaque. PECs and CPECs are loaded with a lot of equity features so that the United States will consider them equity. Luxembourg treats them as debt, and interest is deductible. Usually the group treasury issues PECs or CPECs to its U.S. parent, with subordination and very long terms like 30 years.

According to Pliotis, the design issue is that the PECs or CPECs should not be considered preferred equity, which would remove deferral. The design should ensure that these hybrid instruments are treated as common equity. Interest payments to the U.S. parent are deferred indefinitely.

Kaywood noted that BEPS action 2 would hit the use of hybrid instruments. The action 2 secondary rule and the amended parent-subsidiary directive require EU member countries to change their laws to deny a dividend exemption (Directive 2015/121). The European parent would have to treat deductible payments from a cash pool leader as income after those changes are made.

Luxembourg recently issued a draft law that would comply with the amended directive. A Luxembourg
holding company would not enjoy a participation exemption if dividends paid to it were deductible by an EU-resident payer (article 166 of the Luxembourg Income Tax Act). Ireland responded by requiring a business purpose for dividend relief.

HM Revenue & Customs recently issued a consultation document on BEPS and hybrid mismatches, which proposed new rules based on the BEPS action 2 report. Jacoby noted that the U.K. government may be looking at CPECs. That and other factors may mean that some EU cash pooling may have to be unwound.

**Section 956**

"It would be very unwise to have the U.S. parent as part of a cash pool unless there is a compelling business reason and you could always be sure that it will have a net positive position as a lender," said Pliotis, noting that each operating company’s balance and its legal significance has to be evaluated separately if the taxpayer is relying on netting.

Section 956 treats a CFC’s investment of earnings in U.S. property as gross income that should be included by U.S. shareholders. Investment in U.S. property is measured at the end of each quarter of the CFC’s tax year. The amount included by U.S. shareholders is the lesser of the excess of the shareholder’s pro rata share of the U.S. property held by the CFC over the shareholder’s share of previously taxed earnings and profits, or the shareholder’s pro rata share of the CFC’s undistributed earnings and profits.

Section 956(c)(1)(C) defines U.S. property to include an obligation of a U.S. person, which would include a loan to the CFC’s U.S. parent. Reg. section 1.956-2T(d)(2)(i) defines the term "obligation" to include “any bond, note, debenture, certificate, bill receivable, account receivable, note receivable, open account, or other indebtedness, whether or not issued at a discount and whether or not bearing interest.”

Even though the cash pool lender may have a low margin, there is a risk that debt finance from the operating companies would be aggregated so that it could be considered to be lending to the United States. Cash pooling is considered commingling, so cash pooling has been deemed loans to U.S. parents in some cases, Jacoby explained at the Vienna IBA (Gulf Oil Corp. v. Commissioner, 87 TC 548 (1986), aff’d in part and rev’d in part on other issues, 914 F2d 396 (3rd Cir. 1990)).

Moreover, credit support for U.S. parent borrowing could be treated as an inbound loan. Cross-guarantees by the U.S. parent would be treated as an outbound service. Cross-guarantees among CFCs could be a problem, according to Jacoby, until the look-thru rule has been reauthorized (section 954(c)(6)). Moreover, if all the entities below the U.S. parent are checked, the operating companies could be deemed to have made a payment to the United States. Wouldn’t it be better to avoid intragroup guarantees? Sometimes outside creditors ask for them, according to Jacoby.

At the London IBA, Kaywood noted that a U.S. law firm is being sued by a bankruptcy trustee for malpractice for planning to make a CFC jointly and severally liable for parent borrowing, costing the bankrupt client hundreds of millions of dollars of taxes. He pointed out that even if the foreign tax credit would shelter a section 956 inclusion, it is unlikely that a multinational booked a reserve for the U.S. tax, so there would be an immediate hit to earnings.

Debt funding to the cash pool coming from outside could be aggregated with a loan back to the US to enlarge the section 956 inclusion because of the funding antiabuse rule for corporations, said Pliotis at the London IBA (reg. section 1.956-1T(b)(4)). Under that regulation, a CFC will be treated as holding U.S. property held by an affiliate if one of the principal purposes of funding that affiliate is to avoid section 956. That is, the cash pool leader would be treated as a conduit. (Prior analysis: Tax Notes Int’l, Oct. 26, 2015, p. 299.)

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NEWS ANALYSIS

Spinning China and Tracking Clouds — Yum and Dell

by Mindy Herzfeld

Yum! Brands Inc. has announced plans to spin off its Chinese operations into a separate, publicly traded company. The transaction was rumored for some time, as activist investors agitated for Yum to separate its high-growth Chinese business from the rest of the group. Yum stock rose 5 percent in response to the announcement.

The Yum Chinese spinoff implicates many of the same U.S. income tax issues that led to the structure Yahoo Inc. pursued in spinning off its Alibaba stake. But the Yum spin shouldn’t cause the same concerns at the IRS that have created problems for the Yahoo deal and were addressed in Notice 2015-59 (2015-40 IRB 467). That is because Yum’s Chinese business is wholly owned, appears to be composed primarily of active assets, and seems to include a large operating business. Nonetheless, the Yum spin, like the Yahoo transaction, likely will leave the spun-off company with an unwieldy structure, in which a foreign business will be stuck under a U.S. holding company.

The October 20 news of Yum’s spinoff closely followed the announcement of another large deal, Dell Inc.’s acquisition of EMC Corp. The Dell-EMC transaction breaks new ground in its use of tracking stock as acquisition currency. The complex structure of the Dell-EMC transaction, which allows the Dell parent company to retain some aspects of private company status while also tapping into the liquidity of the public capital markets, may presage a future trend as companies navigate between public and private company status and the tax rules impose increasingly stringent burdens on publicly traded multinational enterprises. The deal also raises questions about how many of the newly proposed rules under the OECD’s base erosion and profit-shifting project will apply to transactions like this one.

Announcing the Yum Spin

Investors have long pushed Yum to split off its Chinese operations. (Prior analysis: Tax Notes Int’l, June 8, 2015, p. 871.) The company said the decision to split followed a rigorous review of strategic options conducted over the past year.

According to the press release announcing the deal, Yum plans to separate into two independent, publicly traded companies. Yum China (the SpinCo) is to become a franchisee of Yum Brands in mainland China. The release says Yum China will have an attractive investment profile and large opportunity for growth, with no significant debt, and that Yum is committed to returning substantial capital to its shareholders in conjunction with the separation (available at http://www.yum.com/company/ithenews/pressreleases/102015.asp).

Yum says it expects to complete the transaction — which it plans to qualify as a tax-free reorganization for U.S. income tax purposes — by the end of 2016. While the transaction is contingent on, among other things, receipt of an opinion of counsel regarding some tax matters, Yum did not indicate whether it will be applying for an IRS ruling for it. It said details about the legal structure and form of the transaction will come later.

Technical Aspects

The rules of section 367 are designed to prevent U.S. taxpayers from disposing of foreign assets without recognizing and paying U.S. tax on the historic buildup of earnings associated with those assets. Section 367(a) generally requires gain recognition when a U.S. person transfers assets to a foreign company in an otherwise nonrecognition transaction. Thus, if Yum Brands U.S. transferred its China business to a new foreign holding company, section 367(a) could require recognition of gain (subject to possible exceptions, including deferral with a gain recognition agreement).

Similarly, section 367(b) requires gain recognition on some transactions between two foreign companies or on other transfers involving a foreign company and a U.S. company. In general, a distribution by a U.S. company of the stock of a controlled U.S. company may qualify as tax free under section 355 to the distributing company and its shareholders, provided the distribution meets several applicable requirements. But this general tax-free rule may not apply when a spin-off involves a foreign person.

Under section 367(e), gain must be recognized in the case of a distribution from a domestic to a non-U.S. person that would otherwise qualify for nonrecognition under section 355. The Treasury regulations expand upon and clarify the statutory rules. Reg. section 1.367(e)-1(b) restates section 367(e) and provides that if a domestic corporation makes a distribution of stock or securities of a corporation that otherwise qualifies for nonrecognition under section 355 to a person that is not a qualified U.S. person, the distributing corporation generally must recognize gain (but not loss) on the distribution. But an important exception in reg. section 1.367(e)-1(c) provides that the general rule won’t apply in a spinoff of a domestic corporation. In short, because of reg. section 1.367(e)-1(c), the statutory gain recognition rule of section 367(e) applies only to spinoffs of foreign companies.

The regulations under section 367(b) also contain rules that could make the spinoff of a foreign company by a U.S. company costly from a tax perspective. Under reg. section 1.367(b)-5, a distribution of foreign China SpinCo shares from Yum to its shareholders that...
otherwise qualifies as tax free under section 355 could also trigger gain to Yum or its shareholders. Other sections may also apply to cause gain to be triggered within the Yum group in a pre-spin restructuring.

Thus, because of the tax inefficiencies involved in both pre-spin restructurings and the spinoff itself, Yum will probably be unable to transfer its Chinese operations into a foreign company and then spin that foreign company out to its shareholders. Instead, it is likely that the Yum Chinese assets would first be transferred to a U.S. holding company, which would then be spun-off to shareholders.

The Yum China SpinCo could merge with a foreign company after the spinoff, subject to the gain recognition rules of section 355(e). But that would implicate the anti-inversion rules of section 7874 and section 367.

Yum Tax Profile

In 2014 Yum Brands had an effective tax rate of 25.5 percent on ongoing operations. The company attributes that rate — which is lower than the combined headline U.S. federal and state rates — to the fact that most of its income is earned outside the United States, where tax rates are generally lower. Yum emphasized that point when it noted in its 2014 financial statements that the benefit of lower overseas rates was negatively affected in 2012 by the repatriation of then-current-year foreign earnings.

In its 2014 annual report, Yum reported a $2 billion book-tax difference in the basis of its foreign subsidiaries, reflecting $2 billion of indefinitely reinvested foreign earnings that could result in U.S. residual tax on repatriated amounts.

Yum’s 2014 financials included the following explanation of the interaction between its foreign earnings, its tax rate, and its U.S. cash needs:

A significant percentage of our profit is earned outside the U.S. and taxed at lower rates than the U.S. statutory rates. Historically, the cash we generate outside the U.S. has principally been used to fund our international development. However, if the cash generated by our U.S. business is not sufficient to meet our need for cash in the U.S., we may need to repatriate a greater portion of our international earnings to the U.S. in the future. We are required to record income tax expense in our financial statements at the point in time when our management determines that such funds are not permanently invested outside the U.S. This could cause our worldwide effective tax rate to increase materially.

In other words, when Yum needs cash in the United States, its overall tax rate may be higher. But Yum needs to reserve U.S. taxes on its foreign earnings only to the extent that it lacks cash in the United States to fund its operating needs, including paying dividends. The 2014 financials tout Yum’s strong track record of returning cash to its shareholders, noting that over the last five years the company has repurchased 61 million shares and paid dividends that grew to $669 million in 2014.

U.S. SpinCo, Foreign Ops

Yum’s dividend history is relevant to the tax analysis because it appears that investors will expect the China SpinCo to continue Yum’s dividend practice. This is especially true where SpinCo is being billed as a company with strong cash flow and no debt. But the China SpinCo may be unable to continue to pay out its free cash flow as dividends without incurring a significant increase in its effective tax rate.

China’s corporate income tax rate is generally 25 percent. It is difficult to insert leverage into a Chinese company, especially one that generates cash and profits. If the only assets to be spun off are Chinese, this would also limit the tax planning options that might otherwise be available to reduce U.S. tax on a repatriation of foreign earnings. Absent a transaction that would allow for a U.S. asset basis step-up in the Chinese assets at the time of the spin, the company would
likely incur residual tax at a full U.S. and state effective rate on the China earnings at the time of repatriation. And if the China SpinCo is to remain debt free, the only place Yum could get that cash would be from the Chinese earnings. Thus, if Yum China is to pay regular dividends, the effective tax rate of the China SpinCo may be significantly higher than Yum’s historical effective rate.

Even if Yum China could eventually merge with a foreign company in order to get its parent company out of the United States, this would not automatically enable the Chinese business to escape the U.S. tax net. The U.S. tax rules work collectively to ensure that the earnings from a valuable business developed by a U.S. company overseas will continue to be taxable in the U.S. in perpetuity.

**Dell-EMC**

On October 12 Dell and EMC announced that they would combine in a transaction in which Denali Holding Inc., a U.S. company and the parent of Dell, would acquire the shares of EMC for a combination of cash and Denali common stock. The Class V common stock being issued as consideration for the acquisition is a tracking stock that will track the earnings of a subsidiary of EMC, VMware Inc. EMC currently owns 81 percent of VMware, with the remaining shares held by the public. The Class V common stock will not track 100 percent of Denali’s interest in VMware, but will track only 65 percent of EMC’s (81 percent) economic interest in VMware, or 53 percent of the total economic value of VMware. VMware and EMC will become part of Denali’s consolidated group for U.S. federal income tax purposes.

Through Denali, Dell is owned privately by Michael Dell, his privately held investment fund, and the private equity firm Silver Lake. The issuance of publicly traded tracking stock by a company whose other classes of common shares are privately held appears to be a novel way to use a tracking stock structure.

Dell explained that it is using tracking stock to acquire the EMC shares in order to give EMC shareholders the opportunity to benefit from any value creation from the expected revenue synergies with Dell. But that doesn’t really explain why an ordinary common stock interest in Dell that tracks the value of both Dell and EMC couldn’t provide those same benefits. The companies say that owning EMC’s interest in the VMware business represents a fundamental part of Denali’s strategic rationale for this transaction, that VMware’s success is important to the business strategy of a combined Dell and EMC, and that Denali believes it is in the best interests of its common shareholders for them to retain a large economic interest in the VMware business.

Dell says it expects that the value of the Class V common stock will be closely correlated to the value of VMware Class A common stock (the publicly traded shares). Further, the public materials state that, given constraints on the amount of cash financing available for the transaction, the issuance of the tracking stock enables Denali to pay a higher purchase price for EMC than it could in an all-cash transaction. Again, these responses raise the question of why the same objectives couldn’t have been achieved by issuing an ordinary class of Denali common shares as consideration.

The explanation of the terms of the tracking stock states that holders of Class V common stock will receive Forms 10-K and other SEC filings that include Denali consolidated financials and segment information with financial results for Denali’s VMware business segment. Class V common stockholders will have voting rights that entitle them to vote together with Denali’s other classes of common stock as a single class to elect three independent directors of Denali and on all other matters to be presented to Denali’s common stockholders for a vote.

Michael Dell and his investment fund MSD Capital will own a class of common stock that, in addition to voting for the three independent directors, elects a separate class of directors. Silver Lake Partners (the private equity owner of a portion of Denali) will own a separate class of common stock that, in addition to voting for the three independent directors, elects another separate class of directors. The common shares owned by Michael Dell, MSD Capital, and Silver Lake Partners will entitle them to 10 votes per share, while the Class V common stock will have one vote per share. As a result, the Class V common stock shareholders will have about 4 percent of the total votes at Denali.

In an investor call held when the deal was announced, management emphasized the benefits of Dell continuing to be privately held. Taking Dell private several years ago, they said, gave them flexibility to innovate. They added that the parent company being private simplifies a lot of things for the EMC structure.

It is difficult to reconcile those statements with the intended tax treatment of the tracking stock. In order not to be treated as owning a direct interest in the assets or the subsidiaries of the issuing company for U.S. tax purposes, the tracking stock must be respected as stock issued by the parent company, with the potential to lose value should the non-tracked businesses experience a downturn. Moreover, the company that issues tracking stock must file financial statements with the SEC, and those statements would have to include consolidated financials, accounting for both Dell and EMC. Despite management’s statements, Dell will not be a private company after the acquisition.

**Complex Structures and the MNE**

The complexity of the Dell-EMC post-acquisition structure calls into question many of the assumptions on which the BEPS project and its final reports are built. Those reports generally assume that a publicly
traded company that files consolidated financials has a single common interest that drives aggressive tax planning according to a uniform goal. In particular, the final report on action 7 — the permanent establishment standard — provides for the combination of the activities of group members to find a PE that would not exist by analyzing the activities of a single entity in the group. (Prior analysis: Tax Notes Int’l, Oct. 19, 2015, p. 207.)

Similarly, the new patent box guidelines that treat transactions between related and non-related entities differently also highlight the different (adverse) treatment afforded to group members. But as the terms of the Dell-EMC deal highlight, in the real world these concepts are difficult to apply — entities that file consolidated financials and a single U.S. consolidated tax return may nonetheless have very different incentives, and may have to interact more like third parties than related parties.

As companies begin to wrestle with the interpretation of the new BEPS guidelines, the implications of applying rules that uniformly treat consolidated groups as single units with a common interest will become clearer and will often lead to unintended results.

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**NEWS ANALYSIS**

**Bitcoin: Currency or Property; Tangible or Intangible?**

*by Ajay Gupta*

Accepting the proposition that bitcoin serves only as a medium of exchange, the Court of Justice of the European Union ruled October 22 that bitcoin is currency, not property, for purposes of EU VAT. The CJEU’s reasoned analysis is a study in contrast with the IRS’s arbitrary declaration that bitcoin is property, not currency, under U.S. tax law. Although commentators have been urging the IRS to reconsider its position, neither they nor the IRS seems to have thought through how that position affects determining the situs of bitcoin for U.S. transfer tax purposes.

**EU VAT Purposes**

In its October 22 ruling in Skatteverket v. David Hedqvist, C-264/14 (CJEU 2015), the CJEU held that exchanging traditional currencies for units of bitcoin is covered by the requirement in the EU VAT directive that member states exempt transactions relating to “currency, bank notes, and coins used as legal tender.” Agreeing with the observation in the advocate general’s opinion that bitcoin “has no purpose other than to be a means of payment,” the Court concluded that buying and selling units of bitcoin with and for traditional currencies falls outside the scope of article 24 of the VAT directive applying to “supply of goods.” Accordingly, the Court found these transactions to “constitute the supply of services,” a phrase that encompasses any transaction not deemed a supply of goods.

Holding this supply of services to be one for consideration, the Court next considered the application of article 135(1) of the VAT directive. Paragraphs (d) through (f) of that article exempt from VAT, respectively, transactions involving deposit and current accounts, payments, transfers, debts, checks, and other negotiable instruments (but excluding debt collection); currency, bank notes, and coins used as legal tender (but excluding metal coins or bank notes of numismatic interest); and shares, interests in companies or associations, debentures, and other securities (but excluding documents establishing title to goods).

Interpreting the text of article 135(1)(d) in light of relevant case law, the Court stated that it refers to transactions in “services or instruments that operate as a way of transferring money,” but not those that involve “money itself.” Observing that “unlike a debt, cheques and other negotiable instruments referred to in Article 135(1)(d) of the VAT Directive, the ‘bitcoin’ virtual currency is a direct means of payment between the operators that accept it,” the Court held paragraph (d) inapplicable.
Similarly, the Court found the transactions beyond the reach of paragraph (f) because “it is common ground that the 'bitcoin' virtual currency is neither a security conferring a property right nor a security of a comparable nature.”

In contrast with its treatment of paragraphs (d) and (f), the Court found paragraph (e) directly implicated. Declining to be restricted by an “exclusively textual” interpretation of the phrase “legal tender,” the Court examined the purpose underlying the exemption from VAT for transactions involving traditional currencies, and then considered whether that purpose extended to transactions involving another currency. Holding that the exemptions in article 135(1)(e) are intended to “alleviate the difficulties connected with determining the taxable amount and the amount of VAT deductible which arise in the context of the taxation of financial transactions,” the Court noted that those difficulties would arise with equal force in transactions involving “non-traditional currencies . . . currencies other than those that are legal tender in one or more countries.”

Pointing out that a currency that has been accepted by the parties to a transaction as an alternative to legal tender has no purpose other than to serve as a means of payment, the Court reasoned that a transaction in such a nontraditional currency continues to be a financial transaction for purposes of article 135(1)(e) and therefore worthy of its exemption from VAT. “To interpret that provision as including only transactions involving traditional currencies would deprive it of part of its effect,” the Court said.

Reiterating that bitcoin “has no other purpose than to be a means of payment [and] is accepted for that purpose by certain operators,” the Court concluded that article 135(1)(e) of the VAT directive exempts from VAT transactions in which traditional currencies are exchanged for units of bitcoin and vice versa.

U.S. Tax Purposes

The CJEU’s analytical examination of bitcoin’s functionality and purposivist reading of EU law stands in marked contrast with IRS Notice 2014-21 because of the avowed anarchic money laundering in 18 U.S.C. section 1956. Both cases arose out of the now-defunct website Silk Road, a marketplace for selling illegal drugs in exchange for bitcoin. In United States v. Fiacelli, 39 F.Supp.3d 544 (S.D.N.Y.2014), the court treated bitcoin as “funds” under the money transmission statute because it can “be easily purchased in exchange for ordinary currency, acts as a denominator of value, and is used to conduct financial transactions.” In United States v. Ulbricht, 31 F.Supp.3d 540 (S.D.N.Y.2014), the court again stressed bitcoin’s purpose as a medium of exchange, noting that “the only value for Bitcoin lies in its ability to pay for things.” Finding that this “sole raison d’être” of bitcoin puts it squarely within the reach of the money laundering statute, the court concluded unequivocally that “one can money launder using Bitcoin.”

In an earlier civil action, SEC v. Shavers, No. 4:13-CV-416 (E.D. Tex. Aug. 6, 2013), the district court held that the Securities and Exchange Commission’s enforcement jurisdiction covers bitcoin-based investment contracts, writing that bitcoin “is a currency or form of money.”

The IRS may have chosen not to follow this reasoning in Notice 2014-21 because of the avowed anarchical aspirations of bitcoin’s developers. In a 500-word essay that accompanied the 2009 launch of the computer code that established a peer-to-peer network for processing bitcoin transactions, the cryptocurrency’s...
founder or founders, using the name Satoshi Nakamoto, wrote: “The root problem with conventional currencies is all the trust that’s required to make it work. The central bank must be trusted not to debase the currency, but the history of fiat currencies is full of breaches of that trust.” Evidently, bitcoin seeks to negate the state. But 31 CFR section 1010.100(m) explicitly limits the definition of a currency to one that is legal tender in a jurisdiction.

Unlike the CJEU in Hegyvist, IRS Notice 2014-21 does not depose purposivism to get around the regulatory requirement that a currency carry the imprimatur of an issuing state. But even if it had and deemed bitcoin a currency, that would still not have answered the vexing questions of the cryptocurrency’s situs. An asset’s situs is critical not just for resolving whether the IRS has jurisdiction over it to satisfy outstanding U.S. tax debts, but also for establishing whether gifting or bequeathing the asset may give rise to U.S. transfer tax liability. If, as critics of Notice 2014-21 demand, bitcoin is treated as currency, where should it be sited? If, on the other hand, the IRS view prevails that bitcoin is property, is it tangible or intangible? In either case, what is its situs?

**Tangible vs. Intangible Dichotomy**

For both jurisdical and U.S. transfer tax purposes, cash — that is, the monetary instrument itself — is sited by physical location. Thus, for example, reg. section 25.2511-3(b)(4)(iv) suggests that a currency note is not treated as a debt obligation and therefore not automatically disregarded in considering the gift tax liability of a nonresident alien. In other words, a gift of cash made within the United States by a nonresident alien will usually be subject to gift tax. But the same gift made overseas will not.

By comparison, credit in a bank account is sited not by its physical location but by invoking the legal fiction of personal jurisdiction. Thus, transfers from a nonresident alien’s bank account — wherever located — escape liability for gift tax. The reason for treating cash and bank account deposits differently, of course, is that a bank account represents mere accounting entries rather than a customer’s segregated funds. Indeed, the contents of a safe-deposit box are sited by location, and a safe-deposit box located in the country has a U.S. situs.

On a more general level, the situs rules turn on whether the particular asset is tangible or intangible. Tangible assets like cash are sited where they happen to be physically located. Siting intangible assets, like bank account deposits, requires resorting to theoretical constructs of ownership and contacts. Consequently, even if the IRS did a U-turn on Notice 2014-21 and classified bitcoin as currency, the situs question would remain unanswered. Answering that question would require the IRS, for example, to specify that a unit of bitcoin is not just currency but also like a currency note, a tangible object sited by its physical location.

Conversely, Notice 2014-21, by itself, says nothing about which side of the dichotomy between tangible and intangible property bitcoin falls.

Ascertaining whether bitcoin is tangible or intangible is far from straightforward. At the outset, it may seem contradictory to posit that a digital currency like bitcoin may be tangible. After all, the *Ulbricht* court’s observation that bitcoin “cannot be put on a shelf and looked at or collected in a nice display case,” negates the dictionary definition of “tangible”: capable of being touched; discernible by the touch; material or substantial.

But *Yates v. United States*, 135 S. Ct. 1074 (2015), may be instructive in this regard. There, the Supreme Court held that an undersized red grouper did not constitute a “tangible object” within the meaning of 18 U.S.C. section 1519, enacted as part of the Sarbanes-Oxley Act of 2002. Finding the dictionary definition not dispositive of the issue, the Court considered instead “the specific context in which that language is used, and the broader context of the statute as a whole.”

By analogy, it may be argued that tangibility, for purposes of U.S. transfer tax situs rules, connotes intrinsic worth. Thus, currency notes lying in a safe-deposit box in a bank have intrinsic worth and are therefore considered tangible assets. On the other hand, a checking account balance in the same amount held at the same bank merely represents bookkeeping entries and is consequently treated as an intangible asset.

Like these currency notes, units of bitcoin have intrinsic worth that can be used, stolen, or irretrievably lost. A private key, consisting of an alphanumeric string, enables a bitcoin user to access his units of bitcoin from his bitcoin address, consisting of a different alphanumeric string, and transfer them to another user’s address. A so-called block chain, or shared public ledger, keeps chronological track of the transactions at each address and establishes its bitcoin balance.

Owning bitcoin comprises nothing more than owning the private cryptographic key to unlock a specific associated address. The owner may choose to store his private key or keys in any one or more of a number of places, including a paper printout, a hard drive, or an online wallet service. Stealing the private key enables the thief to use all units of the bitcoin at the associated address, unless the owner moves them to a different address first. Whereas victims of credit card theft can cancel the stolen card or reverse fraudulent transactions, bitcoin transactions are irreversible. Although the publicly available block chain allows anyone to see the address to which a thief may transfer units of bitcoin, the thief’s identity remains hidden. Similarly, losing the private key deprives the owner of the units of bitcoin at the associated address.

Clearly, the characteristics of bitcoin resemble more closely currency notes in a safe-deposit box than the balance in a bank account. And because possession of the private key can deprive all others of the bitcoin at
the associated address, the location of that private key should determine the situs of the bitcoin. But here is where the analogy to cash seems to break down. An owner may keep multiple copies of the private key in different locations — some real, others virtual. Moreover, he may split one private key into several smaller keys, all of which would be required to initiate and complete a transaction.

Yet, at least for U.S. transfer tax situs rules, those difficulties seem surmountable. For example, the location of the private key actually used to access and transfer units of bitcoin can determine whether a U.S.-sited asset was gifted. And because all split-up smaller keys must eventually be assembled into one operative private key to access and transfer units of bitcoin, the location of that assembled operative private key should determine the situs of the transferred bitcoin.

**Conclusion**

Both IRS Notice 2014-21 and its critics seem to ignore the challenge of determining the situs of bitcoin for U.S. transfer tax purposes. The questions raised and answers suggested here bear on whether a nonresident alien’s transfer of bitcoin may be subject to U.S. gift or estate taxes. We will examine the extent of any such liability in greater detail next week.

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**ECONOMIC ANALYSIS**

**Should We Promote or Punish Excess Profits?**

*by Martin A. Sullivan*

In recent years there has been growing interest in dividing profits between normal and excess profits and taxing each differently. For non-economists, the idea of artificially splitting profits into these two categories is puzzling enough. Adding to the confusion are seemingly contrary views about whether excess profits should be penalized or promoted. Sometimes economists advocate that excess profits should be taxed more heavily than normal profits. And sometimes the opposite course is recommended. To help sort all this out, let’s walk through the different reasons excess profits arise and the policy implications of each.

Historically, taxation of excess profits was mostly about redistributing the profits of corporations that were perceived as unfairly and excessively prospering from a national crisis. The United States imposed excess profit taxes during the First and Second World Wars and during the Korean War. In 1980 Congress imposed a windfall profit tax on major oil companies. Taxes like these aren’t part of the current policy debate.

To keep matters manageable, we assume that normal profits are determined by applying some low-risk or risk-free rate of return to net tangible capital. Excess profits are simply the residual after subtracting normal profits from total profits.

**No IP, No Profit Shifting**

Sometimes excess profits indicate that a business is making smart investments and is generating a genuinely high rate of return on its capital spending. Here it could be argued that excess profits should be fully taxed and that normal profits should be exempt from tax.

That offbeat approach to taxing profits is derived from basic economics. Suppose a business has the opportunity to invest in three $100 investment projects — the first with a 20 percent return, the second with a 15 percent return, and the last with a 10 percent return. If the company’s cost of funds is 12 percent, it will invest in the first two projects and skip the third. Assuming all equity financing of those two projects, the company will have total profits of $35 (20 percent of $100 plus 15 percent of $100). Using 12 percent as our assumed normal rate of return, normal profits will be $24 (12 percent of $200) and excess profits will be $11.

What is the effect of taxing excess profits? In this framework, fully taxing excess profits doesn’t affect investment. Taxing excess profits at, for example, 50...
percent reduces the after-tax profit of the first two projects, but there is still enough profit to make them worthwhile. The first project with $8 of excess profit would yield $16 after tax, and the second project with excess profit of $3 would yield $13.50 after tax. Both yields are still above the $12 cost of funds. For economists, that is an ideal tax because it does not change behavior.

What about an exemption for normal profits? That is simply another manifestation of the economic principle that taxes on capital income are not neutral. They create a bias against saving and investment. Thus, for efficiency’s sake, taxes on capital income should be zero.

But, again, only taxes on normal profits change behavior. So to promote economic growth, as much tax relief as possible should be directed to normal profits. Tax relief for excess profit is wasted because it is a windfall that does not change behavior.

That line of reasoning motivated the allowance for corporate equity that has been available in Belgium since 2006. In 2010 the highly regarded Mirrlees Commission recommended that the United Kingdom consider adopting an allowance for corporate equity.

One huge caveat: That approach is much less attractive if businesses have the option of locating some of their business activities outside the United States. In this case a business is deciding not only how much to invest but also where to invest. On this decision margin, each country’s taxation of all profits—not just taxation of normal profits—affects a company’s investment decisions.

### Profit Shifting

Sometimes excess profits arise in a foreign subsidiary because a multinational has successfully shifted profits into a low-tax jurisdiction. For example, suppose a U.S. parent and its Irish subsidiary each have $100 of tangible capital, generating a 12 percent return. But because the Irish subsidiary sells products at artificially high prices to its parent, the U.S. parent books $4 of profit and the foreign subsidiary books $20. In this case, the Irish subsidiary has excess profit of $8.

In those circumstances, if the United States determines its transfer pricing rules are inadequate, it may want to impose tax on excess foreign profits as a backup. That is the motivation behind the Obama administration’s proposed 19 percent minimum tax on foreign profits. Under the proposal, excess profits would be targeted with an extra tax that includes a deduction equal to a risk-free rate of return equity invested in active assets. As the official explanation puts it, the intention is to provide an exemption on “a return on the actual activities undertaken in a foreign country.” This proposal resembles the 15 percent U.S. tax on foreign base company intangible income proposed by former Ways and Means Committee Chair Dave Camp as part of his 2014 tax reform plan. Under the Camp proposal, the computation of foreign base company intangible income allows a deduction equal to 10 percent of the foreign subsidiary’s adjusted basis in depreciable property.

Although aggressive profit shifting often occurs with the transfer of intangible property, and the Camp proposal is described as a tax on intangible income, the targeted excess profits do not necessarily arise from intangible assets.

### Intangible Assets

In many cases, however, it may be that excess profits are entirely attributable to intangible assets. For example, suppose a business has $100 of tangible assets and $50 of hard-to-identify intangible assets, all generating a 12 percent return. If excess profits are measured by reference only to tangible assets, the company’s total profit will be measured as consisting of $12 of normal profit (that is, 12 percent of $100) and $6 of excess profit. Note that in this case, measured excess returns do not arise from profit shifting. And in fact, there may not actually be any excess return on any asset (if those assets were properly accounted for). There appears to be an excess return only because the returns on intangible assets are being attributed to tangible assets.

If excess profits are flagging the existence of an intangible asset, the question then arises why we might want to tax income from intellectual property differently than other income. Here are three possible reasons:

First, if the excess income identified is attributable to a patent or some other new technology generated by scientific research, it is likely that the asset is providing knowledge spillovers (positive externalities) that benefit the economy generally. In this case, it is appropriate for government to subsidize research because business on its own will invest in less than the socially optimal level of research.

One way to subsidize research is to provide a lower tax rate for income that comes from investment in research. This is one justification for proposed U.S. patent boxes. That line of reasoning only justifies a preferential rate for income from intangibles that generate positive externalities and therefore would not apply to trademarks and other marketing intangibles.

Second, if income from intangible assets is considered to be a category of income particularly vulnerable to transfer pricing abuse (because intangible assets are highly mobile and difficult to value), we may want to impose domestic tax automatically (as foreign base sales income is targeted for immediate taxation under current subpart F rules).

Both carrot and stick can be used to reduce profit shifting. The most straightforward alternative is to lower domestic tax rates across the board. That can be achieved by a general rate reduction. But given the high revenue cost, it might only be feasible to limit rate
reduction to particularly mobile income — in this case, income from intangibles. That is another justification for a patent box. The goal in this case is to prevent other jurisdictions — particularly those with patent boxes — from stealing our tax base.

In the United Kingdom, the calculation of net patent box profits includes a deduction for a routine return equal to 10 percent of the costs associated with generating patent box gross receipts. As a companion to his extra tax on foreign base company intangible income, Camp’s tax reform proposal includes a patent-box-like benefit for specific domestic intangible profits. Those profits are calculated by subtracting 10 percent of the net basis of domestic depreciable assets from qualified income.

Because this justification for a patent box does not depend on the existence of positive externalities, patent box benefits in this case should apply to a wide range of intangibles, including marketing intangibles. Here we are not necessarily talking about moving real business activity but about shifting the location of reported profits to increase U.S. tax revenue. The goal, simply stated, is to get U.S. corporations to pay tax to the United States instead of to foreign governments. It is even conceivable that there can be a salutary Laffer curve effect: Revenue can be raised by lowering rates.

