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Treaty Shopping
by Roy Saunders

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Introduction

Sometimes, companies are set up in jurisdictions merely to obtain the tax benefits that are granted under the relevant tax treaty, whilst the chosen structure in reality has little commercial substance. Tax authorities worldwide are aware of these so-called treaty shopping practices and have become more and more sophisticated in combating such misuse of tax treaties. In this article I will discuss some of the tools available to tax authorities in targeting treaty shopping. Being aware of these tools is essential when establishing the most appropriate and efficient tax structures for cross-border activities.

Most countries are using the OECD Model Convention as the basis in their negotiations with other States to conclude bilateral tax treaties and in the first part of this article I will provide a brief summary on the general purpose of the Model Convention. In the second part of this article I will deal with some of the provisions that are embedded in the Model Convention and in some other bilateral tax treaties that can be used against treaty shopping. Since anti-treaty shopping provisions can also be found in domestic legislation and when applied would override the relevant tax treaty, I will furthermore provide an example of local anti-treaty shopping legislation. In the last part of this article I will touch upon the so-called Controlled Foreign Companies (“CFC”) rules that many jurisdictions have incorporated in their domestic legislation. Although these rules do not specifically target treaty shopping, they can have a significant impact on international tax structures and I will conclude this article with a brief summary of the current status of the compatibility of CFC rules with tax treaties.

OECD Model Tax Convention (2005)

The main purpose of the OECD Model Tax Convention on Income and on Capital is to provide a uniform basis to settle the most common problems of international double taxation. International double taxation is defined as the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods.

The Model Convention does not deal exclusively with the elimination of double taxation but also
addresses other issues, such as the prevention of tax evasion and non-discrimination. More recently, some members have even indicated that the Model Convention should also prevent unforeseen non-taxation that could be the result of applying tax treaties. Members of the OECD should conform to the Model Convention, when concluding or revising bilateral tax conventions that are based on the Model Convention.

The main part of the Convention is made up of Chapters III to V, which settle to what extent each of the two Contracting States may tax income and capital and how international double taxation is to be eliminated. This part contains two categories of rules.

The first category of rules allocate the taxing rights of different classes of income and of capital to the State of source or the State of residence. Three classes can be distinguished:

1. Income and capital that may be taxed without any limitation in the State of source;
2. Income that may be subjected to limited taxation in the State of source; and
3. Income and capital that may not be taxed in the State of source.

Where an exclusive right to tax is allocated to one of the Contracting States, the other Contracting State is thereby prevented from taxing those items and double taxation is avoided. Generally, the exclusive right to tax is allocated to the State of residence. However, with regards to certain types of income such as interest, dividend and (under most bilateral treaties) royalty income, both States have the right to tax, albeit that the amount of tax that may be imposed in the State of source is limited.

The second category of rules determine that where the State of source has limited or full right to tax, the State of residence must provide relief in order to avoid double taxation. The methods of relief granted are either based upon the exemption method or upon the credit method.

Where a resident of a Contracting State receives income from sources in the other Contracting State, or owns capital situated therein, that in accordance with the Convention is taxable only in the State of residence, no problem of double taxation arises, since the State of source must refrain from taxing that income or capital.

Anti-Abuse Provisions In Tax Treaties

The Convention and bilateral tax treaties contain a number of tools that could be used by a Contracting State against treaty shopping. I will discuss here only the most significant ones.

Residence: Place Of Effective Management

In order to claim the benefits of a tax treaty the claimant needs to be resident of at least one of the contracting states. Once it is determined what the State of residence is, the tax treaty then allocates the taxing rights of the various items of income and capital to the State of source and the State of residence. Furthermore, this article also tries to resolve double
taxation as a result of dual residence and to this extent includes a so-called tie-breaker clause which determines the State of residence in case of dual residence.

Under the tie-breaker clause the State of residence for companies is determined according to where its place of effective management is situated. It is the tie-breaker provision that can be used as an anti-abuse measure. In the example shown below, the Jersey Parent provides a loan to Luxembourg Finance Co, which in its turn on lends the funds to the UK Co. Co effectively would be made in the UK, HMRC could claim that on the basis of the tie-breaker rule, Finance Co is resident in the UK. As a result there would be no need for HMRC to apply the tax treaty and the granting a reduction of withholding tax on the interest payments is therefore not in point.

**Beneficial Ownership**

In determining the meaning of beneficial owner a significant weight is given to the OECD publications. In 1986 the OECD published a report entitled "Double Tax Convention and the Use of Conduit Companies" (the Conduit Companies Report). In paragraph 14(b) it was stated that:

> Articles 10 to 12 of the OECD Model deny the limitation of tax in the State of source on dividends, interest and royalties if the conduit is not its "beneficial owner." Thus the limitation is not available when, economically, it would benefit a person not entitled to it who interposed the conduit company as an intermediary between himself and the payer of the income (paragraphs 12, 8 and 4 of the Commentary to Articles 10, 11 and 12 respectively). The Commentaries mention the case of a nominee or agent. The provisions would, however, apply also to other cases where a person enters into contracts or takes over obligations under which he has a similar function to those of a nominee or an agent. Thus a conduit company can normally not be regarded as the beneficial owner; though the formal owner of certain assets, it has very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties (most likely the shareholders of the conduit company).

In principle interest payments are subject to UK withholding tax of 22 percent. However, on the basis of the Luxembourg-UK tax treaty the withholding tax is reduced to 0 percent. Had the loan been granted directly by Jersey Parent to UK Co, the withholding tax due in the UK would not have been reduced under the Jersey-UK tax treaty. If all decisions of the Luxembourg Finance
the OECD Convention and led Professor Baker QC, in paragraph 10B -10.4 of his official commentary on the OECD Model Convention to state:

"The essence of this Commentary is to explain that the "beneficial ownership" limitation is intended to exclude:

(a) mere nominees or agents, who are not treated as owners of the income in their country of residence;

(b) any other conduit who though the formal owner of the income, has very narrow powers over the income which render the conduit a mere fiduciary or administrator of the income on behalf of the beneficial owner.

It is worth making the point that, as seems clear from this amended Commentary the mere fact that the recipient may be viewed as a conduit does not mean that it is not the beneficial owner."

As a practical approach, one can ask whose income the dividends (interest/royalties) are in reality. One way to test this is to ask: what would happen if the recipient went bankrupt before paying over the income to the intended, ultimate recipient? If the ultimate recipient could claim the funds as its own, then the funds are properly regarded as already belonging to the ultimate recipient. If however, the ultimate recipient would simply be one of the creditors of the actual recipient (if even that), then the funds properly belong to the actual recipient.

The meaning of the term beneficial ownership was recently subject to the judgment of a UK court in the *Indofood* case. The subsequent published interpretation by HMRC to this decision is a good illustration of how HMRC will apply beneficial ownership to combat treaty shopping.

The case related to the interpretation of a loan note agreement between JP Morgan and the Indonesian based Indofood group. The Indonesian parent company issued a loan note to note holders *via* the use of a Mauritius finance SPV ("M SPV"). Under the loan agreement any withholding tax on interest would be for the account of Indofood. JP Morgan acted as the agent for the note holders. Based on the Indonesian-Mauritius double tax treaty the Indonesian withholding tax on the interest payments was reduced from 20 percent to 10 percent. The terms of the arrangement determined that if the Indonesian withholding tax went above 10 percent and no "reasonable measure" could be found to avoid the increase, then M SPV could redeem the loan notes.

Because the Indonesian government terminated the tax treaty with Mauritius, Indofood sought to initiate the get-out clause. JP Morgan argued that a Dutch SPV ("Newco") could be used. The loan agreement was governed by English law and the dispute was brought before an English court, who was asked to rule on how an Indonesian tax court would interpret the meaning of beneficial ownership. The Court of Appeal held that Newco could not be considered to be the beneficial owner in the treaty sense.

Recently, the UK tax authorities (HMRC) issued a guidance note on its interpretation of the *Indofood* decision. Where a special purpose vehicle (SPV) has "very narrow powers over the income and its obligations to the bondholder mean that it is unlikely
to enjoy the full privilege to directly benefit from the income,” it may not be the beneficial owner of the income. The guidance note contains a number of examples where the use of a finance SPV is accepted. However, finance structures that fall outside the scope of these examples may only be effective for UK tax purposes if approved by HMRC on a case by case basis. HMRC have also indicated that in the event the SPV is not considered as the beneficial owner and therefore is not entitled to double tax treaty benefits, they would apply, where applicable, the double tax treaty benefits of the State of residence of the (ultimate) shareholder of the SPV.

The general view is that the Indofood case has little relevance to UK tax law since the decision revolved to a large extent around Indonesian law. The decision does not add much to or change the meaning of "beneficial owner" as we know it from the interpretation given by the OECD in its various publications. Furthermore, the facts and circumstances in the Indofood case were such that it was indeed difficult to argue that M SPV or Newco could be considered as the beneficial owner. However, HMRC’s reaction to the Indofood decision and the issue of the guidance note indicates that it will challenge situations where – in HMRC’s view - there is "unacceptable" treaty shopping.

**Limitation On Benefits Provisions (US)**

The limitation on benefits provisions are the most direct form of tools that can be used against treaty shopping. The extensive and complex nature of these rules as we currently know them, were introduced by the US when concluding bilateral treaties with other States. The purpose of these provisions is to ensure that the tax benefits granted by (effectively) the US on the basis of the tax treaty are restricted to the intended beneficiaries. As a general rule, the intended beneficiaries of US tax treaties are residents of the other State (A) with which the US has concluded the tax treaty. Therefore, residents of other States are excluded from the benefits granted under the tax treaty the US has concluded with State A. For example, this would apply in the situation where a resident of a third State (B) would use a company in State A merely to obtain the benefits granted under the US-State A tax treaty. This is particularly relevant if State B has not concluded a tax treaty with the US or when it does, the benefits under that treaty are less generous than the ones granted under the treaty the US has concluded with State A. Naturally, there can be valid commercial reasons for resident of State B to use a company in State A that receives income from the US. In these bona fide situations treaty shopping may not be considered to be the main reason for the structure and the limitation of benefits provisions usually would allow the treaty benefits to be granted.

Typically, the limitation on benefits provisions contain the following tests and derivative tests which will determine whether or not the benefits can be granted, such as:

- Stock ownership test (a company claiming treaty benefits needs to be a so-called "qualified person," meaning that its shares are owned
by individuals resident in that State or other "qualified residents");
- Publicly traded test (the shares of the company claiming the treaty benefits are publicly traded or the company is a subsidiary of a publicly traded entity);
- Base erosion test (less than 50 percent of the income of the company claiming treaty benefits is paid or accrued to persons who are not residents of either Contracting State);
- Active business test (where the company does not satisfy the stock ownership/publicly traded tests, treaty benefits may still be granted if the company is carrying on an active trade or business in its State of residence);
- Headquarter company test (headquarter operations are not considered to constitute an active trade or business and treaty benefits will still be granted under certain conditions).