Third, the justification for providing targeted tax relief for profits from intangible assets is rooted in the economic principle that, in order to minimize distortions, mobile capital should be taxed at a lower rate than immobile capital. To distinguish that from the case in which just the reported profit (not the underlying capital) is mobile, let’s suppose transfer pricing rules work perfectly (or for patent boxes, countries are adhering to OECD guidelines on modified nexus that require substantial activity to be associated with patent box profits).

Of course, a critical question for U.S. economic policy is whether research and development is mobile across national borders. That particular justification for a patent box, however, depends on demonstrating that investment in research is more mobile than other forms of investment. Given that U.S. multinationals are strongly inclined to spread manufacturing investment throughout the world while undertaking most research activity at home, it seems more likely that investment in research is less mobile.

Conclusion

If excess profits truly result from extraordinary profit levels, they may be taxed without affecting a company’s overall level of investment. However, governments must still be concerned that taxation of excess profits will affect the location of investment.

If excess foreign profits result from artificial profit shifting, the United States may want to impose U.S. tax on those profits as a backstop to inadequate transfer pricing rules. However, in practice this domestic tax can only be applied to U.S.-headquartered businesses and therefore cannot reduce profit shifting by foreign-headquartered multinationals.

If excess profits indicate that there are intangible assets, governments, for a variety of reasons, may want to tax domestic excess profits more lightly or tax foreign excess profits more heavily than other profits. If the goal is to promote domestic research, tax relief should be limited to excess profits from new technology and similar innovations.

If the goal is to raise revenue by inducing the legal relocation of mobile intangible assets (not necessarily with any increase in real business activity) into the United States, the U.S. government must keep its domestic rate on intangible income low relative to the combined U.S. and foreign rates on intangible income. A minimum tax or a tightening of subpart F rules can raise the tax rate on foreign profits. Foreign patent boxes can lower it. Also, to raise revenue without double taxation, the United States must also be able to prevent foreign governments from claiming tax jurisdiction over those profits.

To justify preferential treatment of domestic intangible income as an efficient investment incentive, it must be demonstrated that intangible-creating investment is more mobile than other types of investment.

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Film Documents International Tax Avoidance

by William Hoke

The U.S. premiere in New York on October 28 of the film The Price We Pay, which documents what the director says is widespread tax avoidance by multinational enterprises, was followed by a panel discussion in which the participants said serious steps must be taken to allow shortchanged governments to meet vital social needs.

The film, which debuted at the Toronto International Film Festival and has already played in Paris, was directed by Canadian filmmaker Harold Crooks. It is based on the book The Coming Fiscal Crisis by Canada’s Brigitte Alepin.

Early on, the film shows a U.S. Senate hearing in which an executive of Apple Inc. was asked about the tax domicile of one of its subsidiaries incorporated in Ireland. “It does not have a tax residency” was the halting reply of Phillip Bullock, who is identified as the head of the multinational’s tax operations.

That scene was effectively repeated various times throughout the film, with parliamentary committees in the U.K. grilling executives of various U.S. MNEs about their corporate structures and why they paid so little tax in the U.K. The executives invariably stammered in response to uncomfortable questions, citing “tax efficiency” or claiming that “we pay all the tax you require us to pay.” Those softball replies, while presumably legally accurate, were hit out of the park by legislators who snapped back by saying either, “Your tax efficiency is our tax avoidance” or “We’re not accusing you of being illegal; we’re accusing you of being immoral.”

Considering the film’s emphasis on U.S. MNEs, the fact that one of the members of Parliament skewering an Amazon executive was wearing stars and stripes suspenders in blazing red, white, and blue provided a curious counterpoint to the proceedings.

Differing Historical Perspectives

The film tries to show that modern-day tax avoidance has deep historical roots. William Taylor, a church vicar and Labour councilor in the City of London, said that to understand the relationship between the City of London and the rest of the metropolitan area, it is necessary to look to the distant past. And to understand that history, it is also necessary to know that the City of London, widely referred to simply as “the City” and colloquially known as the “Square Mile,” is home to a significant part of the U.K.’s financial sector.

“When William the First came to Britain from Normandy — a French king — to conquer the rest of the country, he stopped at the gate of the City of Lon-
don,” Taylor said. “He didn’t finish the job. The French never finished the job. And the City maintained the rights and privileges that existed in King Edward’s day.”

The film then turns to Stuart Fraser, who is identified as a stockbroker and former chair of the policy and resources committee of the City of London. Fraser talked about the City’s development over the centuries and how it has “built up quite a substantial amount of money which we use for the benefit of the nation.” Fraser said one of the City’s primary goals has been “to promote London’s financial services on a global basis.” Fraser added, “What’s good for the City is good for the country, providing that that money is earned fairly and squarely and doesn’t jeopardize the health of the nation, which it has not.”

Taylor clearly didn’t agree with Fraser’s view of the City’s beneficent impact beyond its immediate area. “The Square Mile of the City of London retains all of the ancient rights and privileges and resources of the ancient City of London, and the people who live outside of the City of London — those 8 million of which I’m one — don’t share those resources, although we are citizens of London,” Taylor said. “What you have today . . . you have this institution that promotes the single interest of finance capital and is using this huge network of resources to promote the single issue of finance capital. It’s a travesty of its history.”

The comments about France’s William the Conqueror “never finish[ing] the job” in 1066 were, perhaps, a clever setup for the introduction later in the film of Pascal Saint-Amans, the point man of the OECD’s action plan to counteract base erosion and profit shifting by MNEs. The film’s U.S. release came just three weeks after the G-20 finance ministers endorsed the OECD’s final reports on the 15 items in the BEPS action plan. (Prior coverage: Tax Notes Int’l, Oct. 19, 2015, p. 210.)

The French connection in righting the alleged wrongs of the City and MNEs was brought up later in the movie with a clip of Timothy Ridley, who is described as the former chair of the Cayman Islands Monetary Authority, speaking at an OffshoreAlert conference in Miami in 2013. “If we are now talking about tax avoidance being bad, that is a significant shift in the nature of the playing field,” Ridley said. “The particularly active players are, of course, the OECD in terms of the tax field. And the current head of the tax division, who’s a Frenchman, needless to say, [is] called Pascal Saint-Amans, who, by the way, doesn’t pay any tax on his OECD salary.”

Civilized Society

The film’s title is possibly a play on a quote that is generally attributed to U.S. Supreme Court Justice Oliver Wendell Holmes Jr. that taxes are the price we pay for a civilized society. (Holmes actually said, “Taxes

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are what we pay for a civilized society,” the words that appear over the entrance to the IRS building in Washington.)

The nexus between taxes and a civilized society is apparent throughout the film, with people talking about the role that tax avoidance has on the government’s ability to finance a variety of features found in many more developed countries.

A Chicago firefighter mocked the city’s mayor, who was visiting the firehouse after a firefighter had died in a fire, for scoffing at his suggestion that a financial transaction tax (FTT) be implemented to fund public sector pensions. The mayor told the firefighter that there is no political support for an FTT and that, if he was serious about one, he should run for public office.

Chicago’s police and firefighter pension funds had a combined deficit of $12.1 billion as of December 31, 2014. Neither was more than 26 percent funded at that time. On October 28, the City Council approved a $7.8 billion budget package with sweeping tax changes, including the largest property tax increase in the city’s history. There was heavy criticism of the plan that the brunt of the higher property taxes fell on the city’s business sector. An FTT was not among the revenue measures passed by the council.

The film also focused on the impact of the corporate world’s alleged avoidance of tax on the government’s ability to build roads, fund education, and provide housing for the needy. The role of globalization and offshore finance on the “dismantling of the welfare state” is a recurring theme. “The welfare system helps cushion the impact of an industrial revolution,” said Alain Deneault, who is described as a philosopher and political science instructor at the University of Montreal. “It also helps the economy find a new balance and invest capital in job creation.”

Financial Transaction Tax

Income redistribution, by way of an FTT, is also brought up near the film’s end. “To tax every financial transaction, that has a nice simple aim . . . a bit of redistribution,” said Saskia Sassen, a sociologist at Columbia University. “It doesn’t kill the monster. But every time you do one of your monstrous activities, no matter how tiny, you redistribute a bit.”

A number of the people appearing in the film said that an FTT would make it less likely that the financial sector’s problems of 2007 and 2008 would occur again and that even if they did, the government would have more funds to deal with the consequences.

FTTs have been discussed for a number of jurisdictions over the years ever since they were first proposed in 1972 by Nobel Prize-winning economist James Tobin. Some European Union member states have been pushing for an FTT, but the efforts have stalled in recent months, largely out of concern that it would drive financial trading away from any countries that embrace the tax. (Prior coverage: Tax Notes Int’l, July 6, 2015, p. 33.)

Alepin likened the threats of banks fleeing an FTT to an apparently unsuccessful proposal in the province of Quebec to increase taxes on the wealthy. “Unless we have real tax cooperation, a jurisdiction like Quebec cannot act alone without being threatened with exile,” Alepin said.

Robin Hood and Chekhov’s Gun

Both the film and the panel discussion afterward promoted the movement to implement an FTT, which is often referred to as a “Robin Hood tax,” with two of the panelists sporting elfinlike green hats. The panelists wearing the Robin Hood hats said they have been heavily involved in pushing for an FTT, with one of them estimating that the tax would provide $300 billion a year to address U.S. social needs.

Asked why the film didn’t focus on specific taxes beyond the FTT and why it didn’t go more deeply into the impact of tax avoidance on social problems such as racial inequality and wealth redistribution, Crooks said that he was trying to achieve a coherent narrative. The core issue for the story he wanted to tell was how the offshoring of the world’s wealth is shifting the balance of power between the nation state and the multinational corporations, Crooks said.

“The story begins with the creation of the offshore world and [I was] thinking about [Russian playwright Anton] Chekhov’s laws of storytelling where he says that . . . if you put a gun or a revolver over on the wall in the first act, you have to use it in the third act,” Crooks said.

Crooks said he started out by describing the creation of the offshore world, then turned to the City of London and its history going back to the day of William the Conqueror, which he followed with a summary of the collapse of the British empire. The film then focused on what he said was the acceleration in the 1970s and 1980s of a system that shifted the balance of power between all nation states and all races on the planet.

“So, in the third act, I had to think of a way to resolve the film that’s related to what I [originally] set up, and I wanted to have an element of activism to it that people could latch onto,” Crooks said. “So I settled upon one specific tax that was kind of a taking the revolver off the wall of the first act and using it.”

Impact of BEPS

Asked about the impact that BEPS is likely to have on reducing the level of tax avoidance by MNEs, James S. Henry, an economist and investigative journalist, said the OECD had made a good start after
tackling a difficult subject. Henry reminded the audience, however, that the BEPS reports are merely recommendations. “At the end of the day, the actual revenue generated by these tax reforms that they still have to get through Congress and other places around the world is still a mystery to me,” Henry said. “I don’t think we have any good metrics for estimating how large that will be.”

Henry also faulted the BEPS process by saying that it left developing countries “in the background.” He referred to the U.N. tax committee as a basic nonentity with four employees and an annual budget of only $400,000. “We have had a difficult time getting big players like India and China and Brazil that basically can take care of themselves in international tax to really stand up and demand a more equitable system,” Henry said.

Panelist David Cay Johnston, a winner of the Pulitzer Prize for exposing loopholes and inequities in the federal tax code, said that while the OECD’s work was an “earnest, serious effort to address the problem,” it was based on the faulty assumption that the existing system can be fixed.

“I think that what we need to do is change the rules and look at a new way to do things,” Johnston said. He added that what needs to be done is to tax gains and not necessarily profits. “That’s a subtle distinction,” he said. “We need to address this, without question.”

Johnston said that progress was being made in that direction until the administration of President George W. Bush objected to the harmonization of tax systems and international tax cooperation. “Tax competition should be in the thesaurus next to ‘how to rip you off’ and ‘how rich people get richer off the tax system,’” Johnston said.

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Alimera Sciences Inc.

Alimera Sciences Inc., a biopharmaceuticals company based in Alpharetta, Georgia, reported in an October Form 8-K that it recorded prior period transfer pricing adjustments of approximately $3.5 million.

Jurisdiction(s): Undisclosed

Altera Corp.

Altera Corp., a programmable logic device manufacturer headquartered in San Jose, California, reported in an October Form 10-Q that it recorded a $26.2 million increase in income taxes payable and receivable, which was primarily due to higher tax liabilities in the United States and foreign jurisdictions for tax exposures related to cost sharing and transfer pricing.

Jurisdiction(s): United States

Jabil Circuit Inc.

Jabil Circuit Inc., a global manufacturing services company headquartered in St. Petersburg, Florida, reported in an October 10-K that it is reasonably possible that its unrecognized tax benefits could decrease during the next 12 months by $1.3 million from cash payments and $11.6 million related to the settlement of audits or the expiration of statutes of limitation. These amounts relate primarily to a possible transfer pricing adjustment.

Jurisdiction(s): Undisclosed

Bristol-Myers Squibb Co.

Bristol-Myers Squibb Co., a global pharmaceutical company headquartered in New York, reported in an October Form 10-Q that it is being audited by a number of tax authorities and that significant disputes may arise regarding transfer pricing. Bristol-Myers estimates that it is reasonably possible the total amount of unrecognized tax benefits at September 30, 2015, could decrease by $280 million in the next 12 months as a result of settlement.

Jurisdiction(s): Undisclosed

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Australia

Court Upholds Chevron Assessment Over Intercompany Loans

An Australian federal judge on October 23 upheld amended tax assessments limiting the interest claimed by Chevron Australia Holdings Pty. Ltd. (CAHPL) on $2.5 billion in intercompany loans and dismissed the company’s claim that retroactive transfer pricing provisions passed in 2012 are unconstitutional.

Justice Alan Robertson of the Federal Court of Australia found that in its appeal of a 2010 Australian Taxation Office (ATO) amended assessment for tax years 2004-2008, Chevron did not show that the 2003 transfer pricing agreement at issue in the proceedings involved arm’s-length consideration or that the ATO’s amended assessments were excessive. In making his arm’s-length determinations, Robertson relied heavily on the nearly 70 pages of testimony in the ATO’s decision. (Prior coverage: Tax Notes Int’l, Oct. 20, 2014, p. 207.)

Under the 2003 arrangement, CAHPL borrowed $2.5 billion from ChevronTexaco Funding Corp., a Delaware company. The loan was to be repaid in the Australian equivalent of U.S. dollars at an interest rate of 4.14 percent over the then-current LIBOR for the Australian dollar (approximately 9 percent).

According to an affidavit from Sezaneh Taherian, Chevron’s then-director of international financing, the company had engaged Deutsche Bank and Goldman Sachs to determine the rate and maximum level of borrowing available to CAHPL. Chevron did not seek a credit agency rating, but assumed that the company would qualify for a Standard & Poor’s rating of BBB, the lowest level considered to be investment grade.

Deutsche Bank and Goldman Sachs determined that to maintain an investment-grade rating, CAHPL could borrow no more than $2 billion, according to Taherian, who said she was then directed to seek an opinion from the company about borrowing up to $2.5 billion. Goldman Sachs determined that at a maximum level of borrowing, CAHPL would have an S&P rating of BB, which would put the company one notch below investment grade.

To fund the loan, ChevronTexaco Funding Corp. borrowed in U.S. capital markets, relying on an explicit guarantee from its parent company to increase its credit rating. CAHPL did not receive a similar guarantee. ChevronTexaco Funding Corp. assumed the foreign exchange risk on the note.

The Arguments

Chevron argued that subdivision 815-A of Australia’s Income Tax Assessment Act, 1997, which was enacted in 2012, is constitutionally invalid because it is retroactive to tax years commencing on or after July 2004, Robertson said. He said the company’s arguments were based on what it perceived to be the arbitrary nature of the retroactive provisions. (Subdivision 815-A allows the ATO to use associated enterprise articles in tax treaties and the OECD guidelines to expand its taxing powers beyond Australia’s domestic transfer pricing rules.)

“As to the applicant’s primary constitutional argument as to ‘arbitrary’ exaction, the respondent submitted that references in the case law should not be understood as inviting consideration of the wisdom or fairness of the criteria by which liability to tax was imposed,” Robertson said. “The requirement that a tax not be ‘arbitrary’ was merely a requirement that it be imposed ‘by reference to ascertainable criteria with a sufficiently general application.’”

The judge also rejected Chevron’s argument that the ATO failed to satisfy the statutory requirement that an international tax agreement containing an associated enterprise article must apply to an entity before subdivision 815-A may be applied. He noted that under subdivision 815-15(5), an associated enterprise article is defined to mean either article 9 of the U.K. income tax treaty or a corresponding provision of another international tax agreement.

In rejecting Chevron’s arguments, Robertson accepted the ATO’s contention that article 9 of both the U.S. and U.K. tax treaties is entitled “Associated Enterprises” and that the language and structure of the two...
Barbados

Prime Minister Urges OECD Action On Tax Haven Blacklists

Blacklisting member countries as tax havens should have no place in the OECD’s Global Forum on Transparency and Exchange of Information for Tax Purposes, Barbadian Prime Minister Freundel Stuart said on October 29.

During a speech kicking off the forum’s eighth plenary meeting in Bridgetown, Stuart noted that his country has “worked very hard over the years” to transform the island from a sugar-producing nation under colonial rule into a competitive financial services center. But “we do not wish to feel that every time we develop a competitive advantage the playing field rules will change and place us on a path of continually having to seek new and legitimate ways of providing for our people,” he said.

As a result, the country has been “working assiduously” to comply with such tax transparency measures as the U.S. Foreign Account Tax Compliance Act and the OECD’s common reporting standard (CRS) on automatic exchange of information in tax matters, according to Stuart. The Barbadian parliament recently passed legislation to give effect to FATCA, and Barbados is at “an advanced stage” in its plan to implement the CRS as an early adopter, promising to undertake its first exchanges by 2017, he said.

Stuart also announced that Barbados signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters on October 28 and planned on signing the OECD’s multilateral competent authority agreement on the automatic exchange of financial account information on October 29.

Barbados will then request a supplementary peer review report, “as we’ve taken action that we believe should lead to an upgrade of our overall country rating from partially compliant to largely compliant,” Stuart said.

The global forum examines compliance with administrative assistance standards through a peer review process. Phase 1 of the process evaluates the legal and regulatory framework of the relevant jurisdiction, and Phase 2 assesses the practical implementation of the international standard on exchange of information on request. After Phase 2 reviews are complete, the global forum rates jurisdictions as “compliant,” “largely compliant,” “partially compliant,” or “noncompliant” with the international standard. Countries can also request supplementary reviews to follow up on recommendations made in an earlier review and improve their ratings.

Barbados is also working hard to implement recommendations in its Phase 2 peer review report, and the country “remains fully committed to and actively engaged in the work of the global forum,” Stuart added.

But Stuart, who is also chair of the 15-member Caribbean Community, expressed frustration that although his country and other Caribbean nations are doing everything they can to comply with internationally agreed-upon standards, “some of us are constantly placed on the defensive,” he said. “We’ve had to fight to defend our legitimacy and existence as international financial centers,” he added.

He railed against Barbados’s inclusion in the European Commission’s controversial compilation of its member states’ tax haven blacklists, which was announced on June 17 along with its corporate action plan. (Prior coverage: Tax Notes Int’l, July 27, 2015, p. 304.)

The compilation drew sharp criticism from many of the jurisdictions listed and prompted Pascal Saint-Amans, director of the OECD Centre for Tax Policy and Administration, and Monica Bhatia, head of the Global Forum Secretariat, to write a letter to global forum members challenging the commission’s compilation, noting that “the only agreeable assessment” of countries’ cooperation is made by the global forum. They also pointed out that many of the jurisdictions the commission identified have received either “compliant” or “largely compliant” ratings. (Prior coverage: Tax Notes Int’l, Aug. 17, 2015, p. 583.)

“That intervention by the OECD and the global forum has mitigated the impact of the damage to the reputation of our countries caused by that blacklist,” Stuart said. However, Barbados had to address the issue again after the District of Columbia announced its own tax haven blacklist in August, singling out 39 countries that must be accounted for when companies file combined reports. A D.C. Council official had said the commission’s compilation had encouraged the District to create a list of its own.

“This type of action can have a devastating impact on the reputation of our countries,” Stuart said. “It increases our risk profiles and affects our ability to retain or attract new investment and also has the potential to jeopardize the ease with which investors can access funding.”

Arguing that the blacklisting of global forum member countries by other members should be eliminated, Stuart called on the forum to come to a “clear position” on the issue. “I believe that with a concerted effort we can address this matter appropriately,” he said.
Other Issues

Stuart also raised the issue that some multinational financial organizations have implemented policies using the global forum’s rating system in a way that “has the unintended consequence of penalizing countries that are rated ‘partially compliant’ or lower,” he said. Stuart revealed that the country almost lost a major Barbadian entity after it had difficulty accessing financing from a financial institution for a multimillion-dollar project because the country had not completed implementation of a recommendation that could trigger a request for a supplementary report within the time frame the financial institution set out.

“Unless such financial institutions communicate with both the global forum and the affected countries, they run the risk of making decisions without fully appreciating the peculiarities of a country and the progress it’s making to address the concerns,” Stuart said. As a result, there should be a mechanism to ensure that countries that are working to implement global forum recommendations “do not suffer the fate of being penalized by other agencies,” he added.

Moreover, the global forum should encourage its members, especially developed countries, to ratify negotiated and agreed-upon tax treaties and to consider the role of the United Nations and the role it can play in international tax cooperation matters by giving developing countries a “full seat at the table,” Stuart said.

“I suggest that you reflect deeply on the genesis of the forum, its objectives, its achievements, and any obstacles to future development with a view to addressing any issues that could undermine the progress made by this global forum so far,” he said.

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China (P.R.C.)

Tax Incentives Target Technology Transfers and Investments

China’s Ministry of Finance and State Administration of Taxation on October 29 issued a circular that implements enterprise income tax incentives for technology transfers and incentives for equity investments by venture capital limited liability partnerships in small and medium-size high-tech companies.

The circular also sets out a tax payment installment plan for individual shareholders of small and medium-size high-tech companies. (Prior coverage: Tax Notes Int’l, Oct. 26, 2015, p. 310.)

Nonexclusive Licensing of Technology

Caishui [2015] 116 (Circular 116) confirms that as of October 1, income derived by Chinese resident enterprises for a minimum of five years of nonexclusive licensing of technology will be included in the scope of income from technology transfers that qualifies for preferential EIT treatment. Resident enterprises will be exempt from EIT on up to CNY 5 million (about $787,000) of income for technology transfers in a tax year and will be eligible for a 50 percent EIT reduction for amounts in excess of CNY 5 million.

For purposes of Circular 116, the term “technology” covers patents (for inventions, designs, and models, including patents for national defense); computer software copyrights; exclusive rights to integrated circuit designs; new biopharmaceutical products; and other technology as determined by the MOF and State Administration of Taxation.

Venture Capital LLPs

Circular 116 also provides that as of October 1, if a venture capital LLP located in China invests equity in privately held small and medium-size high-tech companies for at least two years, its corporate partners may deduct 70 percent of the investments from their respective share of its distributable profits. If their share of distributable profits is less than 70 percent of investments, the difference can be carried over to following years.

A corporate partner’s deemed investments in a privately held small and medium-size high-tech company are equal to those made by the venture capital LLP, divided by the partner’s share of the LLP’s capital stated in the partnership agreement.

Stock Conversion

Circular 116 states that as of January 1, 2016, individual shareholders of small and medium-size high-tech companies located in China who have difficulty paying the 20 percent individual income tax (IIT) on deemed dividends from the companies’ conversion of retained earnings, earnings reserves, and capital surplus into stock in a lump sum may pay it in installments for not more than five calendar years based on their self-payment plan. The shareholders must submit related documents to their competent tax authorities. If they transfer their shares in the high-tech companies before paying all the tax owed and they receive cash from the transaction, they must use the cash to pay the unpaid IIT.

If the high-tech companies enter into bankruptcy before the individual shareholders dispose of their shares and the shareholders receive no income from the disposal or the income received is less than their initial investments, the competent tax authorities may waive any unpaid IIT.
Circular 116 defines a small or medium-size high-tech company as a recognized high-tech enterprise with annual sales revenue of CNY 200 million (about $31.5 million) or less, total assets of CNY 200 million or less, and 500 employees or fewer. The company’s EIT must also be based on its actual profits and not deemed profits.

The tax installment plan does not apply to individual shareholders’ deemed dividends from the stock conversion of small and medium-size high-tech companies publicly traded in Chinese stock markets, including the National Equities Exchange and Quotations.

Stock Bonuses

As of January 1, 2016, high-tech enterprises’ technical personnel can use the five-year installment plan mentioned above for IIT payments on stock bonuses granted by the enterprises for their scientific and technological results if the individual taxpayers have difficulty paying their IIT in a lump sum. The taxpayers must file related documents with their competent tax authorities.

According to Circular 116, the stock bonuses received by technical personnel will be taxed as employment income, and the IIT on the bonuses will be computed in accordance with Caishui [2005] 35. The stock bonus income is determined by the stock’s fair market price when the individual taxpayers obtained it. Technical personnel who transfer the stock and its derivative stock and receive cash from the transfer must use the cash to pay the unpaid IIT.

If the technical personnel dispose of their shares in high-tech enterprises because of the enterprises’ bankruptcy and receive no income or assets from the disposal, or the income or assets received are insufficient to pay the unpaid IIT, the competent tax authorities may waive the remainder of the unpaid IIT.

The term “technical personnel” under Circular 116 is limited to the following persons who have been approved by the company’s board of directors or at a shareholders’ meeting to receive stock bonuses:

- technical persons who have made significant contributions to the company’s research and development and industrialization, including the major persons who undertake key duties to generate scientific results; the chief person who performs a significant development project; and the major technical persons who have made significant innovations or improvements on main products, key technology, or production processes; and

- managers who have made significant contributions to the enterprise’s development, including senior managers who are responsible for its overall business operations and middle- or senior-level managers who are responsible for its main products or services generating at least 50 percent of its gross revenue or profits.

However, any stock incentive plans implemented by enterprises for all their employees will be ineligible for the preferential IIT treatment.

Circular 116 defines the term “stock bonus” as a specific amount of shares or stock granted by an enterprise as a gift to its technical personnel.

Under Circular 116, a high-tech enterprise must have been recognized by a province-level qualified high-tech recognition institution and must calculate its EIT based on actual profits rather than deemed profits.

♦ Jinji (Glen) Wei, certified tax adviser, attorney, and CPA

Estonia

Supreme Court Denies Employer’s Appeal in Social Tax Case

The Estonian Supreme Court has denied a taxpayer’s appeal in a case in which the Estonian Tax and Customs Board (EMTA) rejected an employer’s use of a private limited company to pay a lower tax rate on wages.

The decision in AS Sirowa Tallinn v. EMTA (Case No. 3-3-1-25-15, Sept. 11, 2015) caused a stir because the arrangement disputed in the case is common practice for many Estonian companies, including several international businesses.

In AS Sirowa, the company replaced its managers’ permanent employment agreements with service contracts between corporate bodies — that is, the managers didn’t receive a regular salary; instead, they presented an invoice to AS Sirowa, and the amount they were owed was transferred to their own private limited companies’ accounts (in Estonian, osaühing or OÜ).

If salaries are paid, the employer company must pay a total of 33.8 percent social tax (payroll tax) and unemployment insurance contributions. But if the company makes a transfer to another company and the latter pays the same sum out as dividends, a 20 percent income tax rate applies.

Arguing that the practice is a way to hide salary payments, the EMTA filed a lawsuit against AS Sirowa and claimed the company had to pay all related social security contributions. AS Sirowa made an appeal to the Supreme Court, but it lost the case.

The situation became lively when the EMTA used the word “OÜ-tama” in its press release, suggesting that businesses’ use of private limited companies is synonymous with tax fraud. Estonian business leaders — for example, Toomas Tamsar, chair of the Estonian
Employers Confederation — were critical of the EM-
TA’s attitude. Later, the EMTA said it regretted the
suggestion and chalked the release up to “misinter-
preted information.”

However, many law firms, such as Sorainen, and
observers warn that using service contracts with private
limited companies to replace salary payments has be-
come a “serious tax risk.”

♦ Viktor Trasberg, associate professor in economics,
University of Tartu, Estonia

European Union

EU Parliament Wants Stronger Tax Exchange Plan Than Council

Members of the European Parliament (MEPs) on
October 27 expressed strong disapproval by adopting a
resolution on the recent decision by the Economic and
Financial Affairs Council to weaken proposed rules for
automatic exchange of tax ruling information between
member states.

The ECOFIN decision restricted the scope of the
European Commission’s proposal by delaying imple-
mant until 2017 and extending the turnaround
time from three months to six months. Only rulings
made in the past five years would come under the ju-
risdiction of the new rules, and countries could decide
for themselves whether a ruling had international im-
plications requiring notification to other member states.
The commission had proposed making the exchange
retroactive for the past 10 years of rulings. Members of
the Special Committee on Tax Rulings and Other
Measures Similar in Nature or Effect (TAXE commit-
tee) have advocated for the exchange of any ruling still
in force. (Prior coverage: Tax Notes Int’l, Oct. 12, 2015,
p. 145.)

German MEP Markus Ferber (European People’s
Party (Christian Democrats)), who wrote the July 14
draft report approved by the Parliament, called
ECOFIN’s decision “disappointing.” He spoke Octo-
ber 27 at a press conference held by the leadership of
the TAXE committee. “The council doesn’t want to
hear any of what we are saying. We said that all tax
rulings should go to all tax authorities, retroactively if
they are still in force, and we want that to start in
January 2016,” Ferber said.

German MEP Michael Theurer (Alliance of Liber-
als and Democrats for Europe) said the ECOFIN ver-

version was an unacceptable watering down of the auto-
matic exchange concept, adding that the European
Parliament should implement the OECD’s base erosion
and profit-shifting project model proposals as a frame-
work for European legislation. He also said that

whistleblowers must be protected, not punished, that
piecemeal access to requested documents is unaccept-
able, and that the code of conduct expected of tax ad-
visers should be more thoroughly reviewed.

The issues have become contentious enough that
some MEPs have suggested that the EU’s unanimity
rule should be set aside because it is blocking efforts to
provide fair taxation for all. In an unusual late-night
session, members of the TAXE committee on October
26 voted 34 to 3, with 7 abstentions, to approve a draft
report that now goes to the full Parliament for review
before the end of November.

The European Parliament has yet to determine how
to address outstanding issues and oversee implementa-
tion of the TAXE committee’s recommendations. The
committee’s work will be followed up by a legislative
report to be drafted for ECOFIN that will be voted in
committee on December 1 and in plenary session later
in the month, according to an official statement.

TAXE committee members have requested that their
mandate be extended beyond next month so that they
can continue their investigations because multinational
enterprises have been slow or unwilling to appear be-
fore it and member states have refused to provide full
documentation on existing tax rulings. The committee
released a list of those who have yet to reply. Commit-
tee Chair Alain Lamassoure and other MEPs are urg-
ing the Parliament to rescind the lobbying rights of
MNEs that ignore its invitations. “Even the most pow-
ervful corporations in the world do not want to appear
on a European Parliament blacklist,” Lamassoure said
during the press conference. He announced that HSBC
has agreed to appear in a special committee meeting
on November 16, joining Facebook and Google.

Portuguese MEP Elisa Ferreira (Progressive Alliance
of Socialists and Democrats in the European Parlia-
ment) and Theurer, who wrote the TAXE committee’s
draft report, have refused to meet with MNEs or ac-
cept corporate invitations. Ferreira said cooperation
was less than universal among member states she vis-
ited. Theurer said he had refused to meet with a high-
ranking Google official because the company had
shown disrespect to the Parliament by not appearing in
front of the committee. He also strongly objected to
IKEA hosting a dinner for MEPs to discuss tax issues
instead of making a formal appearance. He said per-
haps the company didn’t want to admit it doesn’t pay
taxes at all.

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EU Parliament Approves Information Exchange With Switzerland

Members of the European Parliament have voted in favor of an agreement with Switzerland that would require the automatic exchange of financial information. (Prior coverage: Tax Notes Int’l, June 1, 2015, p. 792.)

The October 27 vote approves the agreement signed May 27, 2015, by the European Union and Switzerland to begin automatically sharing data on bank accounts held by each other’s citizens by 2018. The deal is intended to make it more difficult for EU citizens to evade taxes by hiding income and assets in Swiss bank accounts, according to a European Parliament release. The measure was approved by a vote of 593 to 37, with 58 abstentions. The Parliament said the EU and Switzerland must now conclude the agreement in time for it to take effect on January 1, 2017. The European Parliament must be consulted, and the agreement must be ratified by the Swiss parliament.

According to the release, the information exchanged will allow EU member states and Switzerland to accurately identify account owners, administer and enforce tax laws in cross-border situations, assess the likelihood of tax evasion, and avoid unnecessary investigations. Jeppe Kofod, rapporteur and Danish member of the European Parliament (Progressive Alliance of Socialists and Democrats), said the measure represents “a very important step in this fight against tax fraud and for tax justice.”

Data to be shared under the agreement includes account holder identity information such as names, addresses, tax identification numbers, and dates of birth. The agreement also requires the exchange of financial data, including interest and dividend income, account balances, and proceeds from the sale of financial assets. The stricter information exchange standards adopted by the agreement are comparable to those already in place among EU member states and will comply with the OECD’s common reporting standard, according to the release.

The agreement, which amends the EU-Switzerland savings agreement, “heralds a new era of tax transparency and cooperation between the EU and Switzerland,” according to EU Tax Commissioner Pierre Moscovici. “It is another blow against tax evaders, and another leap toward fairer taxation in Europe,” he said.

♦ Ryan Finley, Tax Analysts.
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Liechtenstein Signs Tax Transparency Accord With EU

With fanfare appropriate to signal the end of an era, the European Commission announced on October 28 that Liechtenstein has signed a reciprocal agreement to exchange banking information on individual account holders.