One would have thought that these limitation on benefits provisions provide the US with ample scope to fight treaty shopping. However, recently the Democrats have proposed new domestic legislation which effectively would ignore treaty shopping transactions and would apply the relevant tax treaty concluded by the US and the State where the ultimate beneficial owner of the company claiming treaty benefits is resident.

Other
Certain tax treaties contain general or specific provisions that aim to prevent treaty shopping. Examples are the Netherlands-UK double tax treaty that contains specific anti-avoidance provisions with respect to dividend, interest and royalty income. An example of a general anti-treaty shopping provision can be found in the Protocol to the Israel-Switzerland double tax treaty.

Treaty Override
A number of countries have embedded in their local laws provisions that provide that the benefits of tax treaties are not granted in situations where there is perceived misuse of the treaties. Even if the relevant tax treaty does not contain such anti-abuse provision, the treaty benefits can be denied on the basis of local laws. Germany for example, has recently tightened its domestic anti-treaty shopping clauses.

Under the new anti-avoidance legislation non-German holding companies need to satisfy stringent conditions in order to claim a reduction of the interest and/or dividend withholding tax rates as provided for under the relevant double taxation treaty or EU Directives. For example, the benefits, being the reduction in the withholding tax rates, are not available if:
- The shareholders of the non-German holding company themselves would not be entitled to a refund or exemption of withholding tax if they held the German subsidiary directly; and
- There are no economic, legal or other non-tax driven reasons for the interposition of the intermediary holding company business (business purpose test); or
- The foreign holding company does not perform an own business activity, which is the situation if it generates less than 10 percent of its gross
receipts with active services (10 percent gross receipt test); or

- The foreign company is not substantial due to an inadequate infrastructure and the employment of qualified and skilled personnel (substance test).

Particularly, the requirement to derive more than 10 percent of the gross revenues from their own business activities is new and it has to be seen whether such a test would be considered to be compatible with EU law. This requirement would not be satisfied if for example, the income of the non-German holding company only consists of income from its holding activities (dividends, capital gains on its shareholdings and interest on shareholders loans).

To pass the 10 percent income test, a possible solution for the non-German holding company might be to generate sufficient income from other activities such as active management services with regard to the holdings held and administration of licenses and intellectual property and similar services. Please note, that it would seem that the 10 percent income threshold needs to be met every year. If in a year a significant dividend is distributed to the non-German shareholder, this might cause the gross revenues from its active businesses to drop below the 10 percent threshold. It is unclear whether in such a situation the holding company would be considered to have failed the test and we have to await further clarification on this point.

The anti-treaty shopping rules appear only to affect the reduction of withholding tax on dividend and interest payments as provided for under the relevant double tax treaty (or EU Directives) but not the other provisions of double tax treaties.

Germany is not the only jurisdiction in Europe that has incorporated anti-treaty shopping provisions in its domestic legislation. Other examples of countries that have incorporated domestic anti-treaty shopping provisions are for example Switzerland and Austria which do grant reduced rates or exemptions of withholding taxes, but only if the recipient of the relevant income has sufficient economic substance.

CFC Regimes And Compatibility With Tax Treaties

The main purpose of CFC regimes is to counter tax driven foreign investment and to avoid the tax basis erosion in the State of residence of the controlling shareholders ("Home State"). Typically, when certain conditions are satisfied, the Home State imposes domestic taxation at the level of the controlling shareholder to the extent that income accrues to the CFC, either applying a deemed dividend or look-through approach. The target of CFC regimes is usually the passive and low-taxed income of the CFC as opposed to the trading profits. General justification for CFC regimes is that the resident shareholder has control over the CFC and its profit distribution and can determine that passive income subject to low levels of taxation can be retained within the CFC rather than being distributed and incur high domestic taxation.
The OECD and a majority of member States support the position that CFC regimes are compatible within the framework of the Convention. This position has been heavily criticized and tax authorities of various States and scholars hold different opinions. Furthermore, cases decided by national Supreme Courts of a number of States have resulted in different decisions. As a result there is no conclusive view that CFC rules are either considered to be compatible or incompatible with tax treaties.

In the *Cadbury Schweppes* case the European Court of Justice, however, was recently asked whether the application of the UK CFC rules to low-taxed financial services income of Irish subsidiary was a justified hindrance of the freedom of establishment under the EU treaty. It ruled that the UK CFC rules were compatible but only to the extent they apply to wholly artificial arrangements intended to circumvent national law. No doubt further case law will be developed either by the European Court of Justice or by EU national courts to fine tune the meaning of wholly artificial arrangements. At least for the EU member States this is the first step in forming a single consistent view with regards to CFC rules. Due to the absence of an International Court of Justice dealing with the interpretation of tax treaties, this is a luxury that is unfortunately not available to other OECD members when applying tax treaties.

**Future Developments**

A number of tax administrations are increasingly focusing on combating treaty shopping practices and may put pressure on the OECD to include in the Model Convention rules similar to the US limitation on benefits provisions. Furthermore, legislators may tighten existing domestic anti-treaty shopping provisions. Needless to say that these developments would make tax planning for cross border activities more challenging. It is therefore becoming more and more important that in tax planning, commercial reasons form the basis for choosing a particular structure and that each company in the structure has sufficient means (substance, office accommodation and personnel) to perform the tasks and duties it is supposed to undertake.
Pete Miller explores the recent case of Anthony and Tracy Lee Hancock who managed to avoid capital gains tax on most of the proceeds of selling their company. They were able to exploit a defect in the gateway conditions of TCGA 1992, section 116, converting a mixed holding of qualifying and non-qualifying corporate bonds into qualifying corporate bonds which were exempt from capital gains tax on redemption.

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The Facts

Mr. and Mrs. Lee sold their trading company in August 2000, for consideration of GBP9.27m, with a further earn-out. Mr. Hancock received GBP500,000 A loan notes, which were not part of the planning and are not mentioned further. He also received GBP4.1m B loan notes and Mrs. Lee Hancock received GBP4.6m B loan notes. There was a clause entitling the Hancocks to require the loan notes to be redeemed in US dollars, which it was agreed meant that the loan notes were not qualifying corporate bonds (non-QCBs).

For tax purposes, the exchange of shares for non-QCB loan notes is treated, by virtue of TCGA 1992, sections 135 and 127, as not involving any disposal at all, so that the loan notes effectively stood in the shoes of the original shareholdings. Capital gains tax would accrue as and when the loan notes were redeemed or otherwise disposed of, and the gain would be based on the consideration received on redemption or disposal. For example, if the purchaser company became insolvent and the loan notes became worthless, no gain would arise.

This treatment depended on there being a bona fide commercial purpose for the transactions, which would have been Mr. and Mrs. Hancock’s sale of their business. It was also a requirement that there not be a scheme or arrangement for the avoidance of capital gains tax or corporation tax. It is assumed that HMRC had accepted that these conditions were satisfied, and there is nothing in the case report to suggest that the future planning was in contemplation at the time of the original sale of the company.
The earn-out subsequently came to fruition such that Mr. and Mrs. Hancock each received a further GBP477,000 of B loan notes on March 22, 2001. The tax treatment of the earn-out is similar to the share for non-QCB exchange described above. First, TCGA 1992, section 138A treats the earn-out right as if it were a non-QCB loan note. So the pay-out in the form of further non-QCB loan notes is treated as a conversion of the earn-out non-QCB into the new non-QCB loan notes. TCGA 1992, section 132 provides that such a conversion of loan notes is also treated as if there were no disposal and no acquisition, so that the new B loan notes issued to Mr. and Mrs. Hancock were also treated as standing in the shoes of the original shares and no capital gains tax would accrue until the loan notes were redeemed or otherwise disposed of.

While the original sale in return for the earn-out right needed to have a bona fide commercial reason and not have a CGT or CT avoidance motive, the "conversion" of the earn-out to actual non-QCB loan notes under TCGA 1992, section 132 does not have any such conditions.

So, by March 2001, Mr. and Mrs. Hancock held around GBP9.7m of B loan notes of the purchaser company. Assuming these were in due course to be redeemed at full value, substantial capital gains would have arisen to them on the redemption of these loan notes, originally intended for 2004.

The Planning
The B loan notes were redeemable in 2004, although the Hancocks could require early redemption on specified dates. When they decided, in 2002, that they would like to redeem the loan notes, they consulted with their accountants, Haines Watts. Haines Watts suggested that some tax planning might be available, with the cooperation of the purchasers, i.e. the issuers of the loan notes, and it appears from the case report that Pricewaterhouse Coopers were also involved in the planning.

The essence of the planning was that the GBP477,000 B loan notes that each of Mr. and Mrs. Hancock had received in March 2001 were to be converted into qualifying corporate bonds (QCBs), the "Revised B loan notes," by a deed of variation, which removed the right to redemption in US dollars. This was executed on October 9, 2002.

For tax purposes, this is, prima facie, another conversion of securities to which TCGA 1992, section 132 applies, so that the Revised B loan notes would be treated as if they were the same B loan notes as they had been previously. As noted above, the "conversion" under TCGA 1992, section 132, in this case of the non-QCB loan notes to QCB loan notes, does not require the satisfaction of any conditions regarding commerciality or tax avoidance.

Moreover, QCBs are exempt from capital gains tax (by TCGA 1992, section 115), so without further legislation this would be a very easy way to avoid capital gains tax on a disposal; sell your shares, receive QCB loan notes and redeem them tax free!

This is prevented by the operation of TCGA 1992, section 116 which largely provides that, where
a non-QCB security (i.e. shares or loan notes) is being reorganized or converted into a QCB loan note, the capital gain arising on a disposal of the non-QCB is computed, but held over and comes into charge only when the QCB loan notes are redeemed or disposed of. The crucial difference between QCB and non-QCB loan notes, therefore, is that the charge has already been computed and the capital gains tax becomes payable even if the loan notes themselves eventually are worthless and are never redeemed.

So the overall analysis of the conversion of some of the B loan notes into QCBs is:
- TCGA 1992, section 132 says that this is a conversion of securities, to be treated as if there had not been a disposal of the old securities or an acquisition of the new securities.
- TCGA 1992, section 116(10) supersedes this treatment and requires a computation of the gain that would accrue on a disposal of the non-QCB loan notes that were converted, so that, when the QCB loan notes that they had been converted into were redeemed or otherwise disposed of, that gain would come into charge.

The result is that Mr. and Mrs. Hancock now had a mixed holding of B loan notes that were non-QCBs and Revised B loan notes that were QCBs. On May 7, 2003, all of these loan notes were exchanged into Secured Discounted Loan Notes (“SDLNs”) which were agreed to be QCBs. These were then redeemed on June 30, 2003, with the associated redemption premium. It is the treatment of this conversion of a mixed holding of non-QCBs (the B loan notes) and QCBs (the Revised B loan notes) which is the subject of the case.

The Hancocks' Argument

Mr. and Mrs. Hancock’s argument was based on close inspection of what one might refer to as the "gateway provisions" of TCGA 1992, section 116.