The agreement, announced by EU Tax Commissioner Pierre Moscovici at a lunch meeting in Brussels, meets the new OECD/G-20 global standard for the automatic exchange of information, according to a commission statement. Under the agreement, which modifies the EU-Liechtenstein savings agreement, Liechtenstein and EU member states will automatically exchange information on the financial accounts of each other’s residents from 2017. Member states will receive the names, addresses, tax identification numbers, and dates of birth of their residents with accounts in Liechtenstein, as well as other financial and account balance information.

The EU signed a similar agreement with Switzerland in May, which was approved by the European Parliament on October 27. Final approval by the Swiss parliament is expected in time for the agreement to enter into force January 1, 2017, with data collection starting in 2017 and data transfer by January 1, 2018.

After being placed on the EU tax haven blacklist in June, Liechtenstein registered its protest by noting the extent of its recent tax agreements, including the one announced on October 28. (Prior coverage: Tax Notes Int’l, June 29, 2015, p. 1159.)

Liechtenstein was for many years the go-to destination for billionaires needing privacy for their trust accounts. It was hit hard by the 2008 international financial crisis, which forced governments to crack down on worldwide tax evasion. Its banking industry lost ground as money moved to other tax havens outside of Europe, and a series of scandals linked the country to high-profile tax evasion cases.

Resistance Is Futile

“What is happening on the international scale is a real revolution in transparency, which nothing can resist and no one should resist,” said Moscovici. EU member states say the agreement will improve their bilateral relations on fiscal matters with Liechtenstein, according to Moscovici. “We are pulling in the same direction to create more openness and cooperation between tax authorities and to thwart those who seek to evade paying their fair share of tax,” he said.

Andorra, San Marino, and Monaco are also expected to finalize agreements with the EU. Relations between the EU and the microstates of Europe, which have long held on to their bank secrecy rules, have been affected by the increased efforts to control tax evasion in recent years. Liechtenstein is not part of the EU and uses the Swiss franc as currency, but it is a
member of the European Economic Area and the Schengen Agreement on open borders.

Despite some resistance from hardliners intent on keeping national sovereignty strong on tax issues, the EU has been moving toward an internationalized approach to controlling tax evasion to be implemented throughout the union. Members of the European Parliament have called for stronger enforcement across national boundaries and closer alignment with the OECD’s base erosion and profit-shifting standards recently approved by the G-20.

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CJEU Strikes Down Belgium’s Treatment of Interest on Securities

Belgium failed to fulfill its obligations under EU law by taxing interest on debts represented by securities that originated in Belgium and were deposited or credited to an account with a financial institution outside the country while exempting similar securities deposited in Belgian banks, the Court of Justice of the European Union found.

In Commission v. Belgium, C-589/14 (CJEU 2015), the European Commission argued that Belgium infringed on the Treaty on the Functioning of the European Union (TFEU) and the European Economic Area Agreement by maintaining regulations under which interest on debts represented by securities of Belgian origin are exempt from withholding tax when they are deposited or credited to an account in a Belgian financial institution but taxable when they are deposited or credited to an account with a financial institution established in another member state or a third party to the EEA Agreement. Belgium responded by saying it has reported a draft royal decree intended to make the regulations in question compliant, the CJEU said. Belgium claimed that when the decree enters into force, the discrimination claimed by the commission will disappear.

In its October 29 decision, the CJEU noted that article 56 of the TFEU precludes the application of any national legislation that has the effect of making the provision of services between member states more difficult than the provision of services within a member state. It said the case law requires the abolition of all restrictions on the freedom to provide services imposed on the ground that the provider is established in a member state other than that in which the service is provided. It added that article 36 of the EEA agreement is similar to article 56 of the TFEU.

The Court said Belgium’s legislation is likely to deter recipients of interest from investment companies from using banks established in member states, or third-state parties to the EEA Agreement, outside of Belgium.

“Such legislation therefore constitutes a restriction on the freedom to provide services, prohibited in principle by Articles 56 TFEU and 36 of the EEA Agreement,” the CJEU said. “The Kingdom of Belgium has raised before the Court no overriding public interest which could justify, in the present case, that restriction in the freedom to provide services within the meaning of Articles 56 TFEU and 36 of the EEA Agreement.”

The CJEU found that Belgium’s draft royal decree could not be considered by the Court because it came after the deadline set in the reasoned opinion.

The commission had also contended that Belgium had violated the treaty and agreement by maintaining regulations under which an investment company established in a member state or third-state party to the EEA agreement is subject to withholding tax on interest on securities not represented by receivables when investment companies located in Belgium are exempt. However, the CJEU found the claims were contradicted by the relevant statute.

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Greece

Tsipras Fires Independent Tax Chief

Greek Prime Minister Alexis Tsipras fired Katerina Savvaidou, the independently appointed general secretary for public revenues, after she refused to resign over a misdemeanor allegation of breach of duty in tax collection.

Savvaidou was dismissed October 22 while representatives of Greece’s creditors were in Athens reviewing the country’s progress on fulfilling the terms of its bailout agreement. Her position was created in 2010 at the insistence of the troika of the European Commission, European Central Bank, and IMF to ensure nonpartisan tax collection. The position was established with a five-year tenure.

Savvaidou denied any wrongdoing after being charged with breaching her duties by delaying the collection of a tax on TV advertising revenues by about a year. She has maintained that her decision to postpone enforcement of the tax, which previous governments had never been able to collect, was made with the full knowledge and approval of appropriate state legal authorities. The government maintains that it had the legal right to dismiss her once she had been charged with a misdemeanor.
News of her firing was met with dismay by Greek practitioners, who praised her performance and saw the move as an effort by the government to reestablish political control over tax administration. “Mrs. Aikaterini Savvaidou is one of the most respected tax professionals in Greece with very deep academic and professional experience,” said Theodoros Skouzos of Iason Skouzos & Partners in Athens.

Savvaidou’s extensive work in issuing interpretative circulars helped to clarify tax measures and improve tax collection and administration, Skouzos told Tax Analysts. “I have the belief that she was always acting in favor of the country with a strong commitment to the Constitution and the law,” he said.

“It is commonly believed that her firing is simply because the government does not like the independence of the General Secretariat,” Skouzos said, adding that the government did not hesitate to use means detrimental to her reputation to breach the secretariat’s commitment to independence. He said that the criminal accusations of breach of duty and damage to the country will likely be proven false but that it could take a long time for the situation to be resolved.

— Teri Sprackland, Tax Analysts. E-mail: teri.sprackland@taxanalysts.org

Hungary

Bill Would Classify Taxpayers as Risky or Reliable

A draft bill that would classify taxpayers as risky or reliable is under review by the Hungarian parliament. The classifications would take effect January 1, 2016.

A “reliable taxpayer” would meet the following conditions:

- the taxpayer has been registered for tax purposes for more than three years;
- there is no more than a 3 percent difference between the taxpayer’s total tax figures for the current tax period compared with the preceding five years;
- the taxpayer has not been subject to an enforcement procedure for the current year or the preceding five years;
- the taxpayer has not been subject to a bankruptcy or liquidation during the last five years;
- the taxpayer’s outstanding liabilities do not exceed HUF 500,000 (about $1,770) on the first day of the quarter;
- the taxpayer was not subject to a tax number suspension or cancellation in the current year or the preceding five years;
- the taxpayer was not subject to a default fine more than twice in the two years preceding the current year;
- the taxpayer is not currently and has not in the preceding five years been subject to enhanced tax authority supervision; and
- the taxpayer does not qualify as a risky taxpayer.

Reliable taxpayers qualify for the following favorable rules:

- the upper limit of default fine and tax penalties may not exceed 50 percent of the penalties imposed under the general rules;
- when a reliable taxpayer fails to meet a deadline for submitting a tax return requirement, the tax authority will notify him to comply with his tax obligations without charging a default fine;
- reliable taxpayers may request to pay in 12 monthly installments for tax debts not exceeding HUF 500,000;
- VAT will be refunded within 45 days, effective from January 1, 2017, and within 30 days, effective from January 1, 2018; and
- tax audits may not exceed 180 days.

A taxpayer is considered “risky” if:

- he is listed among taxpayers with high tax arrears or tax debt;
- he is listed among taxpayers who are employing undeclared employees; or
- relevant authorities decided to close the taxpayer’s premises twice within one year.

Risky taxpayers would be subject to a higher late payment and other tax penalties. VAT will be refunded to risky taxpayers within 75 days in all cases. The duration of audits for risky taxpayers would be extended by 60 days.

— Slim Gargouri, chartered accountant, Sfax, Tunisia

India

Special Committee to Tackle Tax Simplification

India has created a special committee to examine ways to simplify the country’s Income Tax Act, 1961, and the group will issue its first recommendations by January 31, 2016.

According to a news release, the committee will be responsible for studying and identifying parts of the act that may lead to litigation because of different interpretations. It will also evaluate provisions that affect the ease of doing business in India, identify provisions that
can be simplified in the context of existing jurisprudence, and come up with suggestions to change those provisions to encourage tax certainty without substantially affecting the tax base or revenue collection.

R.V. Easwar, a former Delhi High Court judge and former president of the Income Tax Appellate Tribunal, will oversee the 10-member panel. The committee will be able to set its own procedures and will be responsible for publishing its draft recommendations. After conducting stakeholder consultations, the committee will set out its recommendations in batches. Its term will end in one year, according to the news release.

The government reportedly wants to use the recommendations to usher in changes to the ITA in the annual 2016-2017 budget. However, it will not consider retroactive tax issues.

The previous National Congress government in 2012 introduced retroactive amendments to clarify section 9 of the ITA to allow the government to charge capital gains taxes on cross-border transactions involving Indian assets dating back to 1962. The controversial move, which dampened investor confidence, was largely seen as a way to reverse a landmark Supreme Court decision that threw out a more than $2 billion capital gains tax bill assessed on telecom company Vodafone.

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Columbia Sportswear’s Liaison Office Activities Aren’t Taxable, Court Says

Purchases for export from third-party manufacturers that are coordinated by an Indian liaison office are not subject to income tax, the High Court of Karnataka held October 27 in Columbia Sportswear Co. v. DIT (W.P. No. 39548/2012 (T-IT)). The court also found that Columbia Sportswear Co.’s liaison office does not constitute a permanent establishment under the India-U.S. tax treaty.

Columbia is a U.S-based outdoor apparel company that does not distribute or retail its products in India, the court said. With the permission of the Reserve Bank of India, the company established an Indian liaison office in 1995 in connection with its purchase of goods in the country. Columbia purchases products from Indian vendors on a principal-to-principal basis, and the liaison office conducts only activities relating to coordinating the company’s purchases. It has no revenue streams and does not source products to be sold in India, the court said.

In an effort to achieve tax certainty, Columbia applied to the Authority for Advance Rulings for a determination of its tax liability under the Income Tax Act, 1961. The authority found that design and manufacture were being carried out by the company in India and therefore a portion of the related income accrued to Columbia in India. It also found the liaison office constituted a PE under the tax treaty with the U.S.

On appeal, Columbia contended that the ITA provides that in the case of a nonresident, no income is deemed to accrue or arise in India through operations confined to the purchase of goods in the country for export. It also argued that the liaison office does not constitute a PE because the India-U.S. tax treaty says the term does not include a fixed place of business solely for the purpose of purchasing goods or collecting information for the enterprise.

The high court noted that Explanation 1(b) of ITA section 9, which deals with income deemed to accrue or arise in India, lays out an exception to the rule that income earned in the country is deemed to arise or accrue there. The exception provides that, in the case of a nonresident, no income accrues or arises in India from operations that are confined to the purchase of goods for export. Therefore, the court found there was no income to be taxed.

The court also said that article 7(1) of the India-U.S. tax treaty makes it clear that if a PE conducts sales in India through that PE, only the profits of that enterprise will be taxed. Therefore, there is no tax liability if a purchase is made for export, the court said.

The high court explained that “permanent establishment,” as defined in article 5 of the convention, is a place of business through which the business of an enterprise is wholly or partly carried on. However, it is not a PE if the place of business is for the purpose of purchasing goods or merchandise or collecting information for the enterprise, the court said.

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Malaysia

Budget Offers Incentives for Investment and Food Production

Malaysian Prime Minister and Finance Minister Najib Razak on October 23 presented to Parliament the 2016 draft budget, which includes several tax proposals.

To further invigorate the capital market, the government has drafted a tax deduction on the issuance costs of sustainable and responsible investment sukuk, or Islamic bonds, as well as a 20 percent stamp duty exemption on shariah-compliant loan instruments used to finance the purchase of houses.
Also, the current 100 percent income tax exemption on statutory income of tour operators would be extended from year of assessment 2016 until 2018.

The government proposed that the following incentives be provided for food production industries regarding investments undertaken until 2020. The incentives include:

- companies that invest in subsidiaries that undertake food production projects will be given a tax deduction equivalent to the amount invested;
- companies that undertake new food production projects will be given a 100 percent income tax exemption for 10 years; and
- existing companies undertaking project expansion will be provided with the same incentive for five years.

Under the current treatment, small and medium-size enterprises are eligible to claim an income tax exemption of 10 percent or 15 percent of the increase in the value of exports. To further increase exports, SMEs engaged in exports would have a reduced value-added requirement of 20 to 30 percent (40 to 50 percent for manufactured products). This will apply for years of assessment 2016 to 2018.

Razak revealed that 2016 will be declared Malaysia’s commercialization year to spur commercialization of research and development products by local research institutions. Accordingly, he proposed the granting of new incentives in a bid to boost R&D activities. SMEs that incur expenditures on R&D projects of up to MYR 50,000 for each year of assessment would be eligible to claim a double tax deduction automatically. This will apply for the years of assessment 2016 to 2018.

Razak emphasized the high and encouraging goods and services tax registration and compliance, noting that, to date, almost 400,000 companies have registered for GST with a submission rate of more than 90 percent.

In order to improve GST treatment, the following amendments would be implemented:

- Zero rating of all types of controlled medicines under the Poisons List Group A, S, C, and D as well as an addition of 95 brands of over-the-counter medicines, including treatment for 30 types of illnesses such as cancer, diabetes, hypertension, and heart disease.
- Zero rating of the following food items:
  - soybean-based milk and organic-based milk for infants and children;
  - dhal, or what is popularly known as parpu in the north, such as chickpeas, green beans, and white beans;
  - lotus root and water chestnut;
  - mustard seeds;
  - jaggery powder; and
  - dried mee kolok.

- To enable small-scale farmers to benefit from the flat rate scheme, the government proposed that the annual sales turnover threshold for registration be reduced from MYR 100,000 to MYR 50,000. The requirement to maintain records would also be simplified.

- Companies involved in maintenance, repair, and overhaul activities in the aerospace industry are allowed to participate in the approved trader scheme, which relieves them from paying GST on the imported goods.

- GST relief is also provided for re-importation of goods that were exported temporarily for the purpose of promotion, research, or exhibition.

- For the oil and gas industry, GST relief is provided on the re-importation of equipment such as equipment for oil and floating platforms that is temporarily exported for the purpose of rental and leasing.

- GST relief is also provided on teaching materials and equipment procured by skills and vocational training providers conducting approved programs under the National Skills Development Act 2006.

♦ Slim Gargouri, chartered accountant, Sfax, Tunisia

Mexico

VAT Refunds Among Challenges for SAT Under Energy Reforms

Mexico’s reform of upstream activities in the oil and gas sector raises familiar questions about whether the State Administration of Taxation (SAT) will be issuing timely VAT credits to energy companies that won’t be generating revenues from their projects for years to come.

Speaking October 23 at the University of San Diego School of Law-Procopio International Tax Law Institute annual conference, panel moderator Enrique Hernandez called the recent regulatory changes the most transcendental reform carried out by Mexico’s current administration. The revised approach is vital for the country’s growth, he said.

Mexico amended its constitution in December 2013 to end the country’s 75-year monopoly over the oil and gas sector, opening to private companies a wide range of activities that were previously the exclusive domain of state-owned energy monolith Petróleos Mexicanos (Pemex). (Prior coverage: Tax Notes Int’l, Oct. 6, 2014, p. 40.)
“As opposed to what happened [before] 2014, all of these companies will be paying taxes,” SAT official Jose Tijerina said. “Pemex was not paying tax.”

Tijerina said the SAT has authority to verify the operations and accounting records of the companies awarded contracts under the new regime only when instructed to conduct an audit or site visit by the Ministry of Finance and Public Credit. “The verification won’t be in fiscal or tax terms, as we [currently] know it,” he said. “It will be under international audit laws.”

The SAT is in the process of training its staff to carry out its new audit review responsibilities, Tijerina said. Responding to a question from Hernandez about whether it might make more sense to outsource the reviews to a private-sector firm, Tijerina said the SAT can outsource the verification process.

VAT Delays

Tijerina addressed concerns about delays in VAT refunds to oil and gas exploration companies that won’t have taxable billings or be able to apply input credits against their VAT liabilities for perhaps five years or more. Many companies across a wide range of business sectors have complained that the SAT is holding up refunds of input VAT, apparently to conserve the government’s cash flow in the wake of a sharp decline in oil prices. (Prior coverage: Tax Notes Int’l, Sept. 29, 2014, p. 1106.)

There could be a problem for the SAT if, instead of collecting taxes from oil companies, it has to pay VAT refunds, Tijerina said. “[But] it is our intention not to withhold resources,” he said. “SAT and the Treasury are very aware that these are strategic sectors.” Tijerina added that oil companies are less concerned that they won’t get their VAT refunds within the stipulated 25 days than they are that reimbursement might not come for a year.

Speaking after the conference, Hernandez said the oil companies’ concern is real. “They’re spending a lot and they’re paying VAT on it, but they don’t have any money coming in that they’re charging VAT against to credit it,” he said. “The law says you should get [a refund] within 25 days, but the reality is that many companies are [waiting] more than a year to get it back, and that represents a big financial cost for them. It’s fair, I think, for them to doubt.”

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Morocco

2016 Budget Calls for Progressive Corporate Tax Rates

Morocco’s 2016 draft budget law contains several tax measures, including a proposal to implement a progressive corporate tax scale. Most of the proposed measures are expected to take effect on January 1, 2016.

The progressive corporate income tax rates would apply as follows:
- taxable profit of less than MAD 300,000 (about $30,536): 10 percent;
- MAD 300,000 to MAD 999,999: 20 percent;
- MAD 1 million to MAD 5 million: 30 percent; and
- over MAD 5 million: 31 percent.

The current standard corporate income tax rate is 30 percent.

The 37 percent corporate income tax rate applicable to banks, financial institutions, and insurance companies would remain unchanged.

Currently, dividends paid by offshore holding companies out of profits exempt from corporate income tax are also exempt from withholding tax. This rule is confusing, however, because the holding companies are subject to lump sum taxation and are not exempt for corporate income tax purposes under the rules in force.

Under the proposed measures, the withholding tax exemption would be available for the proportion of profits derived from activities that currently qualify for lump sum taxation. Eligibility for the exemption is conditional on the following conditions set by article 7-VIII of the tax code:
- the sole purpose of the holding company should be the management of shares issued by nonresident companies;
- the holding company should have share-capital denominated in foreign currency; and
- operations undertaken by the holding company should be denominated in foreign currency.

Further, under the current rules, the minimum corporate income tax is calculated at the rate of 0.5 percent, levied on the aggregate value of:
- turnover from the sales of goods and services, excluding VAT;
- other operating income, including directors’ fees received when the company is acting as a member of the management board or similar body of another company;
- income from immovable property;
- financial income; and
• subsidies, whether received from governmental bodies or third parties.

The minimum tax paid for a tax year in which the company incurred a loss, as well as the excess amount of minimum tax paid on the corporate income tax liability for the same year, are creditable against the next three years’ corporate income tax liabilities. The proposed measures would remove the possibility to set off the minimum tax against the corporate income tax liabilities of subsequent tax period.

In a bid to curb tax fraud, the deduction of expenses settled in cash would be capped at a maximum value of MAD 10,000 per day and per supplier.

A reduced VAT rate of 10 percent would be levied on the acquisition of private housing units under an *ijara mutannah bitamlik* lease scheme similar to an acquisition under a *murabaha shariah* credit scheme.

Under the current rules, transport by railway is subject to VAT at the rate of 14 percent. Under the new measures, that VAT rate would be increased to the standard 20 percent rate.

The budget proposals would also improve the refund of input VAT, cover VAT credit derived from investments, and cover equipment acquired from January 1, 2016 onward. Currently, VAT refunds are limited to entities undertaking operations that are VAT exempt or for which VAT is suspended under the provisions of tax code articles 92 and 94. The finance minister pointed out that the current VAT exemption for the first 36 months of newly established entities’ business activities would remain in force.

The VAT refund system would also cover entities operating in agribusiness industries for credit derived from farming materials.

The requirement to file and pay taxes electronically would be broadened to cover all taxpayers regardless of turnover. The requirement would enter into force from tax year 2017. The current four-year time limitation for tax authorities to claim outstanding tax payments would be extended to 10 years if the taxpayer is undertaking fraudulent operations.

♦ *Slim Gargouri, chartered accountant, Sfax, Tunisia*

**Multinational**

**Focus Shifting Away From Switzerland, Former Investigators Say**

The United States is likely to soon move beyond Switzerland in its attempts to pursue and prosecute Americans with undisclosed foreign assets, former officials said October 22 when discussing the U.S. strategy.

Victor Song, a former chief of the IRS Criminal Investigation division, and Mark Matthews, one of Song’s predecessors at CI, appeared at the University of San Diego School of Law-Procopio International Tax Law Institute annual conference as part of a panel discussion on IRS criminal investigations.

Song, now executive vice president of compliance with Samsung Electronics America Inc., said CI was called before Congress in 2008 to explain what it was doing to combat international tax evasion. “We really took the hit for that,” Song said. “The other side of the coin is, after you do take a beating on the Hill, a lot of times you do get extra funding to start doing something.”

Song said CI used to be fairly insular within the IRS because of confidentiality restrictions. As a result of the hearings, he said, CI was given more latitude to work with other IRS divisions, as well as with other countries and global organizations such as the OECD.

In addition to trying to encourage taxpayers to comply, CI started pursuing banks, wealth managers, and preparers who had been facilitating noncompliance, Song said.

Matthews, now with Caplin & Drysdale Chtd., said earlier efforts to combat offshore evasion proved largely ineffective. He said he would send agents into tax havens to attend what he called “festivals of tax evasion.” There were “literally long tables with people hawking their wares of ‘try this, try this,’” he said, adding that it was “very open and very notorious.”

Matthews said he didn’t make a dent in the problem. “The treaties were there, but no one basically responded, or [they] slow-walked your request,” he explained.

Matthews said two things happened to turn the situation around: “The CID finally got a good chief — Victor — or a scary chief, I don’t know which one it was, and [then] a guy named Brad Birkenfeld walked in the door from UBS and told the story that all of us believed was there.”

**The Beginning of the End**

Birkenfeld was a private banking manager with UBS AG in Switzerland before leaving the bank in 2005 and later giving the IRS information about UBS’s complicity with U.S. tax evaders. Birkenfeld’s cooperation ultimately forced UBS to enter into a deferred prosecution agreement with the U.S. Department of Justice in which the bank admitted to helping its U.S. clients evade taxes and agreed to pay a fine of $780 million.

In the first serious breach in the long-standing, rock-solid wall of Swiss banking secrecy, UBS also agreed to turn over the names of approximately 250 U.S. account holders as part of its deal with the DOJ. Swiss bank regulators said the disclosures did not violate bank secrecy rules because the accounts were opened under false pretenses and therefore weren’t entitled to protection.
Emboldened by the UBS disclosures, the U.S. government resuscitated an anemic voluntary disclosure program and created the Swiss bank program. The goals of both programs were to go after tax cheats and their enablers and to encourage as many taxpayers as possible to comply by charging penalties but removing the possibility of prison terms. Under the Swiss bank program, qualifying financial institutions enter into deferred prosecution agreements and are able to lower their penalties by convincing their U.S. clients to come into compliance with the IRS. (Prior coverage: Tax Notes Int’l, June 8, 2015, p. 889.)

IRS Cozies Up to Historic Enemies

Matthews said 106 of the over 300 banks in Switzerland indicated their willingness to work with the IRS by entering the program. The IRS “turned their historical enemies, the Swiss banks, into those pushing people in,” he said. “So suddenly, the banks had a motive because every client that you get to go into the program was a free pass.”

Of course, the clients and former clients of the Swiss banks weren’t happy that the institutions they had relied on to protect their secrecy were cooperating with the IRS. “The banks were asked, ‘If I’m going to go in the program, I want a lot more than a toaster from you,’” Matthews said. “‘I’m going to want you to pay half my penalty.’ That generally didn’t work out.”

Matthews said many banks instead paid their clients’ legal and accounting fees. He said the banks were telling their clients, “the U.S. government is going to shoot me in the head, [and] I’ve got to give up your information anyway. Why don’t you scurry on in and save us all the trouble?”

Although a significant section of Swiss bank secrecy law remains intact, banks cooperating with the U.S. government turn over specific data, including details about the dates, amounts, and destinations of wire transfers that close out U.S. persons’ accounts. While the account holders’ names are not revealed, it is widely expected that the DOJ will use the detailed information on these so-called leaver lists to file group requests with the Swiss competent authority to obtain the identities of U.S. taxpayers who have not disclosed their account details.

Matthews said a team will be looking to see if the U.S. has a tax treaty with the country where the funds transferred out of a Swiss account were sent. “They will now have the beginnings of the evidence to create a valid treaty request and go after that same information in that other bank,” he said. “So [the IRS has] put together a pretty neat little vice here.” The message for individuals who think they’re safe because they got their money out of Switzerland and into countries such as Panama is that “there’s a very high chance they’re going to find you,” Matthews said.

Banks that actively market themselves as discreet destinations for undeclared cash have cause for concern as well. “There’s sort of a special place in hell in the Justice Department’s mind for people who run and hide,” Matthews said. “And the banks who took on people who were running from Switzerland, the Department of Justice really finds that behavior offensive, both on the part of the banks and people who are running. That is a very dangerous thing to be doing these days.”

Steven Toscher, a criminal tax lawyer at Hochman, Salkin, Rettig, Toscher & Perez PC, said the government’s strategy with the voluntary disclosure and Swiss bank programs is brilliant because of the magnitude of the problem and the scarcity of resources available to address it. “It’s based on the presumption they can’t prosecute everybody,” Toscher said. “They just don’t have the resources.”

Nowhere to Hide

Toscher said that when the Swiss bank program first started, it targeted only banks, and not trust companies and other financial institutions that had also been facilitating tax evasion. “Now other types of financial organizations have gone in or had discussions with the [Justice] Department,” he said. “The framework has been set by the Swiss bank program, [so] if you get to them before they get to you, you’re going to be in much better shape.”

Information derived from the leaver lists and other sources is likely to shift the government’s focus away from Switzerland, Song said. There are still many people with their heads in the sand because their undisclosed offshore assets are not held in Switzerland, he said. “I wouldn’t be surprised if you see things in Central and South America and Asia,” Song added.

Matthews said banks in other countries may soon be knocking on the DOJ’s door, looking to cut a deal. “So beware Singapore, Hong Kong, Dubai, Israel, Panama,” he said. “Your day may come.”

The panel moderator asked whether the statute of limitations provides shelter for assets that were in an undisclosed account in 2008 or earlier. Matthews said the DOJ can still resort to conspiracy charges, which he said go back six years from the date of the last act of the conspiracy.

While the DOJ generally doesn’t like to base a prosecution solely on a conspiracy charge, there is a new substantive count for the year in which a leaver opens an undisclosed account in another country, Matthews said. “That’s why they will ultimately be able to have fresh, substantive counts for those waiver years,” he said.

Matthews said one possibility for individuals with undisclosed accounts is to try filing an accurate tax return for the most recent year, along with a foreign bank account report. “But you have left a whole of penalties and exposure back there if you don’t use one of these formal programs,” Matthews said. “If you have a small enough account that might work for some
people, but the government is pretty smart and they’re going to see new FBARs coming in with new accounts on them. They’re not idiots.”

Toscher said individuals with undisclosed accounts derive no satisfaction from the fact that the foreign jurisdiction where their money is stashed has intact bank secrecy laws and does not have a tax treaty with the U.S. because so many foreign financial institutions have correspondent banking accounts with U.S. banks. “They need to deal with dollars,” he said. “The government believes that those correspondent accounts maintained in the U.S., [and] not in the name of individual taxpayers, have a wealth of information regarding individual taxpayers.”

Toscher said that in most early voluntary disclosure cases, tax avoidance wasn’t necessarily the motive for opening an offshore account, and the account holders often weren’t earning significant amounts of income on the undisclosed assets. “People weren’t buying yield; they were buying secrecy,” he said. Many people who ended up paying penalties equal to 20 percent of their highest undisclosed balances were not guilty of “active meat and potatoes criminal tax behavior,” Toscher said, but had instead inherited money or were immigrants coming from countries that did not protect them.

He commended the government for streamlining the offshore voluntary disclosure program last year, easing the penalties on account holders whose failure to disclose and pay tax was non-willful. Most taxpayers who do not have a history of willful noncompliance will qualify for a 5 percent penalty under the streamlined procedures.

Courts Frown on Unequal Punishment

The panelists said the courts have not always been pleased with the fact that many wealthy individuals who had undisclosed accounts in Switzerland are getting off relatively lightly compared with more garden-variety tax evaders, such as restaurant owners or roofing contractors who underreport income on their domestic activities.

Matthews compared the earlier penalties for people who had money squirreled away offshore with those given to small-business owners in the U.S. who underreported income, implying that the latter group is often punished more harshly. “You would think that, dollar for dollar, [those involved in hiding assets in Switzerland] would get more jail time than the regular tax cheat,” Matthews said. “As of a few months ago, over 60 percent of the defendants got probation on an average account size of $7 million. You gotta be kidding me! How can that be? And I don’t think anybody’s done more than two years [in prison].”

The government started off with bad case selection, Matthews said. One of the early prosecutions involved a 72-year-old woman with a high school education who wanted to enter the voluntary disclosure program but whose lawyer missed the deadline. Matthews said the government rejected her application (apparently because UBS had already turned over her name as part of its deferred prosecution agreement). The woman was fined $22 million on a $44 million account. Despite facing a six-year prison term, the woman was sentenced to a single year of probation. According to Matthews, the judge told the defendant after announcing the probation, “Oh, by the way, looking at my watch, I see five seconds have passed. I now end your sentence of probation.” Matthews said the judge terminated the probation because he was mad about the DOJ’s case selection.

Matthews said the DOJ failed to understand the weight that judges were giving to the fact that up to 60,000 people who were later entering into the disclosure program did not suffer a similar fate.

Matthews represented H. Ty Warner, creator of Beanie Babies, who pleaded guilty in 2014 to evading taxes on income derived from an undisclosed account at UBS that he moved to another bank in 2002. Warner was fined $53.6 million and sentenced to two years of probation and 500 hours of community service. (Prior coverage: Tax Notes Int’l, July 20, 2015, p. 222.)

“The government stood up and said that wasn’t a material punishment,” Matthews said. “I’m sorry, [but] most people think a $53 million penalty is a punishment. I think those kinds of factors are causing the judges to say, ‘OK, these people have been punished enough, especially when I look at these other guys.’”

Although the DOJ appealed Warner’s sentence, it was upheld by the Seventh Circuit in July.

The Strangest Sentence of All

Toscher said he would never argue to a judge that his client should be treated more leniently in an overseas tax case because of all the others who were getting off more easily. “Those types of argument don’t work, but [the disparity in sentencing] is the proverbial elephant in the room,” he said, adding that he thinks the sentences “are not reflective of routine tax cases” and will not be “reflective of what the next rounds of foreign criminal tax cases are going to be.”

Toscher said the system for determining punishments in foreign tax cases is imperfect. “The person who got the most jail time in a foreign case was somebody who [pleaded] guilty and cooperated with the government and gave the government all this information: Mr. Birkenfeld,” he said.

Birkenfeld was sentenced to 40 months in prison. After being released on parole after 31 months, he received a whistleblower award of $104 million from the U.S. government for his “exceptional cooperation” with the DOJ.

♦ William Hoke, Tax Analysts. 
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Tax Directors Detail Unconventional Approaches to Transfer Pricing Audits

The U.S. and some other countries are becoming more aggressive in pursuing and litigating transfer pricing cases, and companies’ responses range from the logical to the almost ludicrous, tax directors of international companies said.

Speaking during a roundtable discussion October 22 at the University of San Diego School of Law-Procopio International Tax Law Institute annual conference, panel co-moderator Nate Giesselman of Skadden, Arps, Slate, Meagher & Flom LLP said tax directors should remember that the settlement of a transfer pricing issue is different from most other types of agreements with tax authorities. “If you, as a tax director, are making a reorganization, or an acquisition, or a spinoff, and the IRS comes and says, ‘We think one of your intercompany notes should have been a dividend,’ you can fight that point. And if, at the end of the day, you agree to take the tax hit on that, it’s done and over with, and you can go on with your life,” Giesselman said. But if the IRS says a U.S. subsidiary should be reporting a higher margin than it is, the resulting exposure potentially continues forever, he noted.

A good part of the roundtable discussion was dedicated to what co-moderator Hal Hicks of Skadden referred to as “war stories.”

Paul Yong, international tax director at Sempra Energy, offered the first example. Yong said he previously worked at a company, which he didn’t identify, that was consistently hit with assessments by the same auditor in Canada. According to Yong, the revenue agent wasn’t particularly interested in auditing his company but was bucking for a promotion. “At the end of the audit, he would just assess us, [but] there’d be no support for his assessment,” Yong said. “Rather than argue and fight it, we’d settle. We’d give him a little bit.”

Yong said he was in Canada during an audit one year and was told by his local manager that the auditor brought in some newspapers every day and read them in the morning before getting down to work after lunch. Yong said he told his manager to put hunting, fishing, and automotive magazines on a table in the reception area outside the room where the auditor was working. “Now he picks up a couple of issues of magazines,” the manager told Yong. “He does no work at all.”

At the end of the audit, realizing that he hadn’t done any work, the auditor asked for an extension, Yong said. Yong refused, saying he wanted a meeting with the auditor’s manager, an explanation of the work the auditor had done, and the reason why an extension was needed. “Guess what? Two weeks later, a no-change audit,” Yong said. “Sometimes you can use all your technical knowledge and argue and argue all day, or sometimes you use a little street smarts and get to the same place, a better place.”