Section 116 applies if "either the original shares would consist of or include a qualifying corporate bond and the new holding would not, or the original shares would not and the new holding would consist of or include such a bond," TCGA 1992, section 116 (1)(b). For these purposes, we can read the original shares as meaning the loan notes held before a reorganization or conversion, and the new holding as being the loan notes held afterwards. We are looking at the conversion of the mixed portfolio of B and Revised B loan notes into SDLNs. On a superficial analysis, this mixed holding is clearly a holding that includes QCBs, and we have already noted that the SDLNs are QCBs. Therefore, since the original shares include QCBs and the new holding is all QCBs, Mr. and Mrs. Hancock argued that the gateway provisions of TCGA 1992, section 116 did not apply and section 116 therefore could not apply to the conversion into SDLNs.

The result of the Hancocks' argument is that the conversion of the mixed portfolio of QCBs and non-QCBs into the SDLNs is a conversion within TCGA 1992, section 132 which is treated as a
reorganization, so that there is no disposal of the old B loan notes nor an acquisition of the Revised B loan notes. Since TCGA 1992, section 116 does not apply, the disposal of the mixed holding of loan notes is exempt from capital gains tax under TCGA 1992, section 115.

**HMRC's Position**

HMRC argued that tax arose in respect of both sets of B loan notes separately, as follows:

- As regards the non-QCB loan notes, *i.e.* the B loan notes, the conversion into QCB loan notes triggered a gain to be calculated and held over under TCGA 1992, section 116(10), and that gain then crystallized on redemption of the SDLNs;
- As regards the QCB loan notes, a gain had already been computed under TCGA 1992, section 116(10). The conversion from B loan notes into SDLNs was a conversion within TCGA 1992, section 132, so that the new loan notes effectively continued to stand in the shoes of the Revised B loan notes. The subsequent redemption, therefore brought into charge that had been held over under TCGA 1992, section 116(10).

Conversely, if Mr. and Mrs. Hancock’s argument were correct (see below), so that no charge arose on the technical analysis, HNRC argued that the Ramsay doctrine should be applied, to treat the conversion of the mixed loan note holding on May 7, 2003, and the subsequent redemption of the SDLNs on June 30, 2003, as a single composite transaction of redemption of the B loan notes and Revised B loan notes. In respect of the non-QCB B loan notes, the capital gains tax would come into charge on the basis of their having been redeemed on normal principles, and in respect of the Revised B loan notes, which were QCBS, the gain previously computed under TCGA 1992, section 116(10) would come into charge, on this analysis.

HMRC’s argument that that the loan notes should be looked at individually, as above, relied on the fact that the overall scheme of capital gains tax deals with each asset individually before aggregating gains and losses of a person in a given period. The Tribunal came to the view that the legislation relating to conversions and reorganizations of capital clearly contemplated the possibility of the rules being applied to mixed holdings, however. For example:

- TCGA 1992, section 126 refers to holdings of shares of more than one class;
- TCGA 1992, section 127 refers to shares being treated as a single asset even when they would not necessarily otherwise be so;
- TCGA 1992, section 130 refers to mixed holdings of shares or debentures of more than one class or, indeed, for more than one company; and
- TCGA 1992, section 116 itself clearly refers, as we have already seen, to the holdings including QCBS, which implies the possibility of mixed holdings, again.

There is an unfortunate mismatch in TCGA 1992, section 116, in that sub-sections 116(3) and (4) refer to holdings that "comprise" a QCB, which appears to be at odds with the gateway provision in section 116(1)(b). But the Tribunal held that
sub-sections (3) and (4) should be construed as to agree with section 116(1)(b), and not vice versa.

The Tribunal also found that HMRC’s arguments that the loan notes should be treated separately contravened the clear intention of the words of TCGA 1992, section 116(1)(b), as this provision is clearly "couched in terms that recognize the possibility of the 'original shares' not being wholly comprised of a QCB or a non-QCB." HMRC suggested that this wording had been put in place simply to cover the transitional position on the introduction of the legislation in 1984, an argument dismissed by the Tribunal on the basis that if it had been the intention of Parliament to restrict this analysis to that very narrow set of circumstances, it would have been "straightforward" to draft the rules accordingly.

The Tribunal also decided that they could not "ignore the clear words, and seek to rewrite legislation based on what might be discerned as the true result intended by Parliament. We do not consider that section 116(1)(b) can be construed otherwise than on its own terms." In other words, although they considered it unlikely that Parliament intended the result argued for by the Hancocks, it was not possible to construe the clear words of the legislation in any other way and the Tribunal went on to say that "no purposive construction can fill the gap created by the fact that certain circumstances that might be thought to have been intended to be within section 116 fall outside it according to the clear words of section 116(1)(b)." Furthermore, they stated that they do not see "that the language of section 116(1)(b) admits of an interpretation that can avoid what may be perceived as an injustice or absurdity," so that this was a case "where an anomaly cannot be avoided by any legitimate process of interpretation."

On the Ramsay argument, HMRC submitted that, construing the legislation purposively and viewing the facts realistically, the conversion of securities on May 5, 2003 followed by the redemption on June 30 that year should be treated as a single composite transaction. While the Tribunal accepted the inevitability of the redemption of the SDLNs, they did genuinely exist, albeit for a short period, and they were always going to be redeemed eventually. Viewed realistically, the conversion and the redemption could not be conflated and the transaction could not be viewed realistically as the direct redemption of the B and Revised B loan notes.