More Than Technical Knowledge

Beth Wapner of Qualcomm said transfer pricing isn’t necessarily just technical knowledge. “You read the regs, and maybe they make sense, and maybe they don’t, but it boils down to the numbers that you can present to the auditors and the methodology or the reasonableness of what you’re doing,” she said. “It doesn’t seem to me that the IRS really wins a lot.”

Wapner cited an example the recent U.S. Tax Court decision in Altera Corp. v. Commissioner, 145 T.C. No. 3 (2015), which represented the IRS’s third straight defeat in its long-running attempt to require a U.S. corporation to include stock-based compensation in the costs to be shared with a foreign affiliate for jointly developing intangible assets. (Prior analysis: Tax Notes Int’l, Aug. 3, 2015, p. 386.)

Wapner said her company is participating in the IRS’s compliance assurance program (CAP) program, exchanging information with the agency before filing its tax returns to increase certainty and reduce the administrative burden.

“The CAP program is basically a real-time audit of your tax return,” she said. “It’s a very efficient process. Having worked on audits that were 12 years old and 10 years old, it’s almost impossible to get information. People leave the company or, unfortunately, pass away, or you get boxes of junk, and you can’t find any real information.”

Jose Huerta, the Latin America, Caribbean, and Canada tax director for Visa Inc., said the U.S. side of multinational audits has been managed quite well “on the controversy side.” Huerta said Brazil has given him “heartburn” because the country prescribes a net profit for intercompany transactions, which raises the potential for double taxation.

Wapner agreed. “I always crunch my teeth when I hear we’re doing something in Brazil,” she said.

Working With Developing Countries

Yong said his company has been applying for a unilateral advance pricing agreement with the U.S. Treasury in connection with its assets in Mexico. “There’s only one country that we’re talking to, and it’s taken over two years, and we still don’t have it,” he said.

Yong said it can be easier to deal with the tax authorities of developing countries on transfer pricing issues. “I try not to roll my eyes when they talk about developed countries and developing countries,” he said. “Which one is developed, and which is developing? The U.S. is really behind in terms of trying to provide certainty to companies, while the so-called developing companies are really quicker. Mexico, Chile, and Peru [are] much easier to work with.”
MULTINATIONAL

Hicks, who was previously associate chief counsel (international) in the Office of the Chief Counsel at the IRS, said the agency is confronted with resource constraints that some of its foreign counterparts don’t share. “There really are resource issues a lot of times being the cause of these delays,” he said.

Wapner said her company frequently finds it easier to deal with audits on its home soil than it does abroad. “In Korea, they just basically bring in a SWAT team,” she said. “They go away and make their adjustment.”

In India, she said, audits can remain open for extended periods. “They seem to start their audit close to the end of the statute of limitations,” she said. “They somehow have the ability to reopen closed years.” In contrast, Singapore is “[pretty quick,” Wapner said.

Huerta said that as countries move to implement the OECD’s base erosion and profit-shifting action plans, the audit process will become more complex. “The concern that I personally have in a post-BEPS environment with a competent authority case is that [BEPS has] kind of emboldened the tax authority to be more aggressive to pursue, quite frankly, U.S. multinationals to shore up a shortage in their treasury,” he said. That will lead to significant increases in the workloads of competent authorities and a consequent increase in the amount of time needed to resolve the cases, Huerta said.

Give In to Win

Yong said auditors frequently like to travel to San Diego, where his company is headquartered, and to Los Angeles, which was home to a previous employer. “Los Angeles: Disneyland, Knott’s Berry Farm, all those things,” he said. “We always tried to schedule audits next to long government holidays. A lot of them bring their family, and they don’t get the work done. If you do have auditors coming in, schedule it right next to a long government holiday.”

Yong said his company used to fight auditors. “Most companies stick them in the basement,” he said. “I have found that when you treat them poorly, they look for ways to get revenge.” When once confronted with a tax auditor’s request to produce what he considered to be an unreasonable number of documents, Yong said, he told his audit manager, “Let’s hire some temporary workers that are very good at making Xeroxes, and let’s Xerox everything.” After “trucking documents to them into their offices,” Yong said, the auditors later admitted that they couldn’t get through all of the material they had requested. “Give them what they want,” he said. “There’s no way they can get through them.”

Yong said one of the keys to shorten the tax audit process in the U.S. is to assemble in advance the documents that auditors will typically request. “They come in and they’re amazed,” he said. “That’s really helped in terms of moving things along faster.”

Foreign Tax Credit a Zero Sum Game

Hicks said the U.S. foreign tax credit system, which generally allows a taxpayer to take a credit against its U.S. tax liability for taxes paid abroad, makes the IRS “understandably” reluctant to allow the credit. The taxpayer has to demonstrate to the IRS that any tax paid to a foreign government was compulsory and was not made voluntarily, Hicks said, adding, “It’s very tricky in non-U.S. audits when you settle and how you settle.”

Hicks said that the rules about when an FTC can be taken used to be very procedural but that the IRS is now starting to wield them more rigorously. “The idea is, ‘Have you done enough to fight this non-U.S. audit?’” he said.

Poland

NEWS ANALYSIS

VAT Gap Tops Priority List for New Parliament

The conservative Law and Justice party shook the political stage in Poland on October 25, winning parliamentary elections after eight years in opposition. The party will hold 235 seats in the 460-seat parliament, which means it will be able to govern without a coalition partner.

Andrzej Duda, a lawyer and member of the European Parliament, was elected president in August with the support of Law and Justice. With the president by its side, the party will wield enormous power.

Party leaders made a long list of promises in the parliamentary campaign, many of which focused on social benefits such as child benefits for every family with more than two children, free medication for seniors over 75 years of age, the lowering of the pension age, and a higher minimum wage. Huge sums are needed to fulfill those promises, and taxes are the first stop for funds to cover those needs. VAT and other indirect taxes cover most of the state’s budgetary needs, but VAT is also subject to abuse. The VAT gap caused by unrecorded sales, unduly received VAT refunds, and so on is significant.

Looking to VAT for the Answers

Law and Justice aims to close that gap and recover the lost VAT. Party leaders have already released a draft VAT Law, which was prepared some time ago but never officially presented until now. The draft contains
more than 440 articles, making it longer than the law now in force. Some of the new VAT proposals are much needed while some are controversial. All in all, the draft is not that much different from the VAT Law now in force because most of Poland’s VAT provisions are taken directly from the EU VAT system. Thus, the draft is essentially a public relations maneuver.

Nevertheless, the draft law aims to close as many VAT leaks as possible. It introduces a split VAT payment in which only the net amount from an invoice is paid directly to the seller. The VAT would go to a temporary bank account of the invoice issuer, administered by the tax office. This would counter VAT abuses such as missing trader schemes.

The party also supports the idea of a central register of invoices, to be administered by the minister of finance. Every VAT payer would transfer data on the VAT invoices (including the invoice recipient’s VAT number) to the register. This would allow for the aggregation of input and output VAT data on a national scale and would ensure that input tax claimed by one party is declared output tax in the same settlement period by another party.

While both of these ideas are generally accepted ways to counter VAT abuse, technical infrastructure is needed to operate a central VAT register or a split payment scheme. That infrastructure is not now available to the Polish fiscal administration.

The draft also aims to add VAT on any operation that will result in a “tax benefit” in VAT terms. This concept is imprecise and is not part of the EU VAT rules. Perhaps the authors of the proposal want to target unregistered transactions, but the provisions’ wording cannot be reconciled with EU VAT law.

Law and Justice would make changes to the documentation of transactions subject to VAT. Some of the changes revert to what was removed from the regulations a few years ago, while others introduce new concepts. The party also wants all taxpayers to settle VAT monthly. Currently, a quarterly option is also available.

Party leaders said the standard VAT rate will be lowered from 23 percent to 22 percent.

Law and Justice will likely attempt to introduce the new VAT in early 2016. The party says it could even enter into force on January 1, 2016. This is possible from the standpoint of the legal procedure’s timing, but because of the extent of the changes in the draft VAT Law, it seems highly unlikely.

Other Taxes

Law and Justice also intends to lower the corporate income tax from 19 percent to 15 percent for businesses with annual income under €1.2 million. Investment relief is also planned. The party will likely follow any of the OECD’s base erosion and profit-shifting recommendations that will make transfer pricing audits more efficient. The issue of profit transfers from Polish subsidiaries to their parent companies in other countries has always been high on the party’s agenda, too.

Two new taxes on the table are the supermarket tax and the bank tax. The party would like to levy a charge equal to 2 percent of the revenue of stores with retail space over 250 square meters. The bank tax would likely be levied at the rate of 0.39 percent of a bank’s assets.

Supermarkets and banks have already opposed those proposals. Banks’ stock quotations plunged after the election results were made public, and retail store owners argue that the low space threshold would affect them as well as supermarkets. They say the limit should be set at a minimum of 400 square meters.

Party leaders said the supermarket and bank taxes could also enter into force at the beginning of 2016, but that deadline seems almost impossible to meet.

In any event, banks and supermarkets have made it clear that the new taxes will ultimately be transferred to the end users in the form of higher bank charges, higher mortgage or other financing costs, and higher retail prices, so the party’s plan may misfire in the end.

Many economists say Law and Justice will have to scale back its promises to a level that covers only those in dire situations, or it will not meet its goals at all. The state budget for the next year has already been planned and accepted by the outgoing parliament, and though it can be modified, it is impossible to find the means to cover the extensive social benefits promised by the party on such short notice.

It remains to be seen who will become the next minister of finance. Various names have been thrown into the hat. One likely candidate is Pawel Szalamacha, a legal adviser and founder of the Sobieski Institute who was vice minister in the Ministry of the Treasury from 2005 to 2007. It is also possible that the Ministry of Economy and the Ministry of Finance will come under one roof, with the minister of that new, merged office undoubtedly becoming the most powerful economic leader in Poland.

Maria Kukawska and Mariusz Machcinski, partners and tax advisers, Stone & Feather Tax Advisory, Warsaw

Romania

Dividends Tax Cut to Take Effect January 1, 2016

The government is moving up by one year the effective date of a reduction — from the current 16 percent to 5 percent — of the tax on dividends. The tax cut was originally scheduled to enter into force in January...
2017 as part of the new fiscal code approved by the Parliament in September.

The acceleration of the tax cut was proposed by the Alliance of Liberals and Democrats (Romania), and Romanian Prime Minister Victor Ponta considered it sustainable.

It is expected that reducing the withholding tax on dividends to 5 percent will attract more investors from countries outside the European Union. For example, the current Romania-U.S. tax treaty caps the rate at 10 percent for Romanian-source dividends beneficially owned by U.S.-based shareholders.

The new measure may also attract more Asian investors. For example, South Korean investors may be encouraged to set up businesses in Romania because the current Romania-South Korea tax treaty caps the dividend tax rates as follows:

- 7 percent of the gross amount of the dividends if the beneficiary is a company that owns at least 25 percent of the payer’s capital; or
- 10 percent of the gross amount of dividends in all other cases.

Both the Japan-Romania and the China-Romania tax treaties provide for a maximum rate of 10 percent.

♦ Slim Gargouri, chartered accountant, Sfax, Tunisia

Russia

CFC Guidance Clarifies Corporate Tax Exemption

Russia’s Ministry of Finance recently issued guidance clarifying the corporate tax exemption for profits generated by controlled foreign corporations.

Based on Tax Code article 25.13-1, section 1, the profits of CFCs are exempted from taxation in Russia if at least one of the following conditions is met:

- the CFC is a noncommercial entity that, according to its internal law, does not distribute its profits among its shareholders or other persons;
- the CFC was created in accordance with the legislation of a member country of the Eurasian Economic Union and has permanent tax residency in that country;
- the effective tax rate for the CFC’s profits, determined, as provided by article 15.13-1, by the results of a tax period, is not less than 75 percent of the general corporate tax rate established in Russia;
- the CFC is one of the following:
  - an active foreign company — a company in which the share of profits mentioned in Tax Code article 309.1, section 4, constitutes no more than 20 percent of the CFC’s total profits;
  - an active foreign holding company — a company in which the share of direct participation of a Russian entity (controlling person) totals no less than 75 percent during a period of 366 consecutive calendar days; or
  - an active foreign subholding company — a company in which the share of direct participation of a foreign holding company totals no less than 75 percent during a period of 366 consecutive calendar days;
- the CFC is a bank or an insurance company carrying out its activities in accordance with its internal law on the basis of a license or other special permit;
- the CFC is one of the following:
  - an issuer of circulating bonds;
  - an entity authorized to receive interest income paid under circulating bonds; or
  - an entity to which the rights and obligations of circulating bonds issued by another foreign entity have been assigned;
- the CFC participates in the extraction of natural resources on the basis of production sharing agreements concluded with the relevant foreign country, concession agreements, licensing agreements, servicing agreements, or other agreements that are similar to production sharing agreements, and the share of profits registered by the CFC from its participation in those projects during the relevant tax year constitutes no less than 90 percent of its total registered profits, or the CFC did not register any profits during the relevant tax year; or
- the CFC is the operator of a new offshore deposit of hydrocarbon fuels or is a direct shareholder of the operator of a new offshore hydrocarbon deposit.

Guidance Letter 03-08-05/57368 (dated October 7) also noted that the profits of a CFC are exempted from taxation in Russia in cases mentioned in section 1, subsections 3, 5, and 6, of Tax Code article 25.13-1 if the CFC has permanent tax residency in a country that

1That section includes profits in the form of dividends and other profit distributions (including liquidation payouts); interest payments; profits generated from the use of intellectual properties; profits from the sale of stakes; profits from the sale or lease of immovable properties; profits generated from transactions with fixed-term financial instruments; profits from the provision of consulting, legal, accounting, auditing, advertising, marketing, research and development, and certain other services; and other similar profits.
has an effective tax treaty with Russia, except for countries that do not provide for the exchange of information on tax matters with Russia.

The MOF said the government must approve a list of the countries that do not provide for the exchange of information on tax matters with Russia. The existing list of countries that provide for the beneficial tax regime or do not provide for the disclosure and provision of information on financial transactions shall not be used for the purposes of Tax Code article 25.13-1, it said.

The list to be approved by the government will include not only countries that do not provide for the exchange of information on tax matters, but also jurisdictions with which Russia has not exchanged any information on tax matters or with which Russian tax authorities have had bad experiences in the exchange of tax information.

The MOF stressed that taxpayers are required to notify the relevant tax authority, by the deadlines stipulated by Tax Code article 25.14, section 1, of:
- their participation in foreign companies if the participation stake exceeds 10 percent;
- the creation of unincorporated foreign structures that lack legal personality, and of control over them or the actual right to their income; and
- the CFCs that they control.

The fact that the profits of a foreign CFC are exempted from taxation in Russia on the basis of Tax Code article 25.13-1 does not exonerate a Russian resident taxpayer (controlling person) from the obligation to file the notifications provided by Tax Code article 25.14, the MOF said.

♦ Iurie Lungu, Graham & Levintsa, Chisinau

Ukraine

Guidance Addresses Deemed Controlled Transactions

A transaction will not be deemed controlled for transfer pricing purposes if a member of a nonresident legal entity (but not the entity itself) is on the government's list of low-tax jurisdictions, according to the Ukrainian State Tax Service (STS).

Guidance Letter 18915/6/99-99-19-02-02-15 (dated September 4) responds to an inquiry from a resident corporate taxpayer that executes business transactions with an unrelated nonresident legal entity that is not registered in a jurisdiction on Ukraine's list of low-tax jurisdictions for transfer pricing purposes included in Tax Code article 39.2.1.2. However, one of the members of that nonresident legal entity is a resident of a country on the list. The taxpayer asked the STS to comment on whether the transactions executed with its nonresident counterparty would be deemed controlled for Ukrainian transfer pricing purposes.

The STS noted that the Ukrainian parliament on July 15 adopted Law 609-VIII amending the transfer pricing provisions of the Tax Code. Those amendments, which became effective August 13, revised the criteria to qualify specific business transactions as controlled for Ukrainian transfer pricing purposes.

According to revised Tax Code article 39, business transactions for the purchase and sale of goods, works, or services will be considered controlled for transfer pricing purposes if they involve resident persons and their affiliated nonresidents or if they involve export sales of goods, works, or services through a nonresident agent working on a commission basis, the STS said.

The STS said that for transfer pricing purposes, business transactions will be considered controlled if they influence the taxpayer's taxable objects and involve a nonresident registered in a jurisdiction on the government's list of low-tax jurisdictions; that is, those with a corporate tax rate at least 5 percentage points lower than Ukraine's general corporate rate of 18 percent.

These transactions will be deemed to be controlled if the following conditions are met simultaneously:
- the taxpayer's annual turnover from all activities exceeds UAH 50 million (about $2.2 million) in a tax year; and
- the volume of the taxpayer's business transactions with each of its counterparties exceeds UAH 5 million in a tax year.

In light of the foregoing, the STS said that business transactions involving a resident corporate taxpayer and an unaffiliated nonresident will not be qualified as controlled for Ukrainian transfer pricing purposes if the nonresident does not reside in a low-tax jurisdiction, regardless of whether its members are residents of jurisdictions on the government's list.

The STS also noted that under Tax Code article 140.5.4, a taxpayer must increase its financial results, registered as at the end of a tax (reporting) year, by 30 percent of the value of the goods, works, or services acquired from nonresidents (including affiliated nonresidents) that are registered in jurisdictions on the government's list.

The STS said that a taxpayer doesn't need to follow the above requirements of Tax Code article 140 if it has executed transactions considered controlled for transfer pricing purposes but its expenses incurred in connection with the acquisition of goods, works, or services correspond to the market prices normally applicable to the transactions, and this is confirmed by the transfer pricing report and other documentation that must be filed with the tax authorities based on Tax Code article 39. Similarly, the taxpayer need not follow the requirements of article 140 if its transactions are...
not deemed to be controlled for transfer pricing purposes and the taxpayer can prove that the prices in the transactions correspond to applicable market prices.

The STS also confirmed that a taxpayer that acquired goods, works, or services from an unaffiliated nonresident residing in a jurisdiction that is not on the government’s list doesn’t need to follow the above requirements of Tax Code article 140. According to the STS, the conclusion is also valid if the members of the taxpayer’s unaffiliated nonresident counterparty do reside in the jurisdictions included on the list.

♦ Iurie Lungu, Graham & Levintsa, Chisinau

United Kingdom

U.K. Readies OECD-Compliant Changes to Patent Box

To comply with the OECD’s requirement that new standards for patent box regimes be implemented by July 1, 2016, the U.K. government will release draft legislation in December and an updated draft in the spring reflecting the comments received on its latest consultation.

On October 22 HM Treasury offered the government’s current preferred approaches to modifying the patent box rules to comply with the minimum standards in the OECD’s report on action 5 (counter harmful tax practices more effectively, taking into account transparency and substance) of its base erosion and profit-shifting project and requested public comment on these proposals. (Prior coverage: Tax Notes Int’l, Oct. 12, 2015, p. 103.) The government proposed a grandfathering rule of five years for patent box elections in force by June 30, 2016, which is the maximum allowable under the OECD’s standards. Comments are due by December 4.

Commitment to the Patent Box

In the consultation, the government expresses support for the U.K.’s policy of granting preferential treatment to income from patents or equivalent forms of intellectual property, which it currently does by offering a lower tax rate of 10 percent. “The Patent Box is a key initiative in making the UK tax regime competitive for innovative high-tech companies, driving growth and investment in the UK, creating high-value jobs in innovative industries, and building on the UK’s long and proud history of great inventions and discoveries,” the consultation said. However, the document also acknowledges that “significant amendments” to its current regime will be necessary to comply with the OECD’s new standards, which adopt a “nexus approach” that requires a link between IP development expenditures incurred and the income subject to the preferential rate.

Nexus Ratio and Tracking

The consultation document adopts the OECD’s formula for the “nexus ratio,” which generally represents the share of an IP profit stream attributable to a company’s contribution to IP development. However, the document recognizes that the current manner by which IP profit is determined may require modification to satisfy the new nexus requirement. Specifically, the report says, the new OECD standards may require a “streaming approach,” under which the specific profit streams and corresponding nexus ratios are tracked at the level of each individual patent, product, or product family. This differs from the current patent box rules, which allow use of the company’s aggregate IP profit stream.

The consultation also addresses the issue of the level at which each IP profit stream should be tracked, proposing that companies be able to choose whether to track revenue and costs by individual IP asset, product, or product family. However, legislation would set out broad principles governing this choice, it said. It proposes that profits be tracked at the level of each IP asset, unless doing so would be unrealistic, require arbitrary judgments, or entail tracking and tracing to a category unrelated to innovation or business practice. The document said that tracking at a higher level than the individual IP asset would be permitted but only up to the lowest level that would not entail any of those circumstances.

The document discusses the “rebuttable presumption” rule, which under “exceptional circumstances” allows taxpayers to rebut the presumption that the nexus ratio accurately links IP profit to development contributions and to establish that a higher ratio is more appropriate. It provides two ways to apply the rule: one that allows an adjustment to the nexus ratio when some general requirements are met and another that sets a fixed ratio adjustment corresponding to specified circumstances under which the rule would apply. Although it asks for input regarding which is the best approach, it says the first “seems better overall.”

Treatment of Costs

The consultation document also addresses the appropriate classification and treatment of specific types of costs. Regarding the definition of research and development expenditure for purposes of calculating the nexus ratio, the consultation proposes that the definition be closely aligned with the definition used for purposes of calculating the U.K.’s R&D tax credit, although it also says that the amount used for calculating the nexus ratio need not necessarily equal the amount claimed for purposes of the credit. R&D expenditures must be included in the ratio when they are incurred, it says.
The document says that R&D costs incurred by a company should not receive discriminatory treatment solely because they are incurred through a cost contribution or joint development arrangement and, therefore, that they should be treated as the company’s development contribution rather than as acquisition or related-party subcontracting costs. To ensure the link between R&D expenditures and profits, however, it proposes that in a co-development arrangement only R&D expenditures incurs be included in the nexus numerator and that funding provided or non-R&D contributions be treated as either acquisition costs or related-party subcontracting.

The document provides different options for the treatment of R&D expenditures incurred by companies before a merger, each of which is intended to treat all companies’ expenditures as incurred by the post-merger company while at the same time not giving more favorable treatment to mergers than to direct acquisitions of IP. The options include a tracking rule that specifically identifies the IP revenue and R&D expenditures attributable to the acquired company, a purpose test for mergers, and rules analogous to the restrictions on loss buying.

The document proposes removing R&D expenditure from the nexus ratio after 15 years, which it estimates is the period over which the expenditures contribute to IP profit based on the 20-year patent protection period minus five years to account for patents that may have a priority date that is earlier than the filing date.

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Lawmakers Urge Reforms to Curb Tax Credit Fraud and Error

The government has shown “a paucity of ambition” in tackling the problems of fraud and error when tax credits and benefits are granted, according to a U.K. House of Commons’ Public Accounts Committee (PAC) report. The committee urged administrators to set solid targets to address the issue.

The October 28 report follows a September 14 hearing at which PAC members questioned officials from both HM Revenue & Customs and the Department for Work and Pensions (DWP) about the way their departments have handled fraud and error in the granting of tax credits and benefits. The witness list included Lin Homer, HMRC’s chief executive and permanent secretary, and Robert Devereux, the DWP’s permanent secretary. (Prior coverage: Tax Notes Int’l, Sept. 21, 2015, p. 1010.)

Although HMRC and the DWP have both made strides in cutting fraud and error headline rates since 2010 — especially HMRC in the area of tax credits — fraud and errors in the payment of tax credits and benefits in 2013-2014 led both departments to overpay a total of £4.6 billion to some claimants and to underpay £1.6 billion to others. The issue is of “great concern” to the PAC, according to Labour MP Meg Hillier, chair of the committee.

“Put simply, far too much [of] taxpayers’ money has gone where it shouldn’t — and too little where it should,” Hillier said in a news release. As a result, legitimate claimants were unable to get millions of pounds in support, with each U.K. household losing £200 a year to overpayments, she said.

The report notes that despite HMRC’s success in reducing tax credits fraud and error, the department doesn’t understand how it did so or how much it can do to cut fraud and error even further.

The PAC expressed disappointment that HMRC was unable to identify goals for reducing fraud and error and that it seemed unwilling to set targets. As a result, the PAC is recommending that HMRC set regular targets to curb fraud and error in tax credits as the system transitions to a universal credit that will replace six benefits and tax credits in stages through 2017.

While officials from both departments have said the government’s planned welfare reforms, such as the universal credit and the introduction of a new state pension, will have a positive effect on efforts to reduce fraud and error, those measures are unlikely to solve the problem, according to the report. The PAC said it was surprised to hear that the DWP expects fraud and error levels to rise from £4.6 billion in 2013-2014 to £5.8 billion in 2020-2021 and believes that the universal credit will save a mere £500 million annually in fraud and error overpayment.

The DWP should determine how to target the causes of fraud and error after welfare reforms are implemented and should update the PAC with annual projections so the committee can evaluate the department’s performance, the report says.

Lawmakers criticized HMRC and the DWP for focusing too much on detecting and correcting fraud and error and not enough on prevention. The report recommends that both departments examine why claimants make mistakes; set goals for reducing underpayments; and report back to the committee in six months on their progress.

The report also criticizes HMRC for failing to consider how its actions to address tax credit fraud and error affect individuals. “I am also concerned that steps taken by HMRC to tackle tax credit fraud and error [have] resulted in a blunt-instrument approach to enforcement that does not properly take into account the human impact of its response, particularly on vulnerable claimants,” Hillier said.

Although the tax authority has changed the way it interacts with claimants through, for example, new reporting requirements and the use of digital accounts, the PAC said it is concerned that HMRC “fails to support claimants adequately, is quick to blame claimants
when errors occur, and does not accept responsibility for contributing to mistakes itself.” The report also points out that HMRC uses a private-sector contractor to increase scrutiny of tax credit claims and that the contractor’s methods may be “excessively threatening.”

HMRC should work with the government-wide Fraud, Error and Debit Steering Group to carry out an independent review of claimants’ experiences with the tax credits process, the PAC said. The review should include an assessment of the private-sector contractor’s effect on claimants and should determine how to lessen unnecessary claimant burdens, according to the report.

Anthony Thomas, chair of the Low Incomes Tax Reform Group of the Chartered Institute of Taxation, welcomed the committee’s report. “It is worrying, although not surprising, that the PAC has reason to express their own concern that the approach of HMRC’s private contractor, used to check claims, has been excessively threatening,” he said in a statement.

Thomas said his group is particularly worried about investigations of single claims based on information suggesting that another person lives at a claimant’s property. He said the follow-ups may be heavy-handed in many cases and may even unjustly target the claimant. “Some published tribunal decisions have been very critical of HMRC’s approach, suggesting that HMRC have failed to recognise cases where the burden of proof lies with the department rather than the claimant,” he said.

Questions and Answers

The PAC’s report comes on the heels of a controversy in Parliament over the government’s plans to slash £4.4 billion in tax credits to help meet its election promise of finding £12 billion in welfare savings.

The proposal was passed in the House of Commons, but in an unusual move, the House of Lords voted October 26 to delay approval pending completion of both an impact assessment and a consultation and report on transitional protection for existing tax credit recipients.

The government has accused the House of Lords of breaking a parliamentary convention that says the unelected Lords will not oppose the government on issues of finance or election manifesto promises. Chancellor of the Exchequer George Osborne told the House of Commons on October 27 that he will announce measures offering transitional help to current tax credit recipients in his November 25 autumn statement. He also said that the House of Lords’ decision brings up “clear constitutional issues” that the government will address.

Prime Minister David Cameron appeared in the House of Commons on October 28 to answer questions from members of Parliament about the government’s controversial plan to cut tax credits, which critics say would have a devastating effect on 3 million low-income families, which could lose an average of £1,300 annually.

Labour Party leader Jeremy Corbyn pressed Cameron several times to guarantee that “nobody will be worse off next year as a result of cuts to working tax credits” and questioned why the government would not say whether it plans to cut tax credits as part of its election promise to slash welfare spending.

“What I can guarantee is that we remain committed to the vision of a high-pay, low-tax, lower-welfare economy,” Cameron responded, reiterating that Osborne will announce the government’s new proposals in the autumn statement. “What we want is for people to be better off because we are cutting their taxes and increasing their pay, but the honorable gentleman is going to have to be a little patient.”

However, Corbyn pushed further, noting Cameron’s reluctance to answer his question. “This is not a constitutional crisis; it is a crisis for 3 million families in this country who are very worried about what is going to happen next April,” he said.

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New Measures Target R&D Incentives For SMEs

HM Revenue & Customs plans to take measures to improve access to research and development tax incentives for small and medium-size enterprises, including the launch of an “advance assurance” program for the smallest companies.

In the plan provided in its October 28 report, “Making R&D Easier: HMRC’s Plan for Small Business R&D Tax Relief,” HMRC responded to feedback it requested from SMEs in a January consultation document on improving access to R&D tax incentives. The plan builds on the input received and provides an “administrative framework for the next two years and beyond,” according to the report.

The U.K.’s R&D tax incentive scheme includes special provisions for SMEs. It allows SMEs to deduct 230 percent of their qualifying expenditures or, for loss-making SMEs, the option to instead receive a cash credit of 14.5 percent of qualifying expenditures. According to the report, 15,000 SMEs claimed the incentives in 2013-2014 for a total of £800 million.

One of the plan’s stated goals is to improve awareness of the R&D tax incentive scheme among SMEs. The plan says that according to the responses to the January consultation, HMRC needs to better communicate that tax incentives are not available solely for pure scientific research, but also for a “range of scientific and technological development activities.” To increase awareness, the plan says that HMRC will rely more on
“one-to-many communications” such as e-mail and Twitter. The plan says that HMRC will develop ways to use its own data and other government agencies’ data to identify companies that carry out R&D but have not claimed the incentives.

The plan says that to improve understanding of the R&D tax incentive scheme among SMEs, HMRC will give better guidance on the interaction of the incentive with government grant programs. It says HMRC will issue “bespoke guidance” for smaller enterprises that will be based on significant business events than the statutory scheme. The plan also states that HMRC will expand its work on the “best practice in R&D reporting,” which will include issuing templates and other products to help smaller enterprises track their qualifying activities and expenditures.

Regarding the scheme’s design, the plan states that the comments received did not support any effort to more closely align the definition of R&D for purposes of the tax incentive with the more restrictive definition of R&D for accounting purposes. Based on this feedback, the plan does not provide for any alignment of the definitions of R&D. It commits HMRC to providing improved guidance on the rules applicable to subcontracted R&D and what constitutes an “appreciable improvement” to a process for purposes of qualifying for the incentive. HMRC will continue to review the R&D incentive scheme during the design and implementation of its “Making Tax Easier” program, according to the plan.

The plan incorporates the advance assurance program proposed in the government’s Autumn Statement 2014. The program, which will be launched this month, is an elective scheme that assures qualifying enterprises that they will receive the tax incentive for the first three years for which they claim it without further scrutiny. The program will focus on first-time claimant companies with under £2 million and fewer than 50 employees, according to the plan. The plan says that HMRC intends to collaborate with businesses and finance advisers to develop a link between qualifying for the program and access to financing. Based on HMRC’s experience in administering the program, it will assess whether it should be expanded to cover larger enterprises, according to the plan.

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United States

Up-C Structures in Inversions May Raise Policy Concerns

The use of some so-called Up-C structures in transactions facilitating the movement of U.S. corporations offshore raises policy concerns for the government under section 367, according to John Merrick, special counsel to the IRS associate chief counsel (international).

The Up-C structure gets its name from its sibling, the UP-REIT, or umbrella partnership real estate investment trust. To effect an Up-C, a partnership essentially puts a corporation on top of its ownership structure so that the partnership is now owned by a C corporation.

Speaking October 22 in New York at a Practising Law Institute conference on corporate tax strategies, Paul W. Oosterhuis of Skadden, Arps, Slate, Meagher & Flom LLP said that when a U.S. company gets acquired by a foreign entity or engages in a combination that results in a foreign entity on top, the transaction is commonly structured as a stock acquisition.

“Over the years, we’ve found that most public companies are not concerned with whether their shareholders were taxable on gain in their shares on the transaction,” Oosterhuis said. “The exception is when you have a major shareholder or a major shareholder group that has substantial built-in gain inherent” in its shares, he added. In those cases, the transaction has to be done differently to accommodate that shareholder’s needs.

According to Oosterhuis, the tax advisers in a few recent deals — namely the completed merger of U.S. company Burger King Worldwide Inc. with Canadian company Tim Hortons Inc. and the planned 2016 acquisition of U.S. company Broadcom Corp. by Singapore company Avago Technologies Ltd. — used partnership structures such as the Up-C to achieve deferral for large shareholders.

In August the IRS declined Broadcom’s request for a letter ruling on the section 367(a)(1) implications of its proposed merger. Section 367(a) is an area in which rulings are available based on the taxpayer’s characterization of the reorganization (Rev. Proc. 2015-1, 2015-1 IRB 1).

“Does the Service have any concerns about” these structures? Oosterhuis asked.

Merrick said the government is “very aware” of Up-C structures in the cross-border context. While not speaking to any particular transactions, he said that perhaps the policy argument supporting the use of the Up-C structure in the domestic context is “different than in the international context.”

Merrick said that while the form of Up-C structures can vary, in some cases “the economic return of the partnership interest is almost a mirror reflection of the foreign acquiring stock.” He said in these cases “it’s hard to argue there are no policy concerns” under section 367, which imposes a deferred toll charge on outbound reorganizations.

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Expatriations Ramp Up to Even Higher Annual Record Pace

After falling precipitously in the second quarter of 2015, the number of U.S. expatriates climbed again in the third quarter, reaching a record 1,426 individuals, nearly 7 percent higher than the recently established previous quarterly record.

Treasury on October 26 released the notice listing the names of the expatriates for the quarter ending September 30, as required under section 6039G. The most recent quarter’s number is up by nearly 1,000 from the previous quarter, and is higher than the previous record of 1,336 individuals, set in the first quarter of 2015. If that pace were to continue for the full year, it would mean more than 4,300 individuals will have expatriated in 2015. That number would be significantly higher than the previous annual high of expatriated individuals, set last year, when 3,417 individuals chose to relinquish their U.S. citizenship. (See figure.)