The Tribunal then looked at whether HMRC got home on a purposive construction of the reorganization provisions of TCGA 1992, section 127 as applied by section 132 to the conversion of the B loan notes. The Tribunal considered that the reorganization provisions in the UK provide a rational system of taxation, effectively delaying the payment of tax until instruments are eventually sold or redeemed. Similarly, TCGA 1992, section 116 was part of that rational tax system, in ensuring that, where the instruments concerned were tax-exempt QCBs, a tax liability could not be effectively rolled up into such a tax-exempt instrument and avoided.
Overall, the Tribunal did "not consider that a purposive construction of the reorganization provisions, including section 132, can produce any different result merely on the basis that the transactions that have been entered into were intended, for tax avoidance purposes reasons, to exploit an anomaly in the application of those rules." Although not explicitly stated in the judgment, one might infer an implied suggestion that the legislation needed to be restricted to circumstances where there is no intention to avoid tax.

Essentially, the Tribunal said that they did not see that a purposive approach to the legislation, which might be described as "closely articulated," would get the Revenue the result they wanted. Indeed, the Tribunal pointed out that HMRC's approach was much more in line with the old style Ramsay doctoring, whereby steps could be ignored or conflated where tax avoidance was in point. But this approach was overturned in BMBF v Mawson [2005] STC 1, decided by the House of Lords in November 2004.

The Tribunal's decision can be summarized by their comment that "the gap in the legislation … is not capable of being plugged by a process of purposive construction, nor by applying a broad spectrum antibiotic by means of disregarding any element of those transactions."

**Where To Next?**

Firstly, it seems likely that HMRC will seek leave to appeal this decision to the Upper Tribunal. Reading between the lines, I suspect that there are a number of cases involving this particular planning and HMRC will be keen to get it ruled ineffective. In that context, I see it as unlikely that a superior court would overturn the technical decision, on the basis of the clarity of the words in TCGA 1992, section 116(1)(b). However, the Ramsay/BMBF approach, of construing purposively and viewing realistically, is open to a wider range of interpretation, and a superior court might take the view that the inevitability of these steps, the short life of the SDLNs, and the overall intention to avoid tax are sufficient as to allow a different interpretation of a realistic view of the transactions.

It is also possible, indeed maybe likely, that HMRC will seek to change the law. One possibility would be to change the gateway provisions to TCGA 1992, section 116, in order to remove the possibility of using this planning in the future.

Another idea, and one possibly causing less uncertainty of interpretation of new legislation, would be to apply the same tests to a conversion of securities in TCGA 1992, section 132 as already applies to a share exchange in TCGA 1992, section 135. That is, to ensure that a conversion of securities is only brought within the reorganization rules if it is carried out for bona fide commercial reasons or is not part of a scheme or arrangements with a whole or main purpose of avoiding capital gains tax, corporation tax (and possibly income tax).

It was noteworthy that one of the reasons the Tribunal did not feel that they could find for HMRC
on the basis of a purposive approach to the legislation was that the conversions of securities rules did not contain a requirement that there be a commercial reason for the transactions and that there not be a tax avoidance motive. Had there been such a test in place already, clearly it is unlikely that Mr. and Mrs. Hancock would have survived that test, and the planning would have failed *ab initio.*
A Global Guide To M&A – Sweden
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This article in question and answer format is the latest in a series provided by Taxand from their Global Guide To M&A 2013 www.taxand.com: "Quality tax advice, globally"

From A Buyer's Perspective

1. What are the main differences among acquisitions made through a share deal versus an asset deal in your country?
Through an asset deal the buyer receives new acquisition or tax values on the assets acquired. If the acquisition is made through a share deal, the tax values of the assets remain the same. Therefore a step-up of the tax value of the acquired assets may be possible through an asset deal, but not with an acquisition made through a share deal.

Given that Sweden has participation exemption rules (see section 14 below), the purchase price does not have any direct Swedish tax implications for the buyer, provided that the acquisition is made through a share deal and the acquired shares are deemed to be business related.

On the other hand the target company’s losses (with exceptions described in more detail below in section 6) may be used by the buyer with a share deal but not an asset deal.

2. What strategies are in place, if any, to step up the value of the tangible and intangible assets in case of share deals?
It is not possible to step up the tax value of the underlying assets in the case of a share deal.

3. What are the particular rules of depreciation of goodwill in your country?
For tax purposes goodwill from a share deal is as a general rule non-deductible.

In short, depreciation on goodwill acquired through an asset deal is allowed over five years for Swedish income tax purposes.

4. Are there any limitations to the deductibility of interest on borrowings?
Swedish companies are as a starting point not permitted to deduct interest expenses on intragroup loans. There are also provisions that prevent deduction of interest expenses on loans obtained
for intra-group acquisitions of shares when using back-to-back loans and only the intermediate lender or borrower is an external enterprise.

However a deduction is as a main rule allowed should the interest income have been subject to tax of at least 10 percent for the recipient (the beneficial owner) if the recipient only has had interest income ("10 percent rule"). If however a loan is deemed to have been granted primarily to obtain a significant tax benefit, interest payments are not deductible even if the interest income is subject to at least 10 percent tax.

Deduction may also be allowed under the business purpose rule. The business purpose rule may only be applied in situations where the beneficial owner of the interest income is domiciled within the EEA or a state with which Sweden has concluded a tax treaty. According to the business purpose rule interest payments are deductible if the debt – and the acquisition of shares if the debt is attributable to the acquisition of shares – is deemed to be primarily business motivated.

Furthermore interest is deductible only as long as it is at arm’s length. Whether or not an interest level is deemed to be at arm’s length is mainly a question for loans between associated parties.

Swedish legislation does not include any specific thin capitalization rules, nor does Sweden impose withholding tax on interest payments.