Practitioners have speculated over the cause of the fluctuation in the numbers, though because the Treasury notice reports only names of the individuals without any further detail, looking for a pattern (or lack thereof) can be difficult. However, the most recent spike may lend some credence to the theory that the second-quarter drop was an anomaly and that the rigors of reporting under the Foreign Account Tax Compliance Act are leading to the general upward trend in expatriations. The number of renunciations for the most recent quarter is more than 50 percent greater than the total number of expatriations for the entirety of 2012, the year before the January 2013 release of the FATCA regulations. (Prior coverage: Tax Notes Int’l, Sept. 14, 2015, p. 938.)

Relinquishing citizenship is itself not without tax consequences. Under section 877A, governing the tax responsibilities of expatriation, a covered expatriate who gives up citizenship must pay a mark-to-market exit tax on deemed disposition of his worldwide assets immediately before his expatriation.

Also, in September, the IRS published proposed regulations (REG-112997-10) addressing a tax on U.S. citizens and residents who receive gifts or bequests from individuals who relinquished U.S. citizenship. The tax applies to any property transferred to a U.S. citizen or resident that qualifies as a covered gift or covered

FATCA or Fiction: Is Foreign Asset Tax Compliance Causing People to Renounce U.S. Citizenship?

Expatriations per Quarter

With expatriation numbers showing dramatic spikes since the last quarter of 2012, some tax professionals are blaming the compliance burdens imposed by the Foreign Account Tax Compliance Act (FATCA), as well as prior high-profile U.S. anti-evasion efforts. Signed into law in March 2010, FATCA increased reporting requirements for taxpayers with assets offshore. For more information, see http://www.irs.gov/Businesses/Corporations/Summary-of-FATCA-Timelines.
bequest under section 2801, regardless of whether the property transferred was acquired by the donor or decedent before or after expatriation.

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U.S. Undecided on Creditability of U.K. Diverted Profits Tax

The U.S. Treasury Department and the IRS have yet to determine whether the U.K. diverted profits tax (DPT) or repayments of amounts that the European Union has deemed illegal state aid constitute foreign income taxes for foreign tax credit purposes.

At an October 26 luncheon held in Washington by Bloomberg BNA and Buchanan, Ingersoll, & Rooney, Jason Yen, attorney-adviser, Treasury Office of International Tax Counsel, and Barbara Felker, branch 3 chief, IRS Office of Associate Chief Counsel (International), spoke about forthcoming new foreign tax credit regulations and the effects of the OECD’s base erosion and profit-shifting project.

Yen and Felker said that Treasury and the IRS haven’t decided whether the DPT, which imposes tax on income diverted through “contrived” arrangements, represents a creditable foreign income tax. Yen noted that Treasury and the IRS were “looking forward to receiving” a comment letter on the topic from the New York State Bar Association. “Obviously, the foreign tax regulations were not drafted with these types of taxes in mind,” so Treasury must revisit aspects of the foreign tax regulations, Yen said, adding that no specific guidance is immediately forthcoming and that “everything is on the table.”

Other creditability questions dealt with repayments of amounts deemed to be illegal state aid by the EU, such as the payments required by Starbucks and Fiat. (Prior coverage: Tax Notes Int’l, Oct. 26, 2015, p. 301.) Although the illegal state aid in those cases was in the form of reduced taxes, Felker observed that this type of payment “doesn’t sound like a tax.”

Asked whether income tax imposed by another country adopting a formulary apportionment system would qualify for the foreign tax credit, Felker said “the point of the 901 regulations is to identify the essential features of the U.S. income tax.” She then asked, “Is this foreign levy sufficiently comparable to the base that we’re taxing to make it appropriate to give a dollar-for-dollar credit?” Felker said that as countries impose new tax schemes that diverge from conventional income tax systems and jurisdictional norms, it raises questions about whether there exists double taxation that requires relief.

Yen also discussed the follow-up work of the OECD’s Working Party 11 on BEPS actions 2 (neutralizing the effects of hybrid mismatch arrangements) and 4 (limiting base erosion involving interest deductions and other financial payments). One element of this work, he said, involves implementation of the group ratio rule, an optional feature of the action 4 report that caps interest expense at the group-wide ratio of interest to earnings before interest, taxes, depreciation, and amortization. The United States supports this optional rule, he said, adding that the other area deals with interest expense limitation rules applicable to financial institutions. Beyond these areas, Working Party 11 is working on identifying other types of hybrid mismatches beyond those addressed in the action 2 report. The goal is to complete work by the end of 2016, he said.

Yen provided a general overview of the timeline for new regulations provided in the first quarter update to the Treasury and IRS 2015-2016 priority guidance plan. The first priority, Yen said, is new regulations regarding the allocation by partnerships of foreign income tax under section 704(b), which will be coming “quite soon.” He also noted that there will be a “clean up” of the section 901 regulations and that comprehensive new regulations will be issued under section 901(m). Yen added that it’s a “very, very high priority” to release new regulations under section 905(c). “They’re very difficult regulations, but they’re important ones,” he said.

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Lawsuit Challenges IRS Transition Rules for Offshore Disclosures

The IRS is treating some taxpayers unfairly and illegally denying them the right to withdraw from the more onerous 2012 offshore voluntary disclosure program and directly access the streamlined filing compliance procedures (SFCP) announced last year, according to a lawsuit filed October 26.

By being forced to instead observe the IRS’s transition rules for moving into SFCP, the three women in the suit are exposed to much higher financial burdens, including a requirement to pay tax and interest on up to five additional years of income. Under OVDP, they are also subject to the accuracy related penalty or the delinquency penalty, neither of which they would have to pay under SFCP.

Participants in the 2012 OVDP must pay a penalty of 27.5 percent of the highest balance in their accounts during an eight-year period. The SFCP introduced in 2014 allow an individual who inadvertently failed to report offshore income to make the correct filings for
the most recent three years. By certifying that the reporting and filing failures were not willful, the individual would be subject to a 5 percent penalty or, if nonresident, to no penalty at all.

The complaint filed with the U.S. District Court for the District of Columbia (Maze v. IRS, 1:15-cv-01806) says that when the IRS promulgated the SFCP in 2014, it unilaterally and without explanation prohibited individuals who had entered the 2012 OVDP from receiving the benefits of the 2014 procedures unless they complied with transition rules.

“The application of these transition rules purportedly required plaintiffs who reported their foreign bank accounts and assets through participation in the 2012 OVDP out of a sense of responsibility and candor to satisfy monetary and compliance burdens that similarly situated individuals, who waited until the 2014 SFCP were announced, do not face,” the complaint says.

The plaintiffs’ lawyers also said the IRS never published a notice of proposed rulemaking for the transition rules in the Federal Register and didn’t allow interested persons an opportunity to participate in the process. Further, the transition rules do not satisfy any exception to the Administrative Procedure Act’s notice and comment rulemaking requirements, they said.

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States Moving to Enact Tax Haven Legislation

Although states have been dealing for years with domestic issues related to base erosion and profit shifting, the OECD’s BEPS project has spurred an explosion of interest in addressing foreign-source income, particularly tax haven legislation, panelists said October 28.

Speaking at the 2015 Paul J. Hartman State and Local Tax Forum in Nashville, Tennessee, Todd Senkiewicz of Deloitte Tax LLP in Atlanta noted that seven states now have enacted tax haven legislation, while 11 others have recently considered it. He also said the definition of tax havens in the Multistate Tax Commission’s model combined reporting statute has inspired some states.

“This has exploded overnight,” Senkiewicz said. “Foreign-source income is an area the states are really focused on.”

Included in the states with tax haven legislation are Montana, Oregon, the District of Columbia, and Connecticut. In the first three, a “blacklist” of tax haven countries is in statute.

In contrast, Connecticut has allowed statutorily for a list, but the countries on it have not yet been named. The commissioner of revenue is to name them by September 30, 2016.

Chris Sullivan of Rath, Young and Pignatelli PC in New Hampshire said the Connecticut law includes a provision that a country may be excluded from the tax haven list if it can prove to the commissioner that the company in the country is incorporated for a “legitimate business purpose.” However, Sullivan said, no criteria for what constitutes a legitimate business purpose is given.

“Connecticut shows the difficulties in doing this,” Sullivan said. “Just the part on exclusion — that will be a litigation nightmare.”

Karl Frieden of the Council On State Taxation criticized the list approach, saying the OECD itself is not considering tax haven lists. He said the lists are arbitrary and capricious, and questioned their constitutionality.

“The states are assuming they can safely do this, pass this legislation, when the rest of the international community is not,” Frieden said. “How are they going to police this going forward?”

Helen Hecht of the Multistate Tax Commission said the MTC has advocated an incremental approach. “We’re not saying we are going to tax your income however we want to. We’re saying if you’re going to do this, use a best-practices approach.”

Regarding the tax haven list approach, Hecht said she could see pros and cons.

“The benefit of doing that is there is more certainty,” Hecht said. “The downside is you’re going to be accused of being arbitrary.”

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OVDP Opt-Outs Subject to Same Audit as Other Offshore Taxpayers

Taxpayers who opt out of the IRS’s offshore voluntary disclosure program’s penalty regime will still be subject to the same examination as other taxpayers subject to the IRS’s special enforcement program (SEP), according to Stephen Lepore, SEP manager, IRS Small Business/Self-Employed Division.

Speaking October 27 at the annual Tax Controversy Institute in Beverly Hills, California, Lepore described the purview of SEP, which has grown from information gleaned from the disclosure by UBS AG to include taxpayers who have not come forward, OVDP opt-outs, and cases in which a taxpayer has been removed from the OVDP. However, he added that SEP does not work the OVDP exams. SEP runs concurrent income tax exams, foreign bank account report exams, and penalty exams, he said.

Lepore also described the standard information document request SEP uses, noting that it is being called the “scary IDR.” The SEP IDR can be 12 pages
long, and it asks for individual and foreign tax returns, flow-through and trust information, estate and gift tax information, information returns, FBARs, foreign and domestic bank account information, account signatory information, account transfers and wires, foreign and domestic brokerage accounts, loans, and wills or estate planning, he said. “You might see that we are going to ask for foreign travel records, a copy of your passport, which is probably unusual in a regular revenue agent exam. So if you see that, you know that we are hinting that we have some offshore information,” he added.

When asked about the difficulty in responding to such an extensive IDR, when some of the information may be difficult for the taxpayer to obtain, Lepore said that SEP will extend the time and make a second request. “If we don’t get it for a second time, then we will issue a summons,” he said. If the foreign information holders, such as the banks, are not forthcoming, SEP may approach a foreign tax attaché, issue a third-party summons, or issue a formal document request under section 982, Lepore said, adding that a section 982 request prevents the taxpayer from using records not furnished in a later court proceeding.

Lepore said that the next step after the IDR is to interview the taxpayer, separately if it is a joint return, and then the return preparer. “We talk to business associates, any legal or professional assistance [the taxpayers] had, like bankers and stockbrokers,” he said in response to a question about further third-party contacts during a SEP audit.

SEP consults with the IRS Office of Chief Counsel and may seek input from international examiners and fraud technical advisers when appropriate, Lepore said.

Victor Song, a former IRS Criminal Investigation division chief, described the assistance that tax attachés posted in embassies around the world provide to special agents in international cases. They can be used “to get information, to do interviews, to serve subpoenas, to serve summonses if needed,” he said. “Instead of having the agents get on a plane and fly out all over the world, we had people situated within the embassy confines.” He added that the tax attachés would share information with other law enforcement attachés as well.

Michel R. Stein of Hochman, Salkin, Rettig, Toscher & Perez PC asked Lepore whether SEP has seen any returns from the streamlined alternative to the OVDP. Lepore said the southwestern U.S. area had not seen those cases, but noted that offices in that area are focused on private banking and offshore cases.

FATCA Prominent in Information Reporting Committee Report

The Foreign Account Tax Compliance Act featured prominently in an October 28 report by the IRS Information Reporting Program Advisory Committee (IRPAC), with the committee saying the IRS has created the necessary systems for registration and data exchange but that “much more technology funding is needed to bring IRS systems into the 21st century.”

Accompanying the report was a formal letter to IRS Commissioner John Koskinen, in which 2015 IRPAC Chair Mary Kallewaard expressed the committee’s belief that IRS funding must be restored to previous levels for the tax system to function adequately and for IRPAC recommendations and other process improvements to be feasibly implemented.

Koskinen, who appeared at a public meeting with IRPAC to discuss the report, acknowledged some filers’ and practitioners’ anxiety about understanding and complying with FATCA’s reporting requirements. But he said the IRS’s focus for the next two years would be on rolling out and validating those information sharing and reporting systems and processes — not playing “gotcha” with filers but rather educating them.

“The things that are most important for us are to provide more information and simplification wherever we can on forms, instructions, requirements,” Koskinen told Tax Analysts before departing the meeting. He emphasized the value of cooperation with outside stakeholders on information reporting for what he refers to as the agency’s “unfunded mandates,” particularly the Affordable Care Act and FATCA.

Koskinen said that input from IRPAC members, representing stakeholders such as practitioners, is vital to the daily business of tax administration. “Whether it’s the financial industry, or the healthcare industry, or universities, [industry needs] to understand what the information is we’re requesting” but also to provide feedback, he said.

Among IRPAC’s other recommendations for reducing the compliance burdens for filers and the IRS was its call to waive the reporting requirement under section 6050W for “reportable payment transaction” wire transfers of funds equal to one cent — typically used to verify or open accounts — by issuing guidance to exclude such cases or implementing a minimum threshold.

IRPAC also asked the IRS to provide special relief from incorrect taxpayer identification number penalty assessments for filers of non-wage information returns that current rules do not permit validation of under the TIN matching program, until legislation expands it accordingly.

The committee asked that a checkbox specifically authorizing such validation be added to forms W-9,
“Request for Taxpayer Identification Number and Certification,” and W-4P, “Withholding Certificate for Pension or Annuity Payments.”

Koskinen also addressed the impeachment proceedings initiated against him, telling Tax Analysts he has testified truthfully and “to the best of [his] knowledge every time” in his dealings with Congress.

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Possible Pfizer-Allergan Merger — Biggest Inversion Yet?

One of the United States’ largest pharmaceutical companies, New York-based Pfizer Inc., may have finally found a merger partner that would enable it to move its domicile to Ireland and reduce its U.S. tax bill, even though the deal would likely trigger the surrogate foreign corporation rules and be subject to limitations in a 2014 anti-inversion notice.

In a deal that observers assume would likely fall between the 60 and 80 percent ownership fraction thresholds in Notice 2014-52, 2014-42 IRB 712, Pfizer (with a market cap of $214 billion) and Dublin-based Allergan PLC (with a market cap of $120 billion) jointly announced October 29 that they are in preliminary friendly discussions concerning a potential combination transaction.

The announcements stressed that “no agreement has been reached and there can be no certainty that these discussions will lead to a transaction, or as to the terms on which a transaction, if any, might be agreed.”

Based on market cap alone, it appears that the combination could result in Pfizer retaining a 64 percent stake in the combined entity, meaning that while its new foreign status would be respected, it wouldn’t be able to engage in some planning strategies — including the use of hopscotch loans — to reduce its U.S. tax bill. However, details of the proposed merger are sparse — including whether there could be a premium paid for Allergan or whether shareholders might be cashed out in the transaction by Allergan, subject to the restrictions in the notice on fattening up the foreign entity and skinnying down the U.S. entity — and the ownership fraction would be tested on the closing date.

The immediate value in the deal is that it would enable the resulting foreign multinational to engage in a debt push-down strategy that would generate interest deductions in the high-tax U.S. while the corresponding interest income is earned in low-tax Ireland, said Bret Wells of the University of Houston Law Center. The rate arbitrage “will be a big benefit for the inversion on day one,” he said.

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Officials Explain Rationale for Partnership Subpart F Regs

Moving between the various portions of recently issued regs that seek to address issues regarding subpart F inclusion in the context of loans involving foreign partnerships, officials from the IRS and Treasury explained their rationale for the new rules on October 29.

The IRS and Treasury on September 1 released proposed regs (REG-155164-09) regarding the treatment of U.S. property held by controlled foreign corporations in transactions involving partnerships. The proposed regs would generally treat an obligation of a foreign partnership as an obligation of its partners for purposes of section 956. The government also released temporary regs (T.D. 9733) that provide that a CFC will be considered to indirectly hold investments in U.S. property acquired by any other foreign corporation or a partnership that is controlled by the CFC if a principal purpose for creating, organizing, or funding (through capital contributions, debt, or otherwise) that other foreign corporation or partnership is to avoid the application of section 956 to the CFC. (Prior coverage: Tax Notes Int’l, Sept. 7, 2015, p. 847.)

Under the proposed regs, a partner’s attributable share of U.S. property held by the partnership is based on the partner’s liquidation value percentage (LVP). Liquidation value is the cash a partner would receive if the partnership sold all assets for cash, satisfied all liabilities, and liquidated.

“We thought liquidation value percentage would be readily ascertainable,” Brian Jenn, attorney-adviser in the Treasury Office of International Tax Counsel, said at an event in Washington sponsored by the District of Columbia Bar. Jenn added that Treasury could have used another measure, such as a partner’s interest in partnership profits, which was used in the proposed regs for determining a partner’s share of a foreign partnership’s obligation, but that LVP was a good measure of a partner’s economic interest in partnership property.

Barbara Rasch, branch 2 senior technical reviewer, IRS Office of Associate Chief Counsel (International), emphasized, however, that the IRS and Treasury were interested in comments if practitioners felt that economic interests were not properly reflected by LVP. Jenn added that LVP could potentially be applied more...
broadly in future international reg projects, if it ends up proving itself to be a good tool for determining partners’ interests in partnership property.

Aggregate Approach

The proposed regs use an aggregate approach in determining whether the obligations of foreign partnerships constitute U.S. property, whereby the obligation is generally treated as a separate obligation of each partner to the extent of the partner’s share of the obligation.

In defending the regs’ use of an aggregate approach rather than an entity approach, Jenn said that Treasury was viewing activities within the partnership form as substantially similar to a branch operation.

“If you had a loan from deferred earnings from a CFC to a branch, you could clearly see that there is a benefit to a U.S. shareholder. You’re financing its business, the result of which flows on to the U.S. person’s tax return,” Jenn said. “Similarly, where there is a loan from a CFC to a partnership to the extent of the U.S. person’s partnership interest, you are financing their business. Really those situations look similar to us.”

Amanda Pedvin Varma of Steptoe & Johnson LLP argued that the regs could have taken an approach that examines whether there is a distribution to a U.S. person with an actual economic benefit, as opposed to a more indirect benefit.

“We think there still is a benefit,” Jenn replied, regardless of a cash distribution, given the general availability of the funds.

‘But for’ Rule Targeted at Planning

Under a special partnership distribution rule in the proposed and temporary regs, if a foreign partnership makes a distribution to a partner that is a U.S. person related to a CFC that funded the partnership through an obligation, and it wouldn’t have made the distribution “but for” the funding by the CFC, then rules apply that could increase the amount of the obligation treated as U.S. property held by the CFC.

Varma noted that there is no indication of what facts might be relevant to the “but for” determination within the regs.

“The ‘but for’ test is a facts and circumstances determination,” Rasch said. “Keep in mind that this rule is aimed at planning transactions, where the U.S. shareholder is trying to access cash from the CFC, so it won’t apply to ordinary course transactions. Ordinary, recurring distribution won’t be subject to this rule. But, if there’s a distribution that is unusual or not consistent with the taxpayer’s general practice, or the general practice in their industry, then that could be something that could cause an agent to take a closer look,” Rasch said. (Prior coverage: Tax Notes Int’l, Sept. 28, 2015, p. 1101.)

Jenn explained that the “but for” standard was adopted because it was administrable. He said that such a test was a “reasonable alternative” to using a tracing rule, which suffered from concerns over administrability and difficulty in taxpayer compliance.

“Nobody really knows how to trace with much certainty when you are talking about something fungible like debt proceeds,” Jenn said. He said that he wasn’t sure whether a principal purpose test, used under the regs’ antiabuse rule, was more or less administrable than a “but for” standard, but that Treasury was open to hearing comments on the “but for” test.

Pending Treaties Adopt U.S., International Standards

Pending amendments to the Switzerland-U.S. tax treaty would allow for information exchange between tax authorities under a broader range of circumstances, according to testimony provided at a U.S. Senate Foreign Relations Committee hearing October 29.

Sen. Johnny Isakson, R-Ga., and Sen. Robert Menendez, D-N.J., heard testimony from Robert Stack, U.S. Treasury deputy assistant secretary (international tax affairs), and Thomas Barthold, chief of staff, Joint Committee on Taxation. The hearing addressed pending treaties or amendments to treaties with Hungary, Chile, Poland, Switzerland, Luxembourg, Japan, and Spain, as well as the Convention on Mutual Administrative Assistance in Tax Matters.

In his testimony, Stack stressed the importance of timely approval of the pending treaties, complaining of the “prolonged and unprecedented delay” that may deny U.S. companies protection from double taxation, leave law enforcement without the tools needed to fight tax evasion, jeopardize U.S. leadership on transparency issues, and cause other countries to question the United States’ reliability as a treaty partner. Stack added that the pending treaties enjoy “tremendous support” from the business community.

Regarding the United States’ tax treaties with Hungary and Poland, the most important additions are the adoption of limitations on benefits provisions to prevent treaty shopping, Stack said. He added that corporate tax data indicates the current existence of extensive treaty shopping.

Stack rejected the argument that the information exchange provisions of the pending treaties introduce a “new and unacceptably low standard” for exchanging information between tax authorities, which departs from a traditional standard allowing information exchange only when there is suspicion of tax fraud. Stack said the standard for information exchange adopted in

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the pending treaties and amendments, that the information be “foreseeably relevant,” has been the U.S. standard since 1996 and has since become the international standard. Of the 57 U.S. tax treaties in force, Stack said, only the treaty with Switzerland provides for information exchange only in cases of tax fraud. Stack argued that the restrictiveness of this standard has impeded the enforcement of U.S. tax law on U.S. citizens, and has allowed Switzerland to become a “haven for tax cheats.” These problems make it necessary to amend the treaty with Switzerland, he said.

According to Stack, the foreseeably relevant standard has adequate safeguards to prevent “fishing expeditions” and to protect confidentiality of information. He said that a country must adequately demonstrate the link between the information sought and the investigation underway.

Regarding other amendments to the United States’ existing treaties, Stack said that the pending amendments to treaties with Japan, Spain, and Switzerland introduce mandatory binding “baseball-style” arbitration, in which a neutral arbitrator must choose between one of the positions submitted by the parties to the dispute. On these provisions, Barthold suggested that “the committee may wish to consider the extent to which inclusion of mandatory arbitration rules” now represents U.S. policy.

According to Barthold, the pending treaty with Spain introduces a zero percent withholding tax rate on parent-subsidiary dividends, while the treaty with Japan broadens the eligibility criteria for the zero percent rate.

A unique addition to the treaty with Japan is the provision for limited assistance between tax authorities in the collection of taxes, Stack said. Although it is generally not the policy of the United States to include such provisions in its tax treaties, in this case, they are expected to provide a net revenue gain to the United States. This provision abrogates the common law “revenue rule,” which prevents the United States from collecting revenue for other countries, Barthold said. He added that the United States has expressly reserved on including similar provisions in the multilateral convention. “The committee may want to explore the basis for agreeing to this departure from general policy,” he said.

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Austria Approves Tax Instruments With Luxembourg, Turkmenistan

The Austrian National Council (lower chamber of parliament) on October 15 approved Austria’s pending income tax treaty with Turkmenistan and an exchange of notes to its income tax treaty with Luxembourg, according to updates published on the National Council’s website.

The Austria-Turkmenistan tax treaty was signed in Vienna on May 12. It provides that dividends will be exempt if the beneficial owner is a company (other than a partnership) that directly holds at least 25 percent of the capital of the payer company. In other cases, a top rate of 15 percent will apply. Interest and royalties will be taxable at a maximum rate of 10 percent. Austria uses a modification of the credit and exemption methods to eliminate double taxation, while Turkmenistan generally uses the credit method.

The treaty will enter into force on the first day of the third month following the month in which ratification instruments are exchanged, and its provisions will apply from January 1 of the year following its entry into force. The Turkmen parliament approved the treaty on August 18.

The notes, signed in Luxembourg on June 18, amend the 1962 Austria-Luxembourg tax treaty to bring it in line with the OECD standard. The treaty, which was signed on October 18, 1962, has previously been amended by protocols in 1992 and 2009. A competent authority agreement clarifying the treaty was signed in 1964.

— Sarah Carpenter, Tax Analysts.
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Azerbaijan, Ireland Conclude Tax Treaty Negotiations

Azerbaijan and Ireland have concluded negotiations on an income tax treaty and are expected to sign it soon, according to an Irish Revenue update.

This will be the first income tax treaty between the two countries. It must be signed and ratified by both sides before entering into force.

— Sarah Carpenter, Tax Analysts.
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Azerbaijani Parliament Approves FATCA Agreement With U.S.

The Azerbaijani parliament on October 20 approved a law on the ratification of the pending agreement signed by Azerbaijan and the United States to implement the information reporting and withholding tax provisions of the U.S. Foreign Account Tax Compliance Act, according to local media reports and information published on the parliament’s website.

The agreement was signed in Baku on September 9 and will enter into force on the date of Azerbaijan’s written notification, sent through diplomatic channels to the United States, confirming that Azerbaijan has completed the necessary internal procedures.

— Iurie Lungu, Graham & Levintsa, Chisinau
Bulgaria / Council of Europe / OECD

Bulgaria Signs Mutual Assistance Convention

Bulgaria signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, as amended by the 2010 protocol, on October 26, according to an update published by the Council of Europe.

The convention and amending protocol will enter into force and apply in Bulgaria three months after the deposit of the ratification instrument.

Developed by the OECD and the Council of Europe, and originally opened for signature on January 25, 1988, the convention provides for the mutual exchange of tax information and assistance in the recovery of taxes and the service of documents. The protocol was originally opened for signature on May 27, 2010, and updates the convention in accordance with the OECD standard on information exchange.

— Sarah Carpenter, Tax Analysts.
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Canada / United Kingdom

2015 Exchange of Notes to Canada-U.K. Tax Treaty Available

In an exchange of notes dated July 27 and August 11, Canadian High Commissioner Gordon Campbell and U.K. Financial Secretary to the Treasury David Gauke agreed to rules and procedures relating to arbitration under the Canada-U.K. tax treaty.

Chile / Italy

Chile, Italy Sign Tax Treaty

Officials from Chile and Italy signed an income tax treaty on October 23 in Santiago, according to information published on the Chilean government’s website.

The treaty, which is the first agreement of its kind between the two countries, was signed in the presence of Chilean President Michelle Bachelet and Italian Prime Minister Matteo Renzi. It will enter into force after the exchange of ratification instruments.

— Iurie Lungu, Graham & Levintsa, Chisinau

China (P.R.C.) / Estonia

Estonia Ratifies Protocol to Tax Treaty With China

The Estonian Parliament on October 21 ratified the pending protocol to the China-Estonia income tax treaty, according to information published on the Parliament’s website.

The protocol was signed December 9, 2014, in Tallinn.

This is the first amendment to the 1998 treaty.

— Larissa Hoaglund, Tax Analysts.
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Cuba / U.A.E.

U.A.E. Expresses Interest in Tax Treaty With Cuba

The United Arab Emirates has expressed interest in negotiating a tax treaty and an investment protection agreement with Cuba, the U.A.E. Ministry of Foreign Affairs announced October 24.

A delegation of Cuban officials and business leaders, led by Rodrigo Malmierca Diaz, minister of foreign trade and investment, met October 22 with U.A.E. officials at the first Cuban-Emirati business forum, held in Dubai, and discussed investment opportunities and economic cooperation. Fahad Obaid Al Taffaq, director of economic affairs and international cooperation for the U.A.E. Ministry of Foreign Affairs, stressed the importance of establishing a legal framework for cooperation between their countries in order to strengthen bilateral relations. The U.A.E. opened an embassy in Havana on October 6.

The tax treaty would be the first agreement of its kind between the two countries. It would need to be signed and ratified by both sides before it could enter into force.

— Sarah Carpenter, Tax Analysts.
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Estonia / Japan / Oman

Estonia Intends to Sign Tax Treaties With Japan, Oman

The Estonian government has reiterated its intention to sign income tax treaties with Japan and Oman, according to recent government releases.

Estonia-Japan Parliamentary Group Chair Anne Sulling met October 22 in Tallinn with Akira Amar, Japanese minister of state for fiscal and economic policy, to discuss economic trade and cooperation. At the meeting, Sulling expressed Estonia’s interest in negotiating a tax treaty with Japan. In February 2014 Foreign Minister Urmas Paet had announced that Estonia would like to initiate negotiations with Japan. Any treaty resulting from the negotiations would be the first agreement of its kind between the two countries.

Estonian Prime Minister Taavi Rõivas on October 21 expressed hope that a tax treaty with Oman will be signed soon. Rõivas met with Omani Deputy Prime Minister Fahd bin Mahmoud al Said in Oman to discuss ways to strengthen bilateral economic cooperation.

Treaty negotiations began in 2011, and an agreement was initialed in February 2012. This would be the first income tax treaty concluded between the two countries.

France / Germany / Singapore

France Approves Tax Instruments With Germany, Singapore

The French government on October 21 sent to Parliament for approval two draft laws on the ratification, respectively, of the pending protocol to France’s tax treaty with Germany, and of its pending tax treaty with Singapore, according to information published on the website of the National Assembly (lower house of Parliament).

Protocol to France-Germany Tax Treaty

The protocol to the France-Germany income tax treaty was signed in Berlin on March 31. It is intended to simplify the taxation of retirees who are living in one contracting state but receive pension payments from the other state.

The protocol will enter into force on the first day following the exchange of ratification instruments and generally will apply from January 1 of the year following its entry into force. France will complete the ratification process when the law on the ratification of the protocol is approved by Parliament and signed by the president. The German Bundestag (lower house of parliament) approved the protocol on October 15.

France-Singapore Tax Treaty

The France-Singapore tax treaty was signed on January 15 in Singapore.

It establishes that dividends are taxable at a maximum rate of 5 percent if the beneficial owner is a company that owns at least 10 percent of the share capital of the payer company. A 15 percent rate applies in all other cases. However, if dividends are paid out of income or gains derived from immovable property by an investment vehicle that distributes most of its income annually and whose income or gains from the immovable property are exempt from tax, and the beneficial owner holds at least 10 percent of the capital of the investment vehicle, the dividends may be taxed at the domestic rate of the state in which they arise.

Interest is taxable at a top rate of 10 percent, and royalties are taxable only in the beneficial owner’s state of residence. However, an exemption applies for interest paid by an enterprise of one contracting state to an enterprise of the other contracting state. Both countries use a modification of the credit and exemption methods for the elimination of double taxation.

The treaty will enter into force on the first day of the second month following the exchange of ratification instruments. In France, its provisions will apply from the calendar year following its entry into force. In Singapore, its provisions regarding chargeable tax will apply from January 1 of the second calendar year following its entry into force, and its other provisions will apply from January 1 of the calendar year following its entry into force.

Once in force and effective, the treaty will generally replace the convention signed on September 9, 1974, as amended by the protocol signed on November 13, 2009. France will complete the ratification process when the law on the ratification of the treaty is approved by Parliament and signed by the president.

Germany / Israel

Germany’s Lower House Approves Tax Treaty With Israel

Germany’s Bundestag (lower house of parliament) on October 1 approved the pending income and capital
Germany / Netherlands

Germany-Netherlands Tax Treaty to Enter Into Force

The Germany-Netherlands income tax treaty, signed April 12, 2012, in Berlin, will enter into force December 1, according to an October 20 release published by the German Embassy in The Hague.

The treaty, which generally will apply from January 1, 2016, provides that dividends are taxable at a maximum rate of 5 percent if the beneficial owner is a company (other than a partnership) that directly holds at least 10 percent of the capital of the dividend-paying company. A top rate of 10 percent applies if the beneficial owner is a pension fund that is a Netherlands resident. In all other cases, a 15 percent rate applies.

Interest and royalties are taxable only in the beneficial owner’s state of residence. Both countries generally use a modification of the credit and exemption methods for the elimination of double taxation.


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Guernsey / United Kingdom

2015 Amendment to Guernsey-U.K. Tax Arrangement Available

Tax Analysts has obtained the text of the arrangement and exchange of notes signed September 22 in London and October 7 in St. Peter Port that amend the 1952 Guernsey-U.K. income tax arrangement.

— Larissa Hoaglund, Tax Analysts. E-mail: larissa.hoaglund@taxanalysts.org

Jersey / United Kingdom

2015 Amendment to Jersey-U.K. Tax Arrangement Available

Tax Analysts has obtained the text of the arrangement and exchange of notes signed September 22 in London and October 1 in St. Helier that amend the 1952 Jersey-U.K. income tax arrangement.
Latvia / Qatar

Qatar Ratifies Tax Treaty With Latvia

Qatari Emir Tamim bin Hamad Al Thani on October 27 issued Decree 45 ratifying the pending income tax treaty with Latvia, according to local media reports.

The treaty was signed September 26, 2014, in New York.

Dividends and interest will be taxable only in the contracting state of which their beneficial owner is a resident if the beneficial owner is a contracting state or a political subdivision, a local authority, a statutory body, or the central bank thereof.

For Latvia, the beneficial owner is the Latvian Guarantee Agency or any other institution as may be agreed between the competent authorities of the contracting states.

For Qatar, the beneficial owner is one of the following entities, as long as it is wholly owned by Qatar:

- the Qatar Investment Authority;
- Qatar Holding LLC;
- Qatar’s General Retirement & Social Insurance Authority;
- the Qatar Development Bank; or
- any other institution as may be agreed between the competent authorities of the contracting states.

Royalties will be taxable at a maximum rate of 5 percent. Both countries generally use the credit method to eliminate double taxation.

The treaty will enter into force upon the exchange of ratification instruments, and its provisions will apply from January 1 of the year following its entry into force. Latvia ratified the treaty on December 17, 2014.

— Iurie Lungu, Graham & Levintsa, Chisinau

Mauritania / U.A.E.

Mauritania, U.A.E. Sign Tax Treaty

Officials from the United Arab Emirates and Mauritania signed a tax treaty on October 21, according to local media reports.

The treaty was signed in Nouakchott by Mauritanian Minister of Foreign Affairs and Cooperation Hamadi Ould Baba Ould Hamadi and his U.A.E. counterpart, Abdullah bin Zayed Al Nahyan.