5. What are usual strategies to push-down the debt on acquisitions?

One frequently used strategy to push-down the debt on acquisitions is to acquire the shares of the target company through a Swedish holding company. The target company’s taxable income may thereafter be offset against the holding company’s taxable deficit by means of so-called group contributions. For group contribution purposes a company generally belongs to the same group of companies as another company if one of the companies holds more than 90 percent of the shares in the other company or if the companies have a common (ultimate) parent holding more than 90 percent of shares in both companies.

6. Are losses of the target company/ies available after an acquisition is made?

The Swedish tax regime permits losses to be carried forward indefinitely. Restrictions may however apply where a loss company is involved in a change in ownership (more than 50 percent change of votes). The restrictions may apply either if a loss company or group is subject to an ownership change or if the new owner is a loss company or group.

The restrictions may affect the losses in two ways:

- Tax losses in a loss company that has been subject to an ownership change, exceeding twice the purchase price are normally forfeited;
- Losses maintained in spite of this restriction cannot be used to offset against profits in the purchasing company (the new owner) or its affiliates. This also applies where the new owner is
the loss company or group – the new owner may not offset losses against profits of the acquired company or group.

The restrictions do not apply to losses accrued during the financial year in which the change of ownership occurred.

7. **Is there any indirect tax on transfer of shares (stamp duty, transfer tax etc)?**

   There is no indirect tax, such as stamp duty or transfer tax, on the transfer of shares in Sweden.

8. **Are there any particular issues to consider in the acquisition of foreign companies?**

   When acquiring foreign companies, an assessment should be made as to whether or not the shares of the foreign company fall under Sweden’s participation exemption regime (see section 14 below).

   Also under Sweden’s controlled foreign corporation regime a Swedish resident company that directly or indirectly holds an interest in certain foreign legal entities is subject to immediate taxation on its proportionate share of the foreign legal entity’s profits if the foreign entity is not taxed or if it is subject to low taxation, which according to the main rule is tax lower than 12.1 percent for the financial year 2013 (i.e., 55 percent of the Swedish tax rate of 22 percent for the year 2013). Income will however according to the supplementary rule not be deemed to be subject to low taxation if the legal foreign entity is a tax resident and liable to income tax in one of the countries on the so-called white list, provided that the income in question has not been specifically excluded.

9. **Can the group reorganize after the acquisition in a tax neutral environment? What are the main caveats to consider?**

   Provided that the shares acquired fall under the participation exemption regime, the reorganization can be made without any Swedish tax implications.

   After a group reorganization Swedish aspects that particularly have to be assessed are the rules for limitations on the deduction for interest expenses on intra-group loans, the controlled foreign corporation legislation and whether or not foreign shares acquired by a Swedish enterprise fall under the participation exemption regime.

10. **Is there any particular issue to consider in the case of companies whose main assets are real estate?**

    No particular issues arise in the acquisition of companies whose main assets are real estate.

11. **Thinking about payment of dividends out of your country and a potential exit, is there any particular country that provides a tax efficient exit route to invest in your country?**

    A general exemption from withholding tax applies to dividends on shares in Swedish companies paid to foreign corporate shareholders. This exemption requires that the foreign entity qualifies as a foreign company – a definition that includes companies tax-resident in jurisdictions with which Sweden has concluded a tax treaty if the foreign body is covered by the tax treaty.
However this exemption only applies to Swedish shares qualifying for the participation exemption. This means that shares in the distributing company may not be deemed to be inventory for the shareholder (in the meaning that this term has in Swedish tax legislation). Also other exemptions from withholding tax may apply such as the rules under the EU Parent-Subsidiary Directive (90/435/EEC).

For a foreign corporate shareholder capital gains on shares are not subject to tax in Sweden provided the shareholder in question does not have a permanent establishment in Sweden and that the shares are not attributable to the permanent establishment. However capital gain is exempt for Swedish tax purposes even if the shares are attributable to a Swedish permanent establishment and the holding of the shares falls under the participation exemption regime.

For these rules to apply the jurisdiction of any foreign shareholder should be a state that has concluded a tax treaty with Sweden. The foreign corporate shareholder should also be a body covered by the tax treaty in question.

12. How is foreign debt usually structured to finance acquisitions in your country?
Any foreign debt should be structured in such a way that deduction of interest is not restricted under rules for limitations on deduction for interest expenses on intra-group loans.

From A Seller's Perspective
13. What are the main differences between share and asset deals?
A share deal does normally not have any tax implications for a corporate seller as the sale of shares normally falls under the Swedish participation exemption, while an asset deal as a general rule has tax implications for a seller. Any gain arising upon an asset deal is subject to normal corporate income tax. The gain equals the difference between the sales price and the tax value of the assets that have been disposed.

Transfer tax is not triggered as a result of a share deal. The same normally applies to asset deals. However an asset deal may trigger stamp duty tax if it includes the transfer of real estate. The stamp duty tax is paid by the buyer unless something else has been agreed between the seller and the buyer.

An asset deal is normally not subject to VAT. However it should be assessed on a case by case basis if the asset deal meets the requirements for being exempt for VAT-purposes. A share deal is not subject to VAT.

14. How are capital gains taxed in your country? Is there any participation exemption regime available?
Sweden maintains a classic system for eliminating double taxation in the corporate sector. Capital gains are exempt from tax if the sold company is a corporate entity and the shares are held for business
purposes. For unlisted shares generally all shares in Swedish limited liability companies or corporate entities resident and liable to tax in treaty countries are considered held for business purposes, except under certain specific conditions.

For holdings of listed shares there is a general minimum holding requirement of 10 percent of the voting rights and a minimum holding period of one year.