This is the first income tax treaty between the two countries. It will enter into force after the exchange of ratification instruments.

— Iurie Lungu, Graham & Levintsa, Chisinau

Malta / United States

2015 Arrangement to Malta-U.S. FATCA IGA Available

The Maltese and U.S. competent authorities have signed an arrangement under the two countries' 2013 intergovernmental agreement to implement the U.S. Foreign Account Tax Compliance Act.

Mexico / United States

Competent Authority Arrangement To Mexico-U.S. IGA Available

The Mexican and U.S. competent authorities have signed an arrangement under the two countries' 2015 intergovernmental agreement to implement the U.S. Foreign Account Tax Compliance Act.

Morocco / Saudi Arabia

Morocco Approves for Ratification Tax Treaty With Saudi Arabia

The Moroccan government on October 22 approved for ratification the pending tax treaty with Saudi Arabia, according to local media reports.

The treaty was signed April 14 in Rabat. It establishes that dividends are taxable at a maximum rate of 5 percent if the beneficial owner is a company (other than a partnership) that directly holds at least 10 percent of the dividend payer’s capital. In other cases, a 10 percent rate applies. Interest and royalties are subject to a maximum 10 percent withholding rate. Both countries generally apply the credit method to eliminate double taxation.

The treaty will enter into force upon the exchange of ratification instruments, and its provisions will apply from January 1 of the year following its entry into force.

— Iurie Lungu, Graham & Levintsa, Chisinau

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Netherlands / Rwanda

Netherlands-Rwanda Air Services Agreement to Enter Into Force

The Netherlands-Rwanda air services agreement will enter into force December 1, the Dutch Ministry of Foreign Affairs announced on October 27.

The agreement, signed in Kigali on February 6, 2013, establishes the legal framework for eliminating double taxation of the two countries’ international airlines. Its provisions will apply from December 1. The agreement applies only to the European part of the Netherlands.

— Sarah Carpenter, Tax Analysts.
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Senegal / U.A.E.

Senegal, U.A.E. Sign Tax Treaty

Officials from Senegal and the United Arab Emirates signed a tax treaty on October 22 in Dakar, according to a release from the U.A.E. Ministry of Foreign Affairs.

The treaty was signed by Senegalese Foreign Minister Mankeur Ndiaye and his U.A.E. counterpart, Abdullah bin Zayed Al Nahyan. The ministers agreed that the signing of the tax treaty, along with an investment protection agreement and other memoranda of understanding, will strengthen relations and promote bilateral cooperation.

This is the first income tax treaty between the two countries; however, an air transport agreement was signed on January 18, 2013. The treaty will enter into force after the sides exchange ratification instruments.

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Taiwan (R.O.C.) / Russia

2015 Protocol to China-Russia Tax Treaty Available

Tax Analysts has obtained the English text of the protocol, signed May 8 in Moscow, that amends the China-Russia income tax treaty.

The protocol replaces the treaty article on interest, reducing the withholding rate from 5 percent to 0 percent. It also amends the article on nondiscrimination. This is the first amendment to the treaty, which was signed October 13, 2014, and has not yet entered into force.

The protocol will enter into force 30 days after the exchange of ratification instruments, and its provisions will apply from the same date as the treaty applies, that is, January 1 of the year following its entry into force.

For the texts of these and other treaties, see Worldwide Tax Treaties, your source for daily tax treaty news and more than 9,000 treaties. WTT allows subscribers to directly compare dividends, interest, and royalties withholding tax rates for in-force income tax treaties; compare two or three tax treaties of any status; view treaties in original languages; search an archive of news and analysis by international tax specialists; and review U.S. legislative history, case law, and guidance.

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The Anson Decision – Transparency and Opacity

by Trevor Johnson

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HM Revenue & Customs has lost the Anson case before the U.K. Supreme Court, and yet they announced that they are going to continue their policy of treating U.S. limited liability companies as tax “opaque” because the case turned on its own particular facts. This decision will have resolved some of the concerns expressed by commentators following the Court’s ruling. The author looks into the reasoning behind that ruling and considers whether it is of a more general application.

George Anson’s U.K. tax affairs for the years 1997-1998 to 2000-2001 have now finally been settled following almost 12 years of inquiry and litigation. During that period, his case has been heard by the First-Tier Tribunal (FTT), the Upper Tribunal (twice), the Court of Appeal, and the Supreme Court, which published its decision in July this year.

Anson was a U.K. resident (but non-domiciled) individual who was also a member of a Delaware limited liability company, called HarbourVest Partners LLC, based in Boston. His share of the income of HarbourVest was subject to U.S. federal tax at 39.6 percent and also to Massachusetts state tax at 6 percent. Since together these taxes exceeded the highest income tax rate in the U.K., he would, quite reasonably, not have expected to pay any more tax in the U.K. Anson took up residence in the U.K. around 1997, and for a number of years he declared his income from HarbourVest on the “partnership” supplementary pages to the self-assessment return and claimed relief for the U.S. tax suffered on the “foreign” supplementary pages.

It was only in December 2003 that the Revenue decided to inquire into Anson’s tax affairs and opened a formal inquiry into his 2001-2002 tax return. They later issued “discovery assessments” for the years 1997-1998 to 2000-2001, charging tax on the HarbourVest income and denying any double taxation relief for the U.S. tax suffered. (A discovery assessment is a method whereby the Revenue may charge tax for a previous year when they are out of time to amend the taxpayer’s self-assessment. It is a condition of doing so that they should “discover” that, inter alia, an amount of taxable income has not been assessed or a relief should not have been given.)

This action stemmed from the Revenue’s view that a U.S. LLC was a taxable entity in its own right and therefore the amounts received from HarbourVest were not the profits that had been subject to U.S. tax but instead were some form of dividend. Since under the 1975 U.K.-U.S. double taxation agreement (applicable for the years concerned), article 23(2)(a), relief for U.S. tax is only available against any U.K. tax computed by reference to “the same profits or income” as that on which the U.S. tax was calculated, no relief could be given to Anson for the U.S. tax paid by HarbourVest. (It should be noted that the 2001 agreement, currently in force, contains an equivalent provision: article 24(4).)

Readers in the United States will, of course, be aware that an LLC is treated as transparent for U.S. tax purposes so that tax is charged on the members of the LLC, rather than the LLC as a body. (It can, however, elect to be treated as a corporation, though this did not happen in this case.) Under U.K. tax law, there
is no such option; it recognizes only four types of business vehicle — a company (a legal entity that is taxable in its own right), a limited liability partnership (which, although legally a company, is treated as tax transparent in normal circumstances), a Scottish partnership (which is also a legal entity but treated as tax transparent), and a partnership in the rest of the U.K. (which is not a legal entity and is tax transparent). The overriding question in this case was how HarbourVest should be treated for U.K. purposes. If it was tax transparent, Anson was entitled to double taxation relief and had no further U.K. tax to pay.

The Supreme Court decision emphasized, yet again, the importance of the findings of fact by the FTT. No superior tribunal or court can dismiss or change those findings; they can only overrule the FTT on questions of law. This is, however, subject to one overriding exception: the rule established in the case of Edwards v. Bairstow & Harrison, 36 TC 207 (1955), which stated that the superior body should not overrule a finding of fact if it was one to which the fact-finding tribunal was entitled to reach on the evidence produced at the hearing, even if the court or a different tribunal might have reached an alternative conclusion on the same evidence.

At its hearing in 2010, the FTT heard evidence relating to Delaware law from two expert witnesses. Those witnesses agreed on the following points that the tribunal found as facts:

- a Delaware LLC was a separate legal entity from its members and was brought into existence by executing a certificate of formation, filing that certificate with the Delaware secretary of state, and entering into an LLC agreement;
- the business being carried on by the LLC was being carried on in its own right rather than by its members;
- the assets used to carry on the business were beneficially owned by the LLC and not by its members; and
- the LLC was liable for the debts incurred as a result of carrying on the business — the members had no such liability.

The experts were asked to address a number of questions that had originally been published in a Revenue Tax Bulletin of 1999 as factors to consider when determining the tax transparency or opacity of an overseas entity. One of those questions was:

Are the persons, who have an interest in the entity, entitled to share in its profits as they arise; or does the amount of the profits to which they are entitled depend upon a decision of the entity or its members, after the period in which the profits have arisen, to make a distribution of its profits?

It will be apparent that if the members are dependent on a decision being taken after the profits have arisen, their entitlement is more akin to that of shareholders of a company who are only entitled to their share of the profits following the declaration of a dividend. Alternatively, if they are entitled to a share of profits “as they arise,” their interest would be similar to those of partners in an unincorporated partnership.

Each expert approached this question in a different way. The expert for Anson referred to articles IV and V of the LLC agreement. Section 4(1) of Article IV provided that each member’s capital account was to be credited with his capital contributions and debited with distributions made to him, while section 4(2) required each capital account to be adjusted at least annually and, in particular, that:

all gross income and gains . . . realized during the period in question . . . shall . . . be credited, and all losses, deductions and expenses . . . during the period in question . . . shall . . . be debited, to the respective capital accounts of the members pro rata.

Section 5.1 of Article V provided that:

Subject to the provisions of this Article V, to the extent cash is available, distributions of all the excess of income and gains over losses, deductions and expenses allocated in accordance with Section 4.2 with respect to any calendar year will be made by the Company at such time within seventy-five (75) days following the end of such calendar year and in such amounts as the Managing Members may determine in their sole discretion. The Managing Members may from time to time in their discretion make additional distributions in accordance with the provisions of Article V.

Anson’s expert concluded that section 5.1 created a mandatory requirement (subject to the other provisions of Article V and to sufficient cash being available) to distribute the profits. This was consistent with the crediting and debiting of the members’ capital accounts required by section 4.2. Thus, the members were entitled to participate in a share of HarbourVest’s annual profits as they arose.

The Revenue’s expert treated it as a question of whether the members had a proprietary interest in the profits as they arose. (In other words, did they have ownership of the profits at the instant they arose?) He relied on section 18-701 of the Delaware LLC Act, which provides that “A limited liability company interest is personal property. A member has no interest in specific limited liability company property.”

By equating profits with assets or property, it was determined that the members had no beneficial interest in the assets of HarbourVest and therefore they were not entitled to a share in the profits until a decision was made to make a distribution. The expert also took the view that section 5(1) of Article V of the LLC agreement gave the managing member discretion over the amounts to be distributed.
It will be noted that there were two stages to be completed before a member actually received cash representing his share of the profits. First, the profit of the LLC was to be credited to his capital account in proportion to his interest in the company (section 4.2 of Article IV makes this mandatory); and second, a distribution was to be made (section 5.1 of Article V, but was this mandatory or discretionary?).

On the one hand, it was saying that distributions of profits allocated to members will be made by the company within 75 days of the end of the calendar year, but that the amounts distributed and the date of the distribution will be as the managing members may determine in their sole discretion. The tribunal believed that granting the managing members the ability to make additional distributions would be unnecessary if they had an overriding discretion over distributions generally. The FTT had to resolve the contradiction by coming up with its own interpretation:

The best compromise we can come up with, which we put to both experts, is that the Managing Members’ discretion as to amounts is solely a discretion as to the amounts of separate distributions made during the 75 days, in which case time should be read as time or times. On this basis, the provision is saying that the excess must be distributed within 75 days subject only to the right to set off, make additional reserves in s 5.2 and to withhold taxes, and to cash being available. Such an interpretation sticks closely to the wording and is to be preferred to one that changes the imperative of all, will and the 75 days into an expression of a hope of doing so. It also gives effect to the power to make additional and periodic distributions. On that basis there is no ambiguity and no need to resort to extrinsic evidence. This interpretation admittedly gives a slightly odd result if cash is not available within the 75 days, in that distribution thereafter become discretionary, but the cash flow statement in the accounts show little adjustment between net income and net cash which enabled full distributions to be made for all years, and so the possibility of the lack of cash by 5 the end of the 75 days may be something that the LLC Operating Agreement covers for as a legal eventuality rather than practical likelihood. [Emphasis added.]

The FTT also noted that section 18-101(8) of the Delaware LLC Act defined a member’s interest as a share of profits and losses of an LLC and the right to receive distributions of the LLC’s assets. Section 18-503 of the same act provides that the profits and losses of an LLC shall be allocated among the members in the manner provided for by the LLC agreement:

This means that the profits do not belong to the LLC in the first instance and then become the property of the members, because there is no mechanism for any such change of ownership, analogous to the declaration of a dividend. It is true, as [the Revenue’s expert] has said, that the assets representing those profits [that is, cash in the bank] do belong to the LLC until the distribution is actually made but we do not consider that this means that the profits do not belong to the members; presumably the same is true for a Scots partnership. Conceptually, profits and assets are different, as is demonstrated by the reference to both in the definition of “limited liability company interest” [in section 18-101(8) of the LLC Act]. There is a corresponding liability to the members evidenced by the allocation to their capital accounts. . . . Accordingly, our finding of fact in the light of the terms of the LLC operating agreement and the views of the experts is that the members of [HarbourVest] have an interest in the profits of [HarbourVest] as they arise.

Having reached its conclusion on the basis of the legislation and Article IV of the LLC agreement, the FTT did not regard the dispute about whether distributions under section 5.1 were mandatory or discretionary as relevant. It nevertheless considered the matter and concluded that distributions were mandatory.

In relation to these matters, the FTT concluded:

In summary, our conclusion in relation to the LLC operating agreement is that the combined effect of section 18-503 of the Act and the terms of article IV means that the profits must be allocated as they arise among the members. It follows that the profits belong as they arise to the members. Article V dealing with payment is irrelevant to this conclusion.

Both the Upper Tribunal and the Court of Appeal had criticized the FTT’s findings. Justice Mann, sitting as the Upper Tribunal, construed the FTT’s finding that the profits belonged to the members “as they arose” as meaning that those profits were vested in the members as their property. Since the FTT had found that the assets of the LLC were owned by the LLC, there could not be any asset (that is, profit) that could be owned by the partners. He therefore held that the FTT’s finding was illogical and not supported by the evidence.

In the Court of Appeal, the FTT’s finding — that the effect of the Delaware LLC Act and the LLC agreement was that the profits belonged to the members as they arose — was held to be one on U.K. domestic law to which the Upper Tribunal was entitled to overrule, rather than one of fact.

The judges in the Supreme Court were unanimously supportive of the FTT’s findings. They did not accept any of the criticisms leveled against that finding by the two subordinate bodies. Those criticisms were based on a “conceptual confusion between profits and assets”; that is, that profit was an asset itself, rather than something that was represented by the assets. The FTT had made clear that “conceptually, profits and assets are different” and that the assets of the business belonged...
to the LLC. It had based its finding on expert evidence about the combined effect under the Delaware LLC Act and the LLC agreement and not on any confusion between assets and profits. This was a finding of fact that could not be overruled.

Having agreed that the finding should stand, the Supreme Court went on to consider whether Anson was liable to U.K. tax on the same income as that on which his U.S. tax was calculated. After an extensive review of the history of the U.K.-U.S. double taxation conventions since 1945, and bearing in mind the need under the Vienna Convention on the Law of Treaties to consider the ordinary meaning of the terms of the treaty, the Court had no problem in finding that Anson was taxable on the same income in both the U.K. and U.S. His claim for double taxation relief was therefore upheld.

Immediately following the Supreme Court’s decision, concern was expressed by some tax professionals that this ruling could have adverse effects on U.K. corporate members of U.S. LLCs who were previously treated as receiving their share of profits as tax-exempt dividends. (Though would not the U.S. tax suffered on that profit share exceed the 20 percent U.K. tax and therefore remain effectively U.K. tax free by virtue of double tax relief?) It could also have an effect on U.S. individuals investing in the U.K. via an LLC who would now become liable to U.K. income tax at up to 45 percent. The Revenue’s recent statement that they will continue to regard U.S. LLCs as opaque should alleviate those concerns.

As far as other scenarios are concerned, I am reminded of the old joke about the accountant who was asked the sum of two plus two. His reply was, “What would you like the answer to be?” Those who would like to take advantage of this decision will have to carefully consider the precise terms of the particular LLC agreement and the relevant legislation of the state in which the LLC is formed. In view of the Revenue’s policy statement, it is likely that an appeal will have to be taken before the FTT, which would have to make a similar finding of fact to the one in the Anson case.

A recent TNI article highlighted a number of issues and perhaps in conclusion, I may offer some observations on a couple of those. (Prior coverage: Tax Notes Int’l, July 27, 2015, p. 297.) First, could this decision lead to an LLC being regarded as transparent for U.K. capital gains tax? I think the answer is clearly no (at least as far as a Delaware LLC is concerned). The FTT in the Anson case found as a fact that the LLC’s assets belonged to the LLC and not the members (based on section 18-701 of the Delaware LLC Act). CGT is levied on disposals of assets beneficially owned by the taxpayer, and therefore a member could not become chargeable to CGT on disposals by the LLC.

The question was also raised about whether the Anson decision could apply to a situation in which the LLC had opted to be taxed in the U.S. as a corporation. My initial reaction (and I am open to correction) is that the method of taxing the profits does not have any effect on the nature of the member’s interest in the LLC under U.S. law. The only question that remains is whether double tax relief would be available to the member for the U.S. tax paid by the LLC. It is clear from the wording of article 24(4)(a) of the U.K.-U.S. treaty that all that is required is that the same income is taxed in both countries, not that the same person is taxed. My view is that the Anson decision would have been the same, even if HarbourVest had elected to be taxed as a corporation.

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France Proposes New Tax Rules for E-Commerce and The Sharing Economy

by Rui Cabrita

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The French Senate Finance Committee recently issued two reports proposing measures to ensure taxation of sharing economy users and the collection of VAT at source in e-commerce sales. The author discusses the key changes suggested in the reports and the automated IT processes that would be required for their effective implementation.

Since the proposed measures raise numerous legal and technical issues, an implementation timeline has not yet been set. Nevertheless, the reports may inspire other EU member states to take similar action soon.

Threshold for Taxable Income

In consumer-to-consumer operations, individuals can easily rent or sell assets or skills. While earnings made via these platforms may appear individually insignificant, they could comprise a significant source of budgetary revenue in the aggregate. The problem facing tax authorities, however, is that the traditional criteria used to determine taxable activity for ordinary businesses cannot be effectively applied in the context of the sharing economy.

The first of the Finance Committee’s two recent reports proposes to address this incongruence by implementing an automatic reporting system for taxable income that would apply once a user receives more than €5,000 from consumer-to-consumer platforms in a tax year. Income in excess of that amount would be subject to French personal income tax and possibly social contributions, depending on the nature of the activity.

The report therefore expressly determines a taxable activity threshold for personal income tax purposes — a feature absent from existing legislation.

The report further details that those who exceed the threshold may also need to choose a French business classification for their professional activities. The most straightforward option for affected users may be to operate under the status of auto-entrepreneur.

Withholding VAT on E-Commerce

The second report proposes mandatory withholding of French VAT on e-commerce transactions. Under this procedure, the 20 percent VAT would be collected by

the consumer’s bank automatically at the time of the online payment. Therefore, by default, sellers would be subject to French VAT on sales to French consumers.

The new VAT withholding procedure would help counter some of the major problems facing French tax and customs authorities, including the failure of e-merchants to register for VAT purposes. Because small French or foreign sellers are more likely to engage in VAT fraud and can be difficult to monitor, the mandatory withholding tax could ensure the collection of revenue that may otherwise be lost.

Further, automatic VAT withholding would simplify French VAT treatment of e-commerce operations, which currently is complex and poorly implemented. Online purchases of goods by consumers within the European Community are currently subject to VAT at the rate of the consumer’s member state once the seller exceeds €100,000 of turnover per year in France. Moreover, since January 1, 2015, business-to-consumer intra-Community sales of electronic services have been subject to VAT at the rate of the consumer’s member state from the first euro of turnover. In practice, however, VAT is rarely applied in either context, and its enforcement is not fully audited by the French tax authorities. Efficient VAT collection also depends on sellers’ willingness and ability to meet reporting obligations. Despite the existence of the VAT mini one-stop shop (MOSS) for EU and non-EU sellers, sellers operating foreign websites may continue operating within the EU without charging VAT, leaving the authorities with limited control over their activities. These existing rules have also been said to place an excessive administrative burden on small EU sellers that attempt to track their consumers’ member states under the VAT MOSS.²

The report also addresses the idea of applying French VAT from the first euro of sale for purchases of goods made by French consumers with EU sellers. Before the current €100,000 threshold is removed, a transition period would be observed where a suggested reduced threshold of €35,000 would apply. On this aspect, the report’s authors and the French legislature share the same view, as the implementation of a €35,000 threshold is also mentioned in the draft 2016 Finance Act.

Automated Processes

Automated processes would be established to implement these proposals and to ensure that all electronic payments are accounted for. Information on French users’ earnings from the sharing economy would be collected by automated platforms and transmitted to an independent body to determine whether the €5,000 tax threshold has been met. If so, this information would be reported to the French tax authorities, who would include these earnings on the user’s personal income tax return. This procedure would be voluntary, however, and information would therefore only be shared with French tax authorities with the user’s consent.

As for the new VAT withholding procedure, an independent body would also be required to communicate relevant information to the consumer’s bank — for example, on the seller’s VAT liability or the applicable VAT rate — in order to limit errors in collection. Sellers who are exempt from French VAT or subject to a reduced rate would need to register with the body in charge of the collection process. The report suggested that some companies could be exempt from this automated process, although a procedure for exemption has not yet been defined. Exempt companies could continue charging and collecting VAT under existing rules so as to continue benefiting from the liquidity offered by output VAT.
Using U.K. Holding Companies in International Group Structures

by Andrew Terry

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Establishing a group holding company in the U.K. has become a much more attractive option for multinational businesses in recent years. Treatment of dividends and capital gains has become more lenient, though there are still tax and other issues that should be considered, including the coming register of beneficial owners.

The location of a holding company is a significant consideration in any international corporate structure. Choice of jurisdiction for a group holding company (Holdco) is relevant both from the point of view of tax optimization (maximizing withholding tax-free dividend, interest, and royalty flow up through the group and minimizing tax charges on capital gains) and for commercial reasons. Commercial considerations are important when selecting a holding jurisdiction because it is important that the Holdco be in a credible “blue chip” jurisdiction when seeking to access the international equity and debt capital markets.

Choice of Holdco location will also be relevant in circumstances in which private equity investment is envisaged or a trade sale is planned. For example, a Western buyer is often more comfortable buying a Dutch or U.K. Holdco that owns an underlying operating business in Russia or Kazakhstan than directly purchasing the shares in a local Russian or Kazakh holding company that owns these assets.

Until quite recently, the U.K. was not always a good choice for Holdco location due to potentially high U.K. tax charges on inbound dividends and capital gains. However, over the past 15 years, the U.K. has amended its tax legislation in these areas, and it is now seen as a good place to establish a Holdco.

There are, of course, further nontax considerations when deciding whether the U.K. is a suitable Holdco location. The various tax and nontax aspects of using a U.K. Holdco in an international group structure are discussed below.

Corporation Tax

U.K. resident companies are subject to corporation tax on worldwide income and gains at a competitive rate that is currently fixed at 20 percent; rates are scheduled to fall to 19 percent in 2017 and to 18 percent in 2020. The U.K. would then have the lowest tax rate on corporate profits of any country in the G-20.

A low tax rate is important because, although a U.K. Holdco may often have little income from its own business activities (if any) that is subject to corporation tax, it may receive taxable royalties and interest along with management fees.

Dividends, Interest, and Royalties

U.K. Holdco may receive dividends, interest, and royalties from its foreign subsidiaries. Depending on the relevant domestic law of the subsidiary, these payments may be subject to a withholding tax. However, if there is a double taxation agreement in force between the U.K. and the jurisdiction of the subsidiary, then any withholding taxes may be eliminated or reduced by the relevant article of the agreement. The U.K. is a party to around 110 double taxation agreements, which is more than any other country.
PRACTITIONERS’ CORNER

The U.K. is also an EU member state, which means that it is a party to both the EU parent-subsidiary directive and the EU interest and royalties directive. Under certain conditions, these directives operate to remove foreign withholding taxes that would otherwise be paid in the other EU member state on dividends, interest, and royalties paid by a subsidiary to the U.K. Holdco. The U.K.’s double tax treaty network and EU membership mean that in many cases there will be no foreign withholding taxes when there is a U.K. Holdco, thereby minimizing an international group’s overall tax cost.

Inbound Dividends

Since July 1, 2009, most dividends received by a U.K. Holdco from a foreign subsidiary will be exempt from U.K. corporation tax. Although the legislation is complex, the end result is that nearly all dividends will be exempt as they are likely to fall within one of the specific exemption regimes that apply to either small companies or medium-size and large companies. For exemption to apply under either regime, the dividend should not be a deductibility item in the country of the subsidiary paying the dividend.

Dividends received by small companies — that is, companies with fewer than 50 employees and turnover of less than €10 million or a balance sheet total of less than €10 million — are fully exempt from corporation tax provided they are received from territories that have a double taxation agreement with the U.K. that contains a nondiscrimination article.

Several classes of dividend payments are tax exempt for medium-size and large U.K. companies, such as dividends paid on:

- shares in which the U.K. recipient controls the payer in terms of shareholding, powers, or economic rights;
- nonredeemable ordinary shares;
- shares in which the recipient (together with its connected persons) holds less than 10 percent of the issued share capital of the paying company (or, when there is more than one class in issue, less than 10 percent of the class of shares held); and
- dividends derived from transactions that are not designed to achieve a reduction in U.K. tax.

When, rarely, dividends received by a U.K. Holdco do not fall within one of the above exemptions, then the dividends will be subject to corporation tax at the normal 20 percent rate.

Outbound Dividends

Subject to a minor exception (relating to real estate investment trusts) the U.K. does not under its domestic law levy any withholding tax on outbound dividends, share buybacks, or liquidation distributions paid by U.K. companies regardless of the residency of the person or entity to whom the dividend is paid. This means that a U.K. Holdco can be owned by an individual or a company established onshore or offshore and no dividend withholding tax will apply. This lack of outbound dividend withholding has traditionally given the U.K. a considerable advantage over other traditional European holding company jurisdictions (such as the Netherlands and Luxembourg) that do impose dividend withholding taxes.

Outbound Interest and Royalties

The U.K. imposes a 20 percent withholding tax on outbound interest and on some royalties.

Interest withholding tax applies to payments of annual interest (that is, interest on a debt capable of being outstanding for over one year) made to, broadly, a nonresident. However, in practice, the U.K. interest withholding tax that would otherwise be payable by a U.K. Holdco will often be eliminated or at least reduced by the interest article in the many double taxation treaties to which the U.K. is a party or by the EU interest and royalties directive. When a U.K. Holdco borrows from a parent located in an offshore jurisdiction, the debt can be structured in the form of a euro-bond listed on a recognized stock exchange (such as the Channel Islands Stock Exchange). In these circumstances, the interest can be paid gross and there is no withholding tax.

Interest Deductibility

Funding costs and, in particular, interest payments are usually deductible for corporation tax purposes. However, when a loan is made between connected persons, the level of debt incurred and the rate of interest payable must meet arm’s-length standards to be deductible for U.K. corporation tax purposes. The U.K. also has complex ‘worldwide debt cap’ rules that operate to restrict corporation tax deductions for interest by reference to a group’s consolidated finance costs.

In addition, there are also antiavoidance measures that apply when the main purpose of the financing is to avoid tax and anti-arbitrage rules that counter tax advantages arising from funding structures involving hybrid entities or hybrid instruments.

The Substantial Shareholding Exemption

Broadly, a gain arising from a disposal of shares by a U.K. Holdco may not be a chargeable gain subject to corporation tax if the Holdco is the holding company of a trading group that disposes of a trading company in which the Holdco has held an equity interest of at least 10 percent throughout a period of 12 months.

There is no need for the U.K. Holdco to dispose of its entire shareholding to benefit from this exemption.

The company making the disposal must continue to satisfy the relevant conditions immediately after the disposal of the shares. Therefore, when a U.K. Holdco is incorporated solely for the purpose of owning shares in a single trading subsidiary, on the sale of the subsidiary, it will no longer be a holding company of a trading group and will not, in principle, be able to benefit...
from the exemption. However, in practice the exemption will still be available if the U.K. Holdco is wound up promptly after the sale of the subsidiary.

It is important that the U.K. Holdco will be regarded as a holding company of a trading group and not as an investment company. A trading group is defined as a group whose members carry on trading activities that (disregarding intragroup activities) do not include, to a **substantial extent**, activities other than trading activities.

**Transaction Taxes**

Transfers of shares or interests in shares in U.K. registered companies worth more than £1,000 are subject, generally, to stamp duty or stamp duty reserve tax at a rate of 0.5 percent (rounded upward to the nearest £5 in the case of stamp duty) by the purchaser of the shares.

An issue of shares is not subject to either stamp duty or to capital duty.

**Antiavoidance Measures**

The U.K. has various antiavoidance measures in its tax system that may sometimes affect a U.K. Holdco. Generally, these provisions are intended to bring non-U.K. trading profits or chargeable gains into the charge to U.K. tax to the extent that they have been artificially diverted from the U.K.

**Controlled Foreign Company Regime**

A CFC is a non-U.K. resident company that is controlled by a U.K. resident. The CFC rules are designed to target profits that have been artificially diverted away from the U.K. so that they are generated in low-tax jurisdictions. The rules do not affect profits from genuine economic activity outside the U.K. and therefore do not affect the majority of U.K. holding companies.

The rules apply by imposing a charge on the controlling U.K. company on the profits of its CFCs as they arise, to the extent that those profits are connected to the U.K. and the CFC is not entitled to benefit from any exemptions.

One such exemption applies when the CFC is resident in a jurisdiction with an effective tax rate that corresponds to at least 75 percent of the corresponding level of tax exposure in the U.K. If a charge arises, the U.K. company is charged corporation tax regarding some of the profits of the CFC.

Note that as a result of the July 2015 budget, U.K. resident companies subject to a CFC charge will no longer be able to set current and carryforward losses and surplus expenses or group relief against the CFC charge. This applies to profits arising on or after July 8, 2015.

The main U.K. CFC regime applies to income, but there are other rules that operate to attack the use of artificial offshore structures as a means of avoiding U.K. taxation of capital gains by companies (or other types of taxpayer).

**Transfer Pricing**

In broad terms, the U.K.’s transfer pricing rules apply to large companies where services or transactions take place or loans are entered into between connected parties for a price calculated to provide a U.K. tax advantage. The effect of the rules is to treat the service as being supplied on an “arm’s-length price” rather than the price actually charged.

For example, these rules may prevent a full corporation tax deduction being available regarding interest paid by a U.K. Holdco to shareholders who have provided debt finance.

**Antiabuse Clause**

The parent-subsidiary directive was recently amended to require EU member states to deny the benefits of the directive to arrangements that are not “genuine” and that have a main purpose of obtaining a tax advantage that defeats the objectives of the directive. An arrangement is genuine to the extent that it is introduced for valid commercial reasons reflecting economic reality. This means that when a company has been inserted into a structure purely to obtain withholding-tax-free treatment for dividends, then the benefit of the directive will be disallowed. The deadline for transposing the amendment to the directive into national law is December 31, 2015.

**Beneficial Ownership Register**

As part of the U.K. government’s drive toward greater transparency, effective April 2016 U.K. companies will be required to maintain a registry of their beneficial owners, which will be publicly accessible. It is likely that all the other member states of the EU will also bring in a requirement for similar registers over the next two years.

**General Commercial Factors**

In addition to the tax incentives discussed here, the U.K. has many commercial advantages. London is a leading global financial center, a well-regulated and attractive location to list, raise debt finance, and manage a business. It also offers a stable legal, political, and economic system, and companies incorporated in the U.K. are seen as inherently “respectable.” In addition, the incorporation process is both straightforward and inexpensive.

**Bilateral Investment Treaties**

A final consideration when focusing on the U.K. as a Holdco jurisdiction is the availability of bilateral investment protection with the countries in which U.K. Holdco’s subsidiaries are located. In this connection, the U.K. has a very wide range of in-force bilateral investment treaties.
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Recent Italian Transfer Pricing Decisions

by Piergiorgio Valente and Federico Vincenti

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The authors summarize several of Italy’s recent court decisions addressing transfer pricing questions.

In the past few years, the complexity and importance of risks linked to transfer pricing have significantly increased as a natural consequence of the expansion of globalization and cross-border transactions. Revenue offices worldwide are focusing their audits more and more on transactions by enterprises moving in an international context, resulting in a considerable increase of tax controversies involving transfer pricing.

Recent transfer pricing rulings by Italian courts often involved the tax authorities challenging the selection and application of the transfer pricing method, the comparability analysis created by the taxpayer to support intercompany policies of the group, and the analysis of any special transactions such as loans and intercompany services and transactions involving intangibles.

Comparability Factors and Their Importance

In Ruling 9709 of May 13, 2015, the Italian Supreme Court said transfer pricing adjustments by the tax administration may be deemed legitimate only when those adjustments occurred after a comparison was carried out between the audited transaction and the transactions entered into by and among independent third parties that were actually comparable.

In the case, the Italian tax authorities recaptured for tax non-declared proceeds from sales made by the plaintiff company to its foreign associated companies because the sales were deemed made at a price lower than the one applied to independent clients.

The Court confirmed that both national laws and international regulations require the transactions being compared to be effectively comparable — that is, there must be no differences that might affect the transaction price or, if there are differences, they can be removed through specific and objective adjustments.

The plaintiff drew attention to what it called the tax authorities’ improper behavior, saying they compared sales made by the same company to its own associated companies with sales made to Italian independent third parties operating at a different distribution phase. The plaintiff said it would have been more appropriate to compare sales made to foreign independent third parties, because they are also distributors, just as the associated companies were. The Supreme Court said the arm’s-length value of intercompany transactions must be identified following “a comparison strongly contextualized for qualitative, commercial, time-related and local purposes.”

In Ruling 27296 of December 23, 2014, the Supreme Court pointed out that it is essential to analyze the contractual positions of the parties to both intercompany transactions and the transactions used for comparison purposes.

In the case, the tax authorities examined two sales contracts — one between the German company and the controlled Italian company (the audited company) and one between the audited company and a third Italian company that did not belong to the group. According to the tax authorities, the prices of the products sold by the audited company to the associated German company were two to three times lower than those in the transaction between the audited company and the third Italian company, even though the goods and the reference market were identical.
The Italian Supreme Court found the audited company’s behavior appropriate, reiterating that the price difference was justified on the basis of the different contractual positions adopted by the companies involved in the transactions being compared.