Based on the conditions described above, capital gains on shares are normally exempt in the corporate sector. Should the shares disposed of not be regarded as business related, any gain is subject to tax at the normal corporate tax rate, which is 22 percent for financial years that started January 1, 2013 or later. Losses are deductible but normally only versus gains on securities.

For individuals capital gains are subject to tax at a rate of 30 percent for listed shares and at a rate of 25 percent for unlisted shares. Certain rules apply for closely held companies.

15. Is there any fiscal advantage if the proceeds from the sale are reinvested?
There is no fiscal advantage in Sweden as regards the reinvesting of proceeds from a sale.
The recent call by European Union finance ministers for the EU’s high tax burden on labor to be tackled has the feel of the stable door being locked after the horse has bolted.

The reasons why the effects of the financial crisis continue to linger in certain parts of the world's economy are many and varied. But it stands to reason that the most competitive economies e.g. those with lower tax burdens and simpler tax systems, have bounced back the strongest. We're talking here about the Hong Kongs and Singapores of the world, and, to a lesser extent, the United Kingdom, which seems to be reaping some rewards after slashing corporate tax. Meanwhile those countries creaking under the weight of high taxation, high public spending and massive public debt are either economically stagnant or slipping backwards. And here we mean the Eurozone, and particularly countries like Italy and France.

It doesn’t take a Nobel Prize-winning economist to conclude that the more taxes businesses have to pay when they employ people the less likely they will be to take on labor, especially in times of economic stress. Yet some of the largest labor tax burdens and tax ”wedges” are found in Europe. According to the EU’s own analysis of tax trends in the bloc, labor taxes were the largest source of tax revenue in 2012 for 24 member states, accounting for more than half of total tax revenue in 13 countries. Worryingly, the trend seems firmly upwards, and 20 countries registered an increase in labor taxes in 2012. Belgium has the highest implicit tax rates on labor at 42.8 percent, followed by Italy at 42 percent. The UK has the third-lowest at 25.2 percent.

 Appropriately, the highest tax wedge – the difference between labor costs to the employer and the corresponding net take-home pay of the employee – is to be found in Latvia, home to outgoing Commissioner for Taxation Algirdas Šemeta, where in 2011 a wage-earner took home just 55.8 percent of what he or she cost the employer.

In June, when the Commission released its tax trends report, Šemeta was heard to say that growth-friendly taxation must be put at the heart of member states’ tax reforms. If only this had been the message he carried all the way through his four-year term then Europe might not be quite so deep in the mire as it is now. Instead, Šemeta’s focus has been mostly on anti-tax avoidance initiatives, ”harmful” tax regimes and tax harmonization along the ”high-tax” northern European model. Regular readers of these briefings will know that we are frequent critics of the Tax Commissioner. But it’s nothing personal. His resume indicates that he is an intelligent man; maybe if he had a modicum of experience in business he might have approached the job differently. Instead, his background describes a career public servant and politician, and the policies he advocated have tended to reflect that experience.
Sadly for those hoping for a more business-focused approach to EU tax issues, Šemeta’s successor is going to be Pierre Moscovici. At about the same time as the young Šemeta had become an economist at the Lithuanian Economy Institute, Moscovici had just left the Revolutionary Communists to join the French Socialist Party. After climbing through the Party ranks, Moscovici eventually became Francois Hollande’s finance minister, during a time when France’s already high tax burden was increased to dangerous levels. Like Šemeta, he has never run a company or been involved in the private sector in any meaningful way. So he should fit right in in Brussels!
Tax Appeal Tribunal Issues New Decision On 'Excess Dividends Tax'
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In Brief
On July 18, 2014, the Tax Appeal Tribunal (Tribunal) in the case of (An Appellant) v the Federal Inland Revenue Service (FIRS) decided in Favor of the FIRS regarding the application of Section 19 of the Companies Income Tax Act on "excess dividends" tax.

The decision creates more uncertainty on the issue of excess dividends tax more so since the Tribunal did not apply certain deductions and inferences from an earlier decision of the Federal High Court between the same parties and on almost identical facts.

In Detail
Background
Section 19 of the Companies Income Tax Act (CITA) imposes what is generally known as "excess dividends tax." It provides that, where a dividend is paid out as profit on which no tax is payable due to:

- (a) no total (taxable) profits; or
- (b) total profits which are less than the amount of dividend paid,…

the company paying the dividend shall be charged to tax at 30 percent as if the dividend is the taxable profits of the company for the year of assessment to which the accounts, out of which the dividend declared, relates.

In essence, under Section 19 any dividend paid in the instances set out in the section will be treated as taxable profits subject to tax at the rate of 30 percent.

Facts Of The Case
The Appellant declared and paid dividends to its shareholders in the years 2005, 2006 and 2007. The FIRS, relying on Section 19 of CITA, assessed the dividends to Companies Income Tax (CIT) at the rate of 30 percent on the basis that, according to them, the dividends exceeded the company’s taxable profits for the respective years.
Following an objection by The Appellant, the FIRS subsequently issued a notice of refusal to amend the assessments upon which the company lodged the appeal to the Tribunal.

**Overview Of The Judgment**

*The Appellant’s Position*

The Appellant put forward three major arguments.

First, the dividends were paid out of retained earnings which had already been taxed in prior years.

Secondly, FIRS should have considered and applied Section 80 of CITA which exempts dividend income that has been subjected to withholding tax from further tax. This is relevant given that the company earns dividend income from its subsidiaries.

Third, if Section 19 is considered ambiguous then it should be interpreted in favor of the taxpayer in line with the *contra fiscum* rule.

*FIRS’ Position*

In its defense, the