Selection of the Transfer Pricing Method

On April 21 in Ruling 1670/2015, the Regional Tax Court of Lombardy confirmed that in determining transfer prices among associated enterprises, the comparable uncontrolled price method may be used if it is the most suitable process to quantify the market’s value.

It might be worth recalling that even though the so-called hierarchy of methods was discarded in 2010 in favor of the best method application, both the OECD guidelines and Italian practice state that when it is possible to apply the CUP method, that method is deemed the most direct and reliable to ascertain whether the arm’s-length principle was complied with.

The Italian tax authorities challenged the company’s use of the CUP method, maintaining that the method failed to indicate factual data in the transfer pricing documentation in connection with the average purchase prices of raw materials and instead merely indicated the minimum and maximum prices. Subsequently, the authorities said the transactional net margin method (TNMM) applied and then created a specific benchmarking analysis that led to the adjustment of the transfer prices.

The regional tax court, confirming the lower court (Corte di Prima Istanza), issued a taxpayer-favorable ruling, saying the taxpayer complied with transfer pricing regulations because the commercial transaction prices were determined using procedures analogous to the ones that would have been agreed on in a free — that is, arm’s-length — market among independent parties.

Further, the court disagreed with the tax authorities’ general practice, saying it cannot challenge the determination of transfer prices by merely switching to a method other than the one applied by the audited company and should instead try to abide by the method identified by the company and challenge it if necessary.

According to the regional tax court, it does not matter whether the company indicated the actual average price; what matters is that the company indicated the minimum and maximum prices it could work with. The appellate court (Corte di Seconda Istanza) referred to the OECD guidelines, noting that all values in a range are suitable to represent the values of a free or arm’s-length market, and thus an average value falling between a minimum and maximum price should be adequate.

The appellate court also reiterated an important principle under which companies closing their fiscal year with operating losses may not simply be excluded, because operating losses — like operating profits — are true and proper operating results and therefore should be considered because they provide an accurate picture of the data used for comparison purposes. In fact, under the benchmark analysis, excluding companies with operating losses from the set of comparables would equate to “not examining with due attention the case subject to trial,” the court said.

In Ruling 62/04/15, issued February 11, 2015, the Provincial Tax Court of Varese determined that a company provided evidence to support its use of the CUP method, which was further substantiated by the fact that the prices in the relevant intercompany transaction were similar to those in transactions with independent suppliers.

After challenging the plaintiff’s choice of the CUP method, the tax authorities applied TNMM, which they deemed most appropriate under the circumstances, and adjusted the plaintiff’s taxable base. The court found the tax authorities’ benchmarking analysis was inaccurate because:

- the companies selected as comparables operated in different sectors or in different contexts; and
- only companies closing with operating profits were selected, whereas the physiology of both markets and companies envisage alternate phases (so-called ups and downs) in which profitability shifts from higher to lower levels, which should be kept in mind when comparing transfer prices.

Intercompany Loans

In Ruling 27087 of December 19, 2014, and Ruling 15005 of July 17, 2015, the Italian Supreme Court said non-interest-bearing loans issued by an Italian company to its own foreign associated companies were not subject to national transfer pricing regulations.

According to the Italian tax authorities, the non-interest-bearing loan in question evidenced a situation that clearly benefited the foreign controlled companies, which the transfer pricing regulations are intended to prevent. The tax authorities said an advantage like that would not have occurred had the companies obtained their supplies on a free market.

However, the Supreme Court said the application of transfer pricing rules (article 110, paragraph 7 of the Italian Income Tax Code (Testo Unico Delle Imposte sui redditi, or TUIR) is subject to a twofold condition:

- contractual intercompany transactions generate positive or negative income components for the taxpayer company; and
- application of the arm’s-length value increases taxable income.

The Supreme Court said that for the non-interest-bearing loan at issue, “the service itself — to which the payment of any interests due refers, and which represents the necessary basis for comparison vis-à-vis the arm’s-length value — is missing.” Further, the Court restated that a non-interest-bearing loan is an option...
that does have valid economic reasons — that is, sound business purpose. For example, as pointed out by the Supreme Court in Ruling 15055, the Italian company granted a loan to its own French subsidiary in order to give it the necessary capital to acquire a second-level controlled company, which was also French.

**National Transfer Pricing**

In Ruling 12844 of June 22, 2014, the Supreme Court confirmed its position in Ruling 17955 of 2013 and Ruling 8849 of 2014 regarding the application of the arm’s-length value criterion in article 9 TUIR to intercompany transactions entered into among subjects residing in Italy.

In particular, the Supreme Court said the arm’s-length criterion in article 9 is also valid for transactions entered into by subjects belonging to the same group that reside in Italy:

In observance of the prohibition to abuse the Law, which precludes taxpayer from realizing tax advantages obtained through the distorted use, even if not conflicting with any specific provision, of legal tools that are suitable for the purpose of securing tax advantages or savings, in the absence of any reasons other than the mere expectation of the said benefits. Such principle is rooted, on the one hand, in EU tenets to safeguard resources that are proper to the EU as well as in the constitutional principles of the ability-to-pay principle and of progressive taxation; on the other hand, it does not clash with the “subject to the law” principle, ultimately leading to the disavowal of abusive effects of transactions entered into with the purposes of avoiding the application of tax norms. Such transactions include internal transfer pricing schemes, motivated by convenience, within a national context to transfer taxable matter, by impacting on prices negotiated for the transfer of intercompany goods and the rendering of intercompany services.

**COMING ATTRACTIONS**

A look ahead at upcoming commentary and analysis.

**Belgium's new CFC rule: The ‘Cayman tax’ (Tax Notes International)**

Giovanne Smet and Virginie Derouck discuss Belgium’s new Cayman tax, a controlled foreign corporation provision that allows Belgian authorities to look through low-taxed offshore structures to tax Belgian resident founders and beneficiaries of the structure’s income.

**Do China’s revisions to Circular 2 localize BEPS actions? (Tax Notes International)**

Yansheng Zhu discusses China’s revisions to Circular 2, asking whether the changes reflect China’s localization of the OECD’s base erosion and profit-shifting actions or simply summarize the country’s own antiavoidance practice.

**Eyes on e-commerce: What Europe’s excessive tax burdens on e-commerce can teach us (State Tax Notes)**

George Isaacson and Matthew Schaefer provide insight on tax and legal developments in the area of electronic commerce.

**Finding a cure: Apportionment illness in the biotech and pharmaceutical industries (State Tax Notes)**

Kenny Gast explores the state tax problems caused by upfront, milestone, and royalty payments, and attempts to provide a general overview of the sales factor apportionment issues taxpayers face in the biotech and pharmaceutical industries.

**Goodwill hunting . . . without a license: Proposed section 367 regulations openly defy legislative intent (Tax Notes)**

Ken Brewer questions the validity of proposed regulations that would eliminate the favorable tax treatment of goodwill and going concern value in outbound transfers.

**Friends don’t let corporations pay tax (Tax Notes)**

Jasper L. Cummings, Jr., examines the many ways that corporations with related entities can avoid gain recognition, highlighting how the related party section 1031 can be used in cross-border transactions.
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For tax lawyers with clients operating in the U.S. and Sweden, two recent decisions from the Swedish Board for Advance Tax Rulings (the Board) on whether Swedish companies’ interests in U.S. entities could be classified as business related for the purposes of the Swedish participation exemption and the exemption from withholding tax on dividends. The author provides guidance for affected entities on the most relevant classification criteria used to determine whether interests are business related in applying the exemptions.

Background

Like many other countries, Sweden operates a participation exemption regime for domestic companies that hold business-related shares in foreign entities. Swedish companies are not taxed on dividends from foreign entities in which they hold business-related shares, nor are they taxed on capital gains from sales of business-related shares in foreign entities. Further, if a foreign entity has a business-related interest in a Swedish company, any dividends it receives from the Swedish company may be exempt from withholding tax.

For shares in foreign entities to be classified as business related, the foreign entity must be comparable to a Swedish limited liability company, which by default is taxed at the entity level, without the option of adopting flow-through status for domestic tax purposes. In addition, the shares should not be held as inventory and, if the shares are listed, holding criteria apply. To determine comparability, Swedish courts and the Board examine an array of characteristics, including whether the foreign entity:

1. Has a business-like structure;
2. Engages in business activities;
3. Is subject to taxation at the entity level;
4. Is actively managed;
5. Has a continuous and significant presence in the country where it is active;
6. Has a significant number of employees;
7. Has a substantial amount of assets;
8. Has a significant amount of business transactions;
9. Has a significant amount of business income.

Any withholding tax levied on these dividends cannot be credited against any Swedish tax due on other income. Further, losses arising on the shares are nondeductible for Swedish tax purposes.

If the foreign recipient of the dividends is comparable to a Swedish company, no withholding tax will be imposed. The classification issue is the same as when determining whether dividends and capital gains are tax exempt, with the added dimension of a presumption that entities covered by a tax treaty between Sweden and the other state should qualify. The standard Swedish withholding tax rate is 30 percent.

The entity may still be eligible to make an entity classification (check-the-box) election for U.S. tax purposes.

These criteria were not relevant in the cases at hand and will not be further elaborated upon.

1. The issues discussed in this article may also affect entities in other countries besides the U.S., particularly those in other non-European Union countries.
ensures limited liability for its shareholders;
- is subject to taxation at the entity level;\textsuperscript{6} and
- has the ability to acquire rights and assume liabilities.\textsuperscript{7}

The courts have been reluctant to go beyond these criteria to articulate an exact formula for classifying an interest as business related and have instead stressed that the assessment should be conducted on a case-by-case basis by taking all relevant circumstances into account.

The Board conducted this analysis in two recent rulings to determine whether shares in U.S. entities were business-related interests that qualified for the participation exemption. The interest in the first of these cases was held to be business related, while the interest in the second case was not. Accordingly, only the shares in the first case qualified for the participation exemption.\textsuperscript{8} The second case has since been appealed to the Supreme Administrative Court of Sweden (SAC).

The Two Cases

A. Business-Related Holding in Opaque LLC

The first (Case Nr. 119-14/D) of the Board’s two recent cases in this area concerned a Swedish company’s interest in a U.S. LLC (Y LLC) registered in an unspecified U.S. state.\textsuperscript{9} Y LLC was taxed at the entity level, and the owners’ liability was limited absent any agreement stating otherwise. The main difference between Y LLC and a Swedish company was the absence of share capital, since the owners’ interest in Y LLC was instead registered in capital accounts. Under the rules of the relevant U.S. state, Y LLC could elect to be taxed either at the entity level or as a flow-through entity.\textsuperscript{10} The Board assumed, however, based on information provided by the taxpayer, that Y LLC would not change its existing tax status and that there would be no future agreement by the shareholders to assume any of its liabilities or commitments.

Under these facts and assumptions, the Board concluded that the Swedish company’s interest in Y LLC was business related. The Board noted that Y LLC was in many ways similar to a Swedish company; the only major difference was that the Y LLC holding consisted of an interest in capital accounts rather than shares with corresponding share capital. Quoting precedent,\textsuperscript{11} the Board found that this difference was immaterial, as was the entity’s ability to choose whether to be taxed as an opaque or a flow-through entity.

Analysis

The Board appears to have reached the correct conclusion in this case based on the facts presented, as neither the taxpayer nor the Swedish Tax Agency (STA) appealed the decision. Under a different set of facts, an opportunity for arbitrage may arise if shares were treated as business related when a dividend was issued but were later reclassified as ordinary shares, allowing a tax loss to be claimed on their sale.\textsuperscript{12} However, taxpayers contemplating arbitrage arrangements should consider the application of the Swedish Tax Avoidance Act, a general antiavoidance rule used as a means of striking down controversial tax planning strategies.

B. Non-Business-Related Holding in U.S. DISC

The second case (Case Nr. 87-14/D) concerned a Swedish company’s shares in an American domestic international sales corporation that sold products for other U.S. group companies. The DISC was remunerated under a commission agreement and did not own any premises, and its business was carried out by employees of other group companies.\textsuperscript{13} The entity was also a Delaware corporation that, as a DISC, was exempt from federal income tax. Taxes were instead levied at the ownership level on a portion of the DISC’s income that was characterized as constructive dividends. Any retained earnings triggered an interest charge on the deferred tax that had to be reported as income.\textsuperscript{14}

The Swedish taxpayer presented several questions to the Board, the thrust of which was whether the DISC was comparable to a Swedish company and consequently whether the holding was business related.

Although the Board recognized some similarities between the DISC and Swedish companies, it ultimately concluded that the DISC was not comparable.

\textsuperscript{6}In relation to the level of tax, rates as low as 1 percent have been accepted by the Swedish courts.

\textsuperscript{7}Another consideration is whether the corporate law of the foreign entity’s home jurisdiction is comparable to that of Sweden.

\textsuperscript{8}Although not applicable to the facts of this case, business-related interests can also qualify for an exemption from withholding tax on dividends paid by a Swedish company to a foreign entity.

\textsuperscript{9}Identifying information is usually omitted in the texts of Swedish advance rulings to preserve the taxpayer’s anonymity.

\textsuperscript{10}For domestic tax purposes, U.S. LLCs are by default taxed as flow-through entities and must affirmatively elect to be taxed as corporations.

\textsuperscript{11}SAC 2009 ref. 100.

\textsuperscript{12}This scenario is, of course, somewhat simplified, and a real-life scenario would give rise to complexities extending well beyond the scope of this article.

\textsuperscript{13}In short, the entity fulfilled the criteria for being classified as a DISC.

\textsuperscript{14}IRC section 995. Shareholders of DISCs are also taxed on any actual distributions, on gains upon the disposition of the stock, and if the entity ceases to be a DISC.
Quoting precedent,\(^\text{15}\) the Board was primarily concerned that contrary to one of the hallmarks of Swedish companies, the owners of the DISC were subject to tax, rather than the entity itself. Both the taxpayer and the STA have since appealed the decision in this case.\(^\text{16}\)

**Analysis**

In both the first and second cases, the outcome depended on the level at which taxation occurred. As noted in the second case, the policy behind the classification of business-related shares rests on maintaining the system of double taxation — that is, all income is taxed once at the company level and once at the shareholder level. With this policy in mind, the outcome in the second case appears reasonable, since the DISC’s income was effectively taxed only once. Accordingly, it would be no surprise if the SAC affirmed the Board’s decision.

**Final Comments**

Despite the appeal of the second case, these two recent decisions are reasonably clear-cut based on the facts and assumptions provided, and one can imagine situations where the outcome is less clear. However, an arbitrage opportunity remains if entities can be characterized as opaque for one purpose and flow-through for another.\(^\text{17}\) To combat arbitrage that could reduce the Swedish tax base, the STA would need to rely on either established case law or the Swedish Tax Avoidance Act.

The takeaway from these recent Swedish cases is that substantial tax benefits can be gained when an interest in a foreign entity is classified as business related but that this classification should be conducted with care\(^\text{18}\) and perhaps combined with an application for an advance ruling — a small price to pay for the high level of security that the taxpayer can obtain. Any taxpayer taking a more aggressive approach must also consider the application of the Swedish Tax Avoidance Act, which, depending on the facts, may also be considered in an advance ruling.\(^\text{19}\)

Adding to the complexity of this situation is the OECD’s omnipresent base erosion and profit-shifting project, which may have implications for the matters discussed in this article. Further, following changes in the European Union parent-subsidiary directive (Directive 2011/96/EU), the Swedish government recently proposed a rule stating that the participation exemption would not apply if the dividends received were deducted at the level of the distributor — a rule designed to prevent hybrid mismatch arrangements. This rule is expected to enter into force on January 1, 2016, but the final decision is still pending further review.\(^\text{◆}\)

\(^{15}\)SAC 2009 ref. 100.

\(^{16}\)Note that the STA appealed only to get the decision confirmed by the SAC.

\(^{17}\)Subject to complexities that are not further elaborated on in this article.

\(^{18}\)For U.S. tax purposes, entities such as regulated investment companies, real estate investment companies, and S corporations come to mind as cases where the characterization is not necessarily obvious.

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The OECD released final base erosion and profit-shifting reports on October 5, 2015. Pascal Saint-Amans, director of the OECD’s BEPS project, discussed the 13 reports that day in a webcast. They are addressed in an excellent report by Stephanie Soong Johnston (Tax Notes International, Oct. 12, 2015, p. 103) to which Lee Sheppard, Amanda Athenasiou, Mindy Herzfeld, Ajay Gupta, Ryan Finley, and J.P. Finet made significant contributions. They also had some very good follow-up reports.

The OECD’s introduction states that the BEPS package lays the foundations of a “modern international tax framework under which profits will be taxed where economic activity and value creation occurs.” It says that:

it is now time to focus on the upcoming challenges, which include supporting the implementation of the recommended changes in a consistent and coherent manner, monitoring the impact on double non-taxation and on double taxation, and designing a more inclusive framework to support implementation and carry out monitoring.

The introduction says that some of the revisions may be immediately applicable, such as the revisions to the transfer pricing guidelines,1 while others will require changes that can be implemented by tax treaties, including through the BEPS multilateral instrument. Some will require domestic law changes, such as the provisions on hybrid mismatches, controlled foreign corporations, interest deductibility, country-by-country (CbC) reporting, and the mandatory disclosure rules. Preferential intellectual property regimes will need to be aligned with the harmful tax practices criteria.

The introduction further states that challenges arose during the development process, including some countries enacting unilateral measures and some tax administrations being more aggressive; the increasing uncertainty has been denounced by some practitioners. The BEPS writers say that governments recognize these challenges and that consistent implementation and application will be the key to success. Accordingly, the OECD and the G-20 countries have agreed to continue to work together to support an efficient and consistent implementation of the BEPS project framework.

Action 1 — Digital Economy

The action 1 executive summary says that the digital economy is “increasingly becoming the economy itself.” Thus, it would be difficult — if not impossible — to ring-fence the digital economy from the rest of the economy for tax purposes. The digital economy and its business models nevertheless present some key features that are relevant from a tax perspective. The work on the relevant BEPS provisions took these issues...
into account to ensure that the proposed solutions fully address the digital economy.

Accordingly, it was agreed to modify the list of exceptions to the definition of permanent establishment to ensure that each of the exceptions is restricted to activities that are otherwise of a “preparatory or auxiliary” character, and to introduce a new anti-fragmentation rule to prevent the use of these exceptions through the fragmentation of business activities among closely related enterprises.

For example, the maintenance of a very large warehouse in which a significant number of employees work for purposes of storing and delivering goods sold online to customers of a foreign online seller of physical products (whose business model relies on proximity to customers and quick delivery to clients) would constitute a PE of the seller under the new standard.

The definition of PE was also modified to address circumstances in which artificial arrangements relating to the sales of goods or services of one company in a multinational group effectively result in the conclusion of contracts such that the sales should be treated as if they have been made by that company.

Thus, if the sales force of a local subsidiary of a foreign online seller of tangible products or an online provider of advertising services habitually plays the principal role in the conclusion of contracts with prospective large clients for those products or services, and these contracts are routinely concluded without material modification by the parent company, this activity would result in a PE for the parent company.

Further, under the revised transfer pricing guidance, legal ownership alone does not necessarily generate a right to all (or indeed any) of the return that is generated by the exploitation of the intangible. Instead, the group companies performing the important functions — contributing the important assets and controlling economically significant risks, as determined through an analysis of the actual transaction — will be entitled to an appropriate return.

The controlled foreign corporation proposals would also treat income that is typically earned in the digital economy as subject to taxation in the jurisdiction of the ultimate parent company (that is, like subpart F income), with the aim of eliminating so-called stateless income.

The BEPS task force did not recommend any of the three options that it previously had considered for taxing income from the sales of digital goods and services by foreign suppliers lacking a PE in the customers’ country under current treaty rules. The proposals were a withholding tax on income from specific kinds of digital transactions, a new nexus rule in the form of a significant economic presence, and an equalization levy to tax the nonresident enterprise’s significant economic presence in the given country.

However, the report suggests that countries could implement any of the three options to further protect against base erosion and profit shifting, as long as they respect existing treaty obligations and adapt the rules to ensure consistency with existing international commitments.

Bob Stack, Treasury deputy assistant secretary (international tax affairs), said the language regarding the three options represents a compromise on a sticky issue, but expressed the view that as written, there is not a lot of freedom for countries to adopt any of the options.

The report also recommended that countries apply the OECD’s international VAT/goods and services tax guidelines for the collection of VAT on cross-border transactions and consider implementing the collection mechanisms described in those guidelines.

The report states that its conclusions may evolve as the digital economy continues to develop, so it is important to continue working on these issues and to monitor developments over time. Thus, the work will continue following completion of the other follow-up work on BEPS projects. This future work will be done in consultation with a broad range of stakeholders and on the basis of a detailed mandate to be developed during 2016 as part of designing an inclusive post-BEPS monitoring process.

The digital economy final report is the second-longest of the BEPS reports at 285 pages.

**Action 2 — Hybrids**

Hybrid mismatch arrangements exploit differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to achieve double nontaxation, including long-term deferral. The action 2 executive summary says these types of arrangements are widespread and result in a substantial erosion of the taxable bases of the countries concerned.

Part 1 of the final report provides recommendations for rules to address mismatches in tax outcomes when they arise regarding payments made under a hybrid financial instrument or those made to or by a hybrid entity. It also recommends rules to address indirect mismatches that arise when the effects of a hybrid mismatch arrangement are imported into a third jurisdiction. The recommendations take the form of linking rules that align the tax treatment of an instrument or entity with the tax treatment in the counterparty jurisdiction, but otherwise do not disturb the commercial outcomes.

The rules apply automatically, and there is a primary rule and a secondary — or defensive — rule. This prevents more than one country from applying the rule for the same arrangement and avoids double taxation.

The recommended primary rule is that countries deny the taxpayer’s deduction for a payment to the extent that it is not included in the taxable income of the recipient in the counterparty jurisdiction or it is also deductible in the counterparty jurisdiction. If the
primary rule does not apply, then the counterparty jurisdiction can generally apply a defensive rule, requiring the deductible payment to be included in income or denying the duplicate deduction, depending on the nature of the mismatch.

Part 2 addresses rules designed to ensure that hybrid instruments and entities, as well as dual resident entities, are not used to improperly obtain the benefits of tax treaties and that tax treaties do not prevent the application of the changes to domestic law recommended in part 1.

It states that action 6 (treaties) will address some of the BEPS concerns regarding dual resident entities. Cases involving dual residence under a tax treaty will be resolved on a case-by-case basis, rather than on the basis of the current rule and the place of effective management. This change, however, will not address all BEPS concerns regarding dual resident entities. Domestic law changes will be necessary to address other avoidance strategies involving dual residence.

Part 2 proposes to include in the OECD model tax convention a new provision and detailed commentary that will ensure not only that benefits of tax treaties are granted in appropriate cases to the income of hybrid entities, but also that these benefits are not granted where neither state treats, under its domestic law, the income of such an entity as the income of one of its residents.

Finally, part 2 addresses potential treaty issues that could arise from the recommendations in part 1. The report describes possible treaty changes that would address these issues.

In a three-part paper written by Bob Cassanos of Fried, Frank, Harris, Shriver & Jacobson LLP, Cassanos makes a number of suggestions for improving the BEPS hybrid mismatch rules, which he believes will fall short in practice (see our column at Tax Notes Int'l, Sept. 7, 2015, p. 871). He states that one area in which the approach may fall short is properly allocating the missing tax base to the correct taxpayers. He also expressed concern about the ambiguity of the basis for comparison, the ambiguity of the scope, the difficulties of interpreting and knowing when to apply the rules, and the complex web of overlapping and under- and overinclusion remedies that all contribute to a less-than-satisfying resolution of the issue. Cassanos said that there is already a simpler approach for dealing with situations in which, for example, there is a deduction of interest and no inclusion of the interest income anywhere: withholding of income at the source.

Bob’s suggestions would seem now to be history, and the easy way out will not supplant the complex proposed new rules. Unfortunately, the report explaining the proposed new hybrid rules is an incredible 454 pages — far lengthier than Bob’s paper and more than double the number of pages in the final report’s discussion of the new transfer pricing rules (186 pages).

The final report also contains some additions to the hybrid rules that would make them even more complex, most notably those addressing hybrid transfers, which includes repos and securities lending transactions. Also, a special new rule would deal with disregarded payments made by hybrid entities. A disregarded payment would be one that the payee jurisdiction does not see. The payer jurisdiction would be expected to deny a deduction, and failing that, the payee jurisdiction would be expected to require inclusion.

Action 3 — CFC Rules

This report sets out CFC recommendations, which are described as “building blocks.” The recommendations are not minimum standards, but are designed to ensure that jurisdictions that choose to implement them will have rules that effectively prevent taxpayers from shifting income to foreign subsidiaries. The report retains much of what was in the discussion draft, released April 3, as well as the sense that the various options reflect a deep lack of consensus among the stakeholders. A U.S. spokesperson expressed disappointment that a consensus could not be reached on CFC rules.

Action 4 — Interest

The BEPS action 4 final report does not differ significantly from the earlier discussion draft, which presented a number of choices and left restrictions up to individual countries.

The final report, however, seemingly provides more direction. It analyzes several “best practices” and then provides a suggested approach. The recommended approach is based on a fixed ratio rule that limits an entity’s net deductions for interest and payments economically equivalent to interest to a percentage of its earnings before interest, taxes, depreciation and amortization. At a minimum, the action 4 executive summary states, this should apply to entities in multinational groups.

The recommended approach includes a range of possible ratios of between 10 and 30 percent to ensure that countries apply a fixed ratio that is sufficiently low to deal with base erosion issues while at the same time recognizing that all countries are not in the same position. The report also includes factors that countries should take into account in setting their fixed ratio within this range.

The fixed-ratio approach can be supplemented with a worldwide-group ratio rule that allows an entity to exceed the fixed-ratio limit in certain circumstances. Using a worldwide-group ratio along with a fixed ratio would allow an entity with net interest expense above a country’s fixed ratio to deduct interest up to the level of the net interest/EBITDA ratio of its worldwide group.

Countries may also apply an uplift of up to 10 percent to the group’s net third-party interest expense to
SPECIAL REPORT

prevent double taxation. The earnings-based worldwide-group ratio rule also could be replaced by different group-ratio rules, such as the “equity escape” rule (which compares an entity’s level of equity and assets to those of its group) currently in place in some countries. A country may also choose not to introduce any group-ratio rule. If a country does not introduce a group-ratio rule, it should apply the fixed ratio to entities in multinational and domestic groups without improper discrimination.

The recommended approach allows countries to supplement the fixed-ratio and group-ratio rules with other provisions that reduce the impact of the rules on entities or in situations that pose less BEPS risk. The report also recognizes that the banking and insurance sectors have specific features that must be taken into account and that there is a need to develop suitable rules that address BEPS risks in these sectors.

**Action 5 — Harmful Tax Practices**

The participating countries agreed that the substantial activity requirement used to assess preferential regimes should be strengthened in order to realign taxation of profits with the substantial activities that generate them. Several approaches were considered, and consensus was reached on a “nexus approach.”

This approach was developed in the context of IP regimes and allows a taxpayer to benefit from an IP regime only to the extent that the taxpayer itself incurred qualifying research and development expenditures that gave rise to the IP income. The nexus approach uses expenditures as a proxy for activity and builds on the principle that because IP regimes are designed to encourage R&D activities and to foster growth and employment, a substantial activity requirement should ensure that taxpayers benefiting from these regimes did in fact engage in the activities and did incur the actual expenditures regarding these activities. Saint-Amans said in his webcast that the nexus approach will ultimately limit the toxicity of patent boxes.

In the area of transparency, there was an agreement regarding the exchange of rulings that could give rise to BEPS concerns. There will be a compulsory spontaneous exchange of rulings related to:

- preferential regimes;
- cross-border unilateral advance pricing agreements or other unilateral transfer pricing rulings;
- a downward adjustment to profits;
- PEs; and
- conduits.

Other categories of rulings can be added to the list if the OECD’s Forum on Harmful Tax Practices agrees that the absence of an exchange would give rise to BEPS concerns.

The final report states that an inclusion on the list does not mean that these rulings are per se preferential or that they will in themselves give rise to BEPS issues, but it does acknowledge that a lack of transparency in the operation of a regime or administrative process can give rise to mismatches in tax treatment and instances of double nontaxation. For countries that have the necessary legal basis in place, an exchange of information will take place starting April 1, 2016, for future rulings. The exchange of certain past rulings will need to be completed by December 31, 2016. The report also provides best practices for cross-border rulings.

The report includes a review of 43 preferential regimes, 16 of which are IP regimes. Regarding substantial activity, the IP regimes reviewed were all considered inconsistent, either in whole or in part, with the nexus approach described in the report. Countries with these regimes will now need to review them for possible changes to conform. The BEPS review process will be ongoing.

**Action 6 — Treaty Abuse**

The action 6 executive summary says that taxpayers engaged in treaty shopping and other treaty abuse strategies undermine tax sovereignty by claiming treaty benefits in situations in which these benefits were not intended to be granted, thereby depriving countries of tax revenues. The BEPS participants countries have therefore agreed to include antiabuse provisions in their tax treaties, including a minimum standard to counter treaty shopping.

Section A of the final report includes new treaty antiabuse rules that provide safeguards against the abuse of treaty provisions and offer a certain degree of flexibility regarding how to do so. These new treaty antiabuse rules first address treaty shopping, which involves strategies through which a person that is not a resident of a state attempts to obtain benefits that a tax treaty concluded by that state grants to residents, for example, by establishing a letterbox company in that state.

The following approach is recommended to deal with these strategies:

- provide a clear statement that the states that enter into a tax treaty intend to avoid creating opportunities for nontaxation or reduced taxation through tax evasion or avoidance, including treaty shopping arrangements;
- include a specific antiabuse rule (the limitation on benefits rule) that limits the availability of treaty benefits to entities that meet specific conditions in the OECD model tax convention; and
- include a more general antiabuse rule based on the principal purpose of transactions or arrangements (the principal purpose test (PPT)) in the OECD model tax convention.

The latter provision is to address other forms of treaty abuse, including treaty shopping situations that would not be covered by an LOB rule.
The report recognizes that each of the LOB and PPT rules has strengths and weaknesses and may not be appropriate for — or accord with treaty policy of — all countries. Also, the domestic law of some countries may include provisions that make it unnecessary to combine these rules to prevent treaty shopping.

The participating BEPS countries have committed to ensure a minimum level of protection against treaty shopping (the minimum standard). This commitment will require countries to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for nontaxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping arrangements.

The U.S. will not use a PPT approach in its treaties. Such an approach was rejected by the Senate several years ago. Nearly all U.S. treaties, of course, contain an LOB provision. The U.S. also has domestic rules to help prevent treaty shopping (anti-conduit rules under section 881). Thus, the U.S. will be compliant. Nonetheless, U.S. tax advisers will need to understand the new PPT rules. They will likely find themselves dealing with foreign-to-foreign treaties in their practices.

Section A also provides new rules to be included in tax treaties in order to address other forms of treaty abuse. These targeted rules address:

- certain dividend transfers that are intended to artificially lower withholding taxes payable on dividends;
- transactions that circumvent the application of the treaty that allows source taxation of shares of companies that derive their value primarily from movable property;
- situations in which an entity is a resident of two contracting states; and
- situations in which the state of residence exempts the income of PEs situated in third states and when shares, property, debt claims, or rights, are transferred to PEs set up in countries that do not tax that income or offer preferential treatment to that income.

Changes to the commentary to the OECD model tax treaty convention will clarify that treaties do not prevent application of the contracting state’s right to tax its own residents or imposition of a “departure” or “exit” tax under which liability to tax some types of income that has accrued for the benefit of a resident is triggered in the event that the resident ceases to be a resident of that state.

Section B of the report addresses the part of action 6 that seeks clarification “that tax treaties are not intended to be used to generate non-taxation.” This clarification is provided through a reformulation of the title and preamble of the model tax convention that will state that the joint intention of the parties to a treaty is to eliminate double taxation without creating opportunities for tax evasion and avoidance, in particular through treaty-shopping arrangements.

Section C of the report addresses the third part of the work mandated by action 6, which is “to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country.” Additional work will be required to fully consider proposals recently released by the U.S. concerning the LOB rule and other provisions included in the report. Since the U.S. does not anticipate finalizing its new model tax treaty until the end of 2015, the relevant provisions included in the report will need to be reviewed after that finalization and will therefore be finalized in the first part of 2016. An examination of the issues related to the treaty entitlement of specific types of investment funds will also continue after September 2015 with a similar deadline.

**Action 7 — PE Status**

Action 7 is entitled “Preventing the Artificial Avoidance of Permanent Establishment Status.”

**Commissionnaires**

Commissionnaire arrangements, a specific target of action 7, may loosely be defined as an arrangement through which a person sells products in a state in its own name but on behalf of a foreign enterprise that is the owner of the products. Through such an arrangement, the foreign enterprise is able to sell its products in a state without technically having a PE in that state to which the sales may be attributed for tax purposes and without, therefore, being taxable in that state on the profits derived from those sales.

Commissionnaire arrangements have been a major preoccupation of the tax administrations in many countries, as shown by the number of cases dealing with these arrangements that have been litigated in OECD countries. In most of the cases that went to court, the tax administration’s arguments were rejected.

The executive summary states that as a matter of policy, where the activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise should be considered to have a taxable presence in the country unless the intermediary is performing these activities in the course of an independent business. Changes to articles 5(5) and 5(6) of the OECD model tax convention and the related commentary that is included in section A of the report address commissionnaire arrangements and similar strategies by ensuring that the wording of these provisions better reflects this underlying policy.

**Habitually Concludes Contracts**

Commentators on the discussion draft’s broadening of the term “habitually concludes contracts” to the term “habitually concludes contracts or negotiates the material elements of contracts” were concerned that the proposed new rule was so broadly worded that it...
could apply to some of the most basic business practices of modern multinational enterprises and that it would capture much more than simply commissionaire arrangements. They were also concerned that it would apply to many transactions that do not raise BEPS-related concerns.

The Tax Executives Institute stated, for example, that many businesses require goods and services to be delivered in multiple locations around the world. To ensure that the goods and services are always provided under the same terms and conditions and meet the same standards, a global master sales or service agreement is often negotiated by a lead provider (for example, the parent company) to save time in negotiation and administration of contracts.

The master agreement’s terms are then incorporated by reference into local agreements with local subsidiaries. The local agreement is reviewed, approved, and signed by the local subsidiary; however, to keep each local subsidiary from renegotiating the contract, modifications are generally limited to changes that are necessary because of specific local business needs or to satisfy local legal, tax, and other regulatory requirements.

TEI was concerned that under the discussion draft, the parent company would likely have a PE in each location that a local agreement is executed based on the master services agreement. Given that the local subsidiary is already paying tax for its local activities, the lead service provider that negotiated the global master agreement should not also have a PE in that jurisdiction merely by virtue of the agreement.

TEI also was concerned that the proposed commentary in the discussion draft stretched the interpretation of the phrase “concludes contracts” beyond any reasonable definition. Specifically, it indicated that a contract may be considered to be concluded in a state (1) even without any active negotiation of the terms of that contract or (2) if a person accepts, on behalf of an enterprise, the offer made by a third party to enter into a standard contract with that enterprise, even if the contract is signed outside of that state.

To address these concerns, the final report uses the language habitually “concludes contracts” or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise.” The revised commentary says that while the term “concludes contracts”:

provides a relatively well-known test based on contract law, it was found necessary to supplement that test with a test focusing on substantive activities taking place in one State in order to address cases where the conclusion of contracts is clearly the direct result of these activities although the relevant rules of contract law provide that the conclusion of the contract takes place outside that State. The phrase must be interpreted in the light of the object and purpose of paragraph 5, which is to cover cases where the activities that a person exercises in a State are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, i.e. where that person acts as the sales force of the enterprise. The principal role leading to the conclusion of the contract will therefore typically be associated with the actions of the person who convinced the third party to enter into a contract with the enterprise. The phrase therefore applies where, for example, a person solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods belonging to the enterprise are delivered and where the enterprise routinely approves these transactions. It does not apply, however, where a person merely promotes and markets goods or services of an enterprise in a way that does not directly result in the conclusion of contracts.

Where, for example, representatives of a pharmaceutical enterprise actively promote drugs produced by that enterprise by contacting doctors that subsequently prescribe these drugs, that marketing activity does not directly result in the conclusion of contracts between the doctors and the enterprise so that the paragraph does not apply even though the sales of these drugs may significantly increase as a result of that marketing activity.

The following is another example that illustrates the application of paragraph 5. RCO, a company resident of State S, distributes various products and services worldwide through its websites. SCO, a company resident of State S, is a wholly-owned subsidiary of RCO. SCO’s employees send emails, make telephone calls to, or visit large organisations in order to convince them to buy RCO’s products and services and are therefore responsible for large accounts in State S; SCO’s employees, whose remuneration is partially based on the revenues derived by RCO from the holders of these accounts, use their relationship building skills to try to anticipate the needs of these account holders and to convince them to acquire the products and services offered by RCO. When one of these account holders is persuaded by an employee of SCO to purchase a given quantity of goods or services, the employee indicates the price that will be payable for that quantity, indicates that a contract must be concluded online with RCO before the goods or services can be provided by RCO and explains the standard terms of RCO’s contracts, including the fixed price structure used by RCO, which the employee is not authorized to modify. The account holder subsequently concludes that contract online for the quantity discussed with SCO’s employee and in accordance with the price structure presented...
by that employee. In this example, SCO’s employees play the principal role leading to the conclusion of the contract between the account holder and RCO and such contracts are routinely concluded without material modification by the enterprise. The fact that SCO’s employees cannot vary the terms of the contracts does not mean that the conclusion of the contracts is not the direct result of the activities that they perform on behalf of the enterprise, convincing the account holder to accept these standard terms being the crucial element leading to the conclusion of the contracts between the account holder and RCO.

A U.S. spokesperson stated that the U.S. was pleased with this change in language from that proposed in the earlier discussion draft.

Preparatory or Auxiliary

When the specific exceptions to the definition of PE in article 5(4) of the OECD model tax convention were first introduced, the described activities were generally considered to be of a preparatory or auxiliary nature.

The executive summary to the action 7 final report says there have been dramatic changes in the way that business is conducted since the introduction of these exceptions. This was discussed in part in the final report on action 1 (digital economy). Depending on the circumstances, activities previously considered to be merely preparatory or auxiliary in nature may today correspond to core business activities. In order to ensure that profits derived from core activities performed in a country can be taxed in that country, article 5(4) will be modified to ensure that each of the exceptions included therein is restricted to activities that are otherwise of a “preparatory or auxiliary” character.

Commentators on the earlier discussion draft had objected to various options proposed as replacements to the present rules. The BEPS drafters decided that the “preparatory or auxiliary” approach would work best, with a clarification of the scope of this term. The U.S. disagreed with this approach on the grounds that the standard “preparatory or auxiliary” is too subjective. Some countries believe the issue should be resolved by the anti-fragmentation rule, discussed below.

Accordingly, the final draft, while adding the “preparatory or auxiliary” limiting language to the OECD model treaty, also provides that it is optional, provided countries that do not include it as an overall limitation include an anti-fragmentation provision in their treaties.

The new limiting provision (“preparatory or auxiliary”) will be discussed in the OECD model convention commentary as follows:

It is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not. The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. Each individual case will have to be examined on its own merits. In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise, does not exercise a preparatory or auxiliary activity.

As a general rule, an activity that has a preparatory character is one that is carried on in contemplation of the carrying on of what constitutes the essential and significant part of the activity of the enterprise as a whole. Since a preparatory activity precedes another activity, it will often be carried on during a relatively short period, the duration of that period being determined by the nature of the core activities of the enterprise. This, however, will not always be the case as it is possible to carry on an activity at a given place for a substantial period of time in preparation for activities that take place somewhere else. Where, for example, a construction enterprise trains its employees at one place before these employees are sent to work at remote work sites located in other countries, the training that takes place at the first location constitutes a preparatory activity for that enterprise. An activity that has an auxiliary character, on the other hand, generally corresponds to an activity that is carried on to support, without being part of, the essential and significant part of the activity of the enterprise as a whole. It is unlikely that an activity that requires a significant proportion of the assets or employees of the enterprise could be considered as having an auxiliary character.

Fragmentation

BEPS concerns related to article 5(4) also arise from what the report calls the “fragmentation of activities.” The executive summary states that given the ease with which multinational enterprises may alter their structures to obtain tax advantages, it is important to clarify that PE status cannot be avoided by fragmenting a cohesive operating business into several small operations in order to argue that each part is merely engaged in preparatory or auxiliary activities that benefit from the exceptions of article 5(4). The U.S. agreed with the need for an anti-fragmentation rule.

However, most comments regarding the discussion draft’s fragmentation proposals objected to both proposed approaches to changing the rule. All commentators agreed that a fragmentation rule would be difficult to apply in practice, even those few who supported a change. TEI stated that many multinational enterprises are divided functionally on a worldwide basis so that, for example, the purchasing function is separated from the manufacturing function, which is separated from the sales function. Each of these corporate functions has its own management, reporting lines, and financial statements. Commercial advantage is the primary driver for using the specialization, expertise, economies...
of scale, and flexibility that accompanies this manner of conducting worldwide operations.

TEI’s specific concern was that an anti-fragmentation rule could cause a multinational enterprise to have multiple PEs in a given country or a PE in situations in which there really should not be a PE — for example, when there are no BEPS concerns — simply by having a rule that fails to recognize how large modern corporate enterprises operate in today’s business environment.

The new anti-fragmentation language in article 5 (4.1) will provide:

Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and

a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or

b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,

provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.

The OECD model treaty commentary will provide:

The purpose of paragraph 4.1 [above] is to prevent an enterprise or a group of closely related enterprises from fragmenting a cohesive business operation into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity. Under paragraph 4.1, the exceptions provided for by paragraph 4 do not apply to a place of business that would otherwise constitute a permanent establishment where the activities carried on at that place and other activities of the same enterprise or of closely related enterprises exercised at that place or at another place in the same State constitute complementary functions that are part of a cohesive business operation. For paragraph 4.1 to apply, however, at least one of the places where these activities are exercised must constitute a permanent establishment or, if that is not the case, the overall activity resulting from the combination of the relevant activities must go beyond what is merely preparatory or auxiliary.

The following examples illustrate the application of paragraph 4.1:

Example A: RCO, a bank resident of State R, has a number of branches in State S which constitute permanent establishments. It also has a separate office in State S where a few employees verify information provided by clients that have made loan applications at these different branches. The results of the verifications done by the employees are forwarded to the headquarters of RCO in State R where other employees analyse the information included in the loan applications and provide reports to the branches where the decisions to grant the loans are made. In that case, the exceptions of paragraph 4 will not apply to the office because another place (i.e. any of the other branches where the loan applications are made) constitutes a permanent establishment of RCO in State S and the business activities carried on by RCO at the office and at the relevant branch constitute complementary functions that are part of a cohesive business operation (i.e. providing loans to clients in State S).

Example B: RCO, a company resident of State R, manufactures and sells appliances. SCO, a resident of State S that is a wholly-owned subsidiary of RCO, owns a store where it sells appliances that it acquires from RCO. RCO also owns a small warehouse in State S where it stores a few large items that are identical to some of those displayed in the store owned by SCO. When a customer buys such a large item from SCO, SCO employees go to the warehouse where they take possession of the item before delivering it to the customer; the ownership of the item is only acquired by SCO from RCO when the item leaves the warehouse. In this case, paragraph 4.1 prevents the application of the exceptions of paragraph 4 to the warehouse and it will not be necessary, therefore, to determine whether paragraph 4, and in particular subparagraph 4 a), applies to the warehouse. The conditions for the application of paragraph 4.1 are met because

— SCO and RCO are closely related enterprises;

— SCO’s store constitutes a permanent establishment of SCO (the definition of permanent establishment is not limited to situations where a resident of one Contracting State uses or maintains a fixed place of business in the other State; it applies equally where an enterprise of one State uses or maintains a fixed place of business in that same State); and
— The business activities carried on by RCO at its warehouse and by SCO at its store constitute complementary functions that are part of a cohesive business operation (i.e. storing goods in one place for the purpose of delivering these goods as part of the obligations resulting from the sale of these goods through another place in the same State).

Splitting Up Contracts

The executive summary says that the exception in article 5(3), which applies to construction sites, has also given rise to abuses through the practice of splitting up contracts between closely related enterprises. The PPT that will be added to the OECD model tax convention as a result of action 6 will address the BEPS concerns related to these abuses. To make this clear, a new example will be added to the commentary on the PPT rules.

Multilateral Instrument

The changes to the definition of PE that are included in the report will be among the changes proposed for inclusion in the multilateral instrument that will implement the results of the BEPS work on treaty issues.

PE Profits

To provide greater certainty about the determination of profits to be attributed to a PE and to take account of the need for additional guidance on the issue of attribution and profits to PEs, follow-up work on attribution and profits issues related to action 7 will be carried on with a view to providing the necessary guidance before the end of 2016, which is the deadline for the multilateral instrument negotiation.

Actions 8-10 — Transfer Pricing

The arm’s-length principle is used by countries as the cornerstone of transfer pricing rules. The executive summary states that it is embedded in treaties and appears in article 9(1) of the OECD and U.N. model tax conventions. A shared interpretation of the arm’s-length principle by many of those countries is provided in the OECD’s transfer pricing guidelines for multinational enterprises and tax administrations. The BEPS action plan required guidance on the arm’s-length principle to be clarified and strengthened. Furthermore, if transfer pricing risks remain after clarifying and strengthening the guidance, the BEPS action plan foresees the possibility of introducing “special measures,” either within or beyond the arm’s-length principle.

The work on transfer pricing focused on three key areas. Work under action 8 considered transfer pricing issues relating to intangibles, since misallocation of the profits generated by valuable intangibles has contributed to BEPS.

Work under action 9 addressed the contractual allocation of risks and the resulting allocation of profits to those risks, which may not correspond to the activities actually carried on. The work also addressed the level of returns to funding provided by a capital-rich multinational group member where those returns do not correspond to the level of activity undertaken by the funding company.

The action 10 efforts focused on other high-risk areas, including addressing profit allocations resulting from transactions that are not commercially rational for the individual enterprises concerned (recharacterization), targeting the use of transfer pricing methods in a way that results in diverting profits away from the most economically important activities of the multinational group, and neutralizing the use of specific types of payments between members of the multinational group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with value creation.

As noted earlier, the BEPS final report’s introduction states that the new transfer pricing guidelines may be immediately applicable with no further action needed on the part of participating countries. Stack stated that the BEPS final report on actions 8-10 clarifies the arm’s-length standards that are already in the IRS regulations and that Treasury and the IRS do not anticipate making substantial changes to the section 482 regulations.

Commercial Rationality

The revised transfer pricing guidance requires careful analysis of the actual transaction between associated enterprises by considering the contractual relations between the parties in combination with the conduct of the parties. Their conduct will supplement or replace the contractual arrangements if the contracts are incomplete or not supported by the parties’ conduct. The executive summary states that in combination with the proper application of pricing methods in a way that prevents the allocation of profits to locations where no contributions are made to these profits, this will lead to the allocation of profits to the enterprises that conduct the corresponding business activities. In circumstances when the transaction between associated enterprises lacks commercial rationality, the guidance authorizes disregarding the arrangement for transfer pricing purposes.

Use of the term “commercial rationality” represents a change in the final report for transactions to be recognized from the earlier approach that transactions must have had fundamental attributes of transactions between unrelated parties to be recognized. The concern, as stated by Treasury’s Michael McDonald (who served as co-chair of the relevant OECD working party), was that the discussion draft’s standard could have been interpreted too broadly, whereas the intent is to provide nonrecognition of transactions only in exceptional circumstances.

2Id.
Risk and Intangibles

The revised guidance includes two important clarifications relating to risks and intangibles.

Risks are defined as the effect of uncertainty on the objectives of the business. Uncertainty exists and risk is assumed in a company’s operations every time steps are taken to exploit opportunities and every time a company spends money to generate income. No profit-seeking business takes on risk associated with commercial opportunities without expecting a positive return.

The executive summary states that this economic notion that higher risks warrant anticipated returns made multinational groups pursue tax-planning strategies based on contractual reallocations of risks, sometimes without any change in business operations.

To address this, the report provides that risks contractually assumed by a party that cannot in fact exercise meaningful and specifically defined control over the risks, or does not have the financial capacity to assume the risks, will be allocated to the party that does exercise that control and has the financial capacity to assume the risks.

McDonald stated that the report more clearly gives equal weight to functions, assets, and risks. One interpretation of the 2014 discussion draft was that risk could be allocated to functions, which was not the intended meaning.

For intangibles, the guidance clarifies that legal ownership alone does not necessarily generate a right to all (or indeed any) of the return that is generated by the exploitation of the intangible. The group companies performing important functions, controlling economically significant risks, and contributing assets — as determined through the accurate delineation of the actual transaction — will be entitled to an appropriate return reflecting the value of their contributions. Specific guidance will ensure that the analysis is not weakened by information asymmetries between the tax administration and the taxpayer in relation to hard-to-value intangibles or by using special contractual relationships such as a cross-contribution agreement.

The final guidance also addresses the situation when a capital-rich member of the group provides funding but performs few activities. If this associated enterprise does not in fact control the financial risks associated with this funding (for example, because it just provides money when it is asked to do so without any assessment of whether the party receiving the money is credit-worthy), then it will not be allocated profits associated with the financial risks and will be entitled to no more than a risk-free return (or less if, for example, the transaction is not commercially rational and therefore the guidance on nonrecognition applies).

Finally, the guidance ensures that transfer pricing principles will allocate profits to the most important economic activities. It also will not be possible to allocate the synergistic benefits of operating as a group to members other than the ones contributing to the synergistic benefits. For example, discounts that are generated because of the value of goods ordered by a combination of group companies will need to be allocated to those group companies.

Profit Split

Follow-up work will be done regarding the transactional profit-split method during 2016 that will be finalized in the first half of 2017. This work should lead to detailed guidance on the ways in which this method can usefully and appropriately be applied to align transfer pricing outcomes and value creation, including in the circumstances of integrated global value chains.

Stack, in any event, said the U.S. is reluctant to push taxpayers toward using profit-split methods when traditional pricing models using valuation methods and comparables will suffice.

Related Guidance

The final report’s guidance is linked with other BEPS actions. This guidance will ensure that capital-rich entities without any other relevant economic activities (“cash boxes”) will not be entitled to any excess profits. The profits the cash box is entitled to retain will be equivalent to no more than a risk-free return. Moreover, if this return qualifies as interest or an economically equivalent payment, then those already marginal profits will also be targeted by the interest deductibility rules of action 4.

In addition, it will become extremely difficult to structure payments to the country where the cash box is tax-resident in a way that avoids withholding taxes because of the guidance on preventing treaty abuse (action 6). Finally, a cash box with limited or no economic activities is likely to be the target of CFC rules (action 3). The role of cash boxes in BEPS strategies will be seriously discouraged.

A transfer pricing analysis requires access to the relevant information. Access to the transfer pricing documentation provided by action 13 will enable the guidance provided in the final report to be applied in practice, based on relevant information on global and local operations in the master file and local file. In addition, the CbC reports will enable better risk assessment practices by providing information about the global allocation of the multinational group’s revenues, profits, taxes, and economic activity.

Stack said, however, the U.S. is able and willing to suspend information exchange with countries that misuse data taken from CbC reports, such as using things like headcount and making assumptions about allocable profits.

Commodities and Developing Countries

The report also contains guidance on transactions involving commodities, as well as on low-value-adding intragroup services. As BEPS creates additional transfer pricing challenges for developing countries, and these two areas were identified by them as being of critical importance, this guidance will be supplemented
with further work mandated by the G-20 developing-
country working group, which will provide knowledge,
best practices, and tools for developing countries to use
to price commodity transactions for transfer pricing
purposes and to prevent erosion of their tax bases
through common types of base-eroding payments.

Mutual Agreement Procedures

Transfer pricing depends on a facts and circum-
cstances analysis and can involve subjective interpreta-
tions of these facts and circumstances. To address the
risk of double taxation, the work under action 14 to
improve the effectiveness of dispute resolution mecha-
nisms includes a new minimum standard providing for
access to the mutual agreement procedures of article
25 of the model tax convention for all transfer pricing
cases. In addition, the 20 countries that have made a
commitment to mandatory binding arbitration under
article 14 have specified that they will allow arbitration
for transfer pricing cases so that double taxation will be
eliminated.

Special Measures

The executive summary states that the work under
actions 8-10 of the BEPS action plan will ensure that
transfer pricing outcomes better align with value cre-
ation of the multinational group. This will ensure that
the role of capital-rich, low-functioning entities in
BEPS planning will become less relevant. As a conse-
quence, the goals set by the BEPS action plan in rela-
tion to the development of transfer pricing rules have
been achieved without the need to develop so-called
special measures outside the arm’s-length principle.

Risk and Recharacterization, Intangibles, Etc.

The final report contains significant revisions regard-
ing risk and recharacterization, intangibles, cost-
contribution arrangements, and low-value-adding
services. The OECD transfer pricing guidelines are ma-
terially changed regarding these areas, and they will be
discussed at length in the second part of this article,
which will be published in the November 9 issue of
Tax Notes International.

Action 11 — Measuring and Monitoring BEPS

The April 16 discussion draft on action 11 indicated
that measuring the scale and effect of BEPS is chal-
 lenging because of the complexity and the serious data
limitations. The final report does not improve upon
that assessment. However, it nonetheless states in an
ipse dixit manner that although measuring the scale of
BEPS is challenging, “we know that the fiscal effects of
[base erosion and profit shifting] are significant.”

The report states that six indicators of this base ero-
sion activity highlight taxpayer base-eroding behaviors
using different sources of data, employing different
metrics, and examining base erosion channels. The re-
port adds that new empirical analysis of the fiscal and
economic effects of BEPS — along with “hundreds”
of existing empirical studies that find the existence of
profit shifting through transfer mispricing, strategic lo-
cation of intangibles, debt, and treaty abuse — confirm
that profit shifting is occurring on a significant scale, is
likely to be increasing, and creates adverse economic
distortions.

The report then states, however, that these indicators
and all analyses of BEPS are severely constrained by
the limitations of the currently available data. The
available data is not comprehensive across countries or
companies, and often does not include actual taxes
paid. In addition, the analyses of profit shifting to date
have found it difficult to separate the effects of profit
shifting from real economic factors and the effects of
deliberate government tax policy choices. Improving
the tools and data available to measure BEPS will be
critical for measuring and monitoring it in the future.

The report makes a number of recommendations
intended to improve the analysis of the available data
while recognizing the need to maintain appropriate
safeguards to protect the confidentiality of taxpayer
information. The report is the third-longest of the
BEPS reports at 268 pages.

Action 12 — Mandatory Disclosure Rules

Action 12 addresses mandatory disclosure regimes
to fight abusive tax schemes. The executive summary
states that mandatory disclosure regimes should be
clear and easy to understand, should balance additional
costs to taxpayers with the benefits ob-
tained by the tax administration, should be effective in
achieving their objectives, and should accurately iden-
tify the schemes to be disclosed. One objective of man-
datory disclosure regimes is deterrence: taxpayers may
think twice about entering into a scheme if it has to be
disclosed. Pressure is also placed on the tax avoidance
market as promoters and users have only a limited op-
portunity to implement schemes before they are closed
down.

The final report does not set forth a minimum stand-
ard, and countries are free to choose whether to intro-
duce mandatory disclosure regimes. To successfully
design an effective mandatory disclosure regime, the
following features need to be considered: who reports,
what information needs to be reported, when the infor-
mation has to be reported, and the consequences of
non-reporting.

The report recommends that countries introducing
mandatory disclosure regimes consider a list of five
specified items, such as should the disclosure require-
ment be imposed on both the promoter and the tax-
payer, or should the primary obligation to disclose be
imposed on either the promoter or the taxpayer? Also,
penalties should be introduced to ensure compliance
with mandatory disclosure regimes that are consistent
with general domestic law.

Action 13 — Transfer Pricing and CbC Reporting

The action 13 executive summary states that guid-
ance on transfer pricing documentation requires multi-
national enterprises to provide tax administrations with
high-level information regarding their global business operations and transfer pricing policies in a “master file” that is to be available to all relevant tax administrations.

Second, the guidance requires that detailed transactional transfer pricing documentation be provided in a “local file” specific to each country, identifying material related-party transactions, the amounts involved in those transactions, and the company’s analysis of its transfer pricing determinations regarding those transactions.

Third, large multinational enterprises are required to file a CbC report that will provide annually and for each tax jurisdiction in which they do business the amount of revenue, profit before income tax, and income tax paid and accrued. It also requires multinational enterprises to report the number of their employees, stated capital, retained earnings, and tangible assets in each tax jurisdiction. Finally, it requires multinational enterprises to identify each entity in the group that does business in a particular tax jurisdiction and to provide an indication of the business activities in which each entity engages.

The executive summary says that consistent and effective implementation of the transfer pricing documentation standards — in particular of the CbC report — is essential. Therefore, countries participating in the BEPS project agreed on the core elements of implementing transfer pricing documentation and CbC reporting. This agreement calls for the master file and local file to be delivered by multinational enterprises directly to local tax administrations. CbC reports should be filed in the jurisdiction of tax residence of the ultimate parent entity and shared between jurisdictions through automatic exchange of information under government-to-government mechanisms.

The new CbC reporting requirements are to be implemented for fiscal years beginning on or after January 1, 2016, and applied, subject to a review in 2020, to multinational enterprises with annual consolidated group revenue equal to or exceeding €750 million.

A U.S. spokesperson said temporary regulations to implement CbC reporting for 2016 will be released by Treasury and the IRS before the end of 2015. He emphasized that the CbC reports are for risk assessment purposes only and that the intention is for the templates to give companies flexibility to provide the information in the best way for them. Data for 2016 are to be reported in 2017 and exchanged in 2018.

There has been some discussion in the U.S. regarding the IRS’s authority to collect CbC information from taxpayers and provide that information to foreign governments. Senate Finance Committee Chair Orrin G. Hatch, R-Utah, raised these questions. Recent comments by Bob Stack indicate the Treasury is comfortable that, indeed, it has this authority.

**Action 14 — Dispute Resolution Mechanisms**

Article 25 of the OECD model tax convention provides a mechanism, independent of ordinary legal remedies available under domestic law, through which the competent authorities of the contracting states may resolve differences or difficulties regarding the interpretation or application of the convention on a mutually agreed basis. This mechanism — the mutual agreement procedure — is of fundamental importance to the proper application and interpretation of tax treaties, notably to ensure that taxpayers entitled to the benefits of the treaty are not subject to taxation by either of the contracting states that is not in accordance with the terms of the treaty.

The BEPS countries have agreed to important changes in their approach to dispute resolution, in particular by having developed a minimum standard regarding the resolution of treaty-related disputes, committed to its rapid implementation, and agreed to ensure its effective implementation through the establishment of a robust peer-based monitoring mechanism that will report regularly through the committee on fiscal affairs to the G-20.

The minimum standard will:

- ensure that treaty obligations related to the mutual agreement procedure are fully implemented in good faith and that mutual agreement cases are resolved in a timely manner;
- ensure the implementation of administrative processes that promote the timely resolution of treaty-related disputes; and
- ensure that taxpayers can access the mutual agreement procedures when eligible.

The BEPS countries’ implementation of the minimum standard will be monitored using detailed terms of reference and assessment method to be developed in 2016.

A set of 11 best practices is also described in the report. Countries are free to adopt them, and they are not a part of the minimum standard. David Varley, acting director of the IRS’s transfer pricing operations, expressed disappointment that they were not included as a part of the minimum standard.

In addition to the commitment to implement the minimum standard by all countries, 20 countries have declared their commitment to provide for mandatory binding mutual agreement procedure arbitration in their bilateral tax treaties as a mechanism to guarantee that their treaty-related disputes will be resolved within a specified time frame. The final report states that this represents a major step forward. These countries collectively were involved in more than 90 percent of the outstanding mutual agreement procedure cases at the end of 2013, as reported to the OECD.
Stack expressed optimism that more countries would join the 20 countries that have already agreed to mandatory binding arbitration, although he added that political support will be key to that effort.

While binding arbitration is important, some developing countries expressed objections regarding costs, fairness, accessibility, sovereignty, information security, and coordination with domestic law. This could present serious problems moving forward as some important developing countries are not among the 20 that have agreed to binding mandatory arbitration.

**Action 15 — Multilateral Instrument**

Action 15 provides for an analysis of the tax and public international law issues related to the development of a multilateral instrument to enable countries that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. Interested countries will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution. Part 2 will be continued in the next issue of *TNI*.
Have Americans ever been more passionate about taxes?

Ask Joe.

“The Boston Tea Party … was a revolt against tax loopholes, not high taxes.”

— Joseph Thorndike, PhD
Contributing Editor
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November 3
Transfer Pricing — Hong Kong. The two-day TP Minds Asia conference will cover a variety of transfer pricing topics. It will feature keynote speeches from the OECD, U.N., World Bank, and regional tax authorities in addition to industry-led presentations, interactive panel debates, and technical workshops.

- Tel: +44 (0) 20 7017 7790
- E-mail: kmregistration@informa.com
- Website: http://www.taxcoop-conference.com

November 4
BEPS Final Reports — Webcast. Deloitte Tax LLP will host part 2 of a webcast that will discuss the significant recommendations that have been described in the final BEPS reports published October 5; topics will include hybrid mismatch arrangements (action 2), interest deductions (action 4), treaty abuse (action 6), and the definition of permanent establishment (action 7).


November 5
BEPS Project Action 7 — Webcast. EY will sponsor a series of webcasts that will provide a comprehensive review of the final BEPS reports and the outlook for country action. This will be the fourth of the series and will cover permanent establishment developments and action 7.

- Website: http://goo.gl/XapzQe

November 11
Multinational Tax — Williamsburg, Virginia. The College of William & Mary Law School will hold its 61st Tax Conference. This three-day event will provide an in-depth look at current topics in tax law for lawyers and accountants, including multinational tax planning for the U.S. pass-through entities and employee benefits in acquisitions.

- Tel: (757) 221-3817
- Website: http://law.wm.edu/academics/intellectuallife/conferencesandlectures/taxconference/index.php

November 12
BEPS Project Actions 8-10 — Webcast. EY will sponsor a series of webcasts that will provide a comprehensive review of the final BEPS reports and the outlook for country action. This will be the fifth of the series and will cover transfer pricing and actions 8-10.

- Website: http://goo.gl/k8cJDC

November 13
Taxpayers’ Rights — Amsterdam. Confédération Fiscale Européenne will host a one-day conference that will discuss taxpayers’ rights and ask whether this concept requires adaptation in a digital tax world based on fair competition, transparency, and information exchange. Invited speakers will include the European Commission, the OECD, national tax administrations, and tax practitioners.

- E-mail: brusselsoffice@cfe-eutax.org
- Website: https://www.cfe-eutax.org/node/4740

The calendar is available online as Doc 2015-23878.

Submissions to the Tax Calendar may be sent by fax to (703) 533-4646 or by e-mail to tni@taxanalysts.org.
November 17

Non-Dom Tax Planning — London. IBC will host a one-day conference that will provide guidance on the opportunities for tax-efficient planning for non-U.K. domiciles; topics will include tax of residential property, business investment relief, a deemed domicile analysis, and inheritance tax changes.

- Tel: +44 (0) 20 7017 7790
- E-mail: kmregistration@informa.com
- Website: http://www.iiribcfinance.com/event

Transfer Pricing and APAs — Webcast. Deloitte Tax LLP will host a webcast that will discuss key learnings from recently concluded advance pricing agreements in China and India, including accepted transfer pricing methods, accepted approaches for dealing with location-specific advantages, best practices for speedy bilateral resolution, and bilateral and multilateral APAs.


November 18

Private Client Tax Planning — London. IBC will host a one-day conference that will focus on the complexities and challenges of the interaction between the U.S./U.K. tax systems. Topics will include an analysis of planning for the “old and cold” foreign non-grantor trust, treatment of “foreign” estates, and practical issues regarding U.S. estate tax reporting for non-U.S. persons.

- Tel: +44 (0) 20 7017 7790
- E-mail: kmregistration@informa.com
- Website: http://www.iiribcfinance.com/event

International Taxpayers Rights — Washington. The National Taxpayer Advocate will sponsor a two-day conference that will explore how taxpayer rights globally serve as the foundation for effective tax administration. Discussion topics will include rights to confidentiality and privacy in an age of transparency, taxpayer rights and procedural justice in audit, impact of taxpayer service on compliance, and challenges in “operationalizing” taxpayer rights in both mature and developing tax administrations.

- E-mail: tprightsconference@irs.gov


November 19

BEPS Project — Webcast. EY will sponsor a series of webcasts that will provide a comprehensive review of the final BEPS reports and the outlook for country action. This will be the fifth of the series and will cover antiabuse measures under actions 3, 5, 6, and 12.

- Website: http://goo.gl/cjbKr5

Annual Conference on Taxation — Boston. The National Tax Association will hold its 108th Annual Conference on Taxation. This three-day event will feature discussion on a variety of tax topics, including corporate tax evasion, the earned income tax credit, and international corporate tax policy.

- Tel: (202) 737-3325
- E-mail: natltax@aol.com

November 23

Financial Products and Services Conference — London. The 4th Annual OffshoreAlert conference will feature two days of discussion on a variety of financial issues, including tax fraud and evasion, bitcoin, FIFA corruption, and advanced techniques in asset investigation and debt enforcement.

- Tel: +1 (305) 372-6296
- Website: http://www.offshorealert.com/conference/london

November 24

Indirect Tax — Webcast. Deloitte Tax LLP will host a webcast that will discuss recharge, disbursements, and reimbursements in the Asia Pacific region; the nature of typical inbound and outbound recharges; indirect tax issues and guidance; and case studies on practicalities.


Pan-European Fund Tax Roadshow — Zurich. Deloitte Tax LLP will host a half-day event that will present recent pan-European tax developments, including the OECD creditor reporting system and hot topics relating to the forthcoming challenges with a special focus on cross-border fund distribution.


November 25

Offshore Taxation — London. IBC will host a one-day conference that will cover a variety of offshore tax topics, including advice to give clients, estate planning for non-doms, problems with the statutory residence test, planning considerations for dual residents, and offshore trustees.

- Tel: +44 (0) 20 7017 7790
- E-mail: kmregistration@informa.com
- Website: http://www.iiribcfinance.com/event

Pan-European Fund Tax Roadshow — Geneva. Deloitte Tax LLP will host a half-day event that will present recent pan-European tax developments, including the OECD creditor reporting system and hot topics relating to the forthcoming challenges with a special focus on cross-border fund distribution.


November 26

BEPS Transfer Pricing Implementation — Webcast. Deloitte Tax LLP will host a webcast that will discuss changes to the OECD’s transfer pricing guidelines and how they will be applied to countries such as Australia, Japan, China, and Korea.


Pan-European Fund Tax Roadshow — Los Angeles. This three-day
program from the Practising Law Institute will focus on tax issues related to major corporate transactions, including single-buyer acquisitions, multi-party joint ventures, cross-border mergers, and complicated acquisitions of public companies with domestic and foreign operations.

- Tel: (800) 260-4PLI
- Website: http://goo.gl/Sh1B3g

December 3
BEPS Project Actions 2 and 4 — Webcast. EY will sponsor a series of webcasts that will provide a comprehensive review of the final BEPS reports and the outlook for country action. This will be the sixth of the series and will cover financial payments and actions 2 and 4.
- Website: http://goo.gl/Ex2WSn

December 9
Tax Fraud and Tax Controversy Conference — Las Vegas. The American Bar Association will hold its 32nd Annual National Institute on Criminal Tax Fraud combined with the 5th Annual National Institute on Tax Controversy. This joint event will feature government and industry representatives providing insight on various aspects of tax controversy, tax litigation, and criminal tax defense.
- Tel: (800) 285-2221
- Website: http://www.tggroup.com/GWUIRSInstitute

December 17
Annual International Tax Issues Institute — Washington. The George Washington University Law School will hold its 28th Annual Institute on Current Issues in International Taxation. This two-day event will feature panel discussions from speakers including IRS Commissioner John Koskinen and a variety of industry experts.
- Website: http://shop.americanbar.org/ebus/ABAEVENTSCalendar/EventDetails.aspx?productId=203592094

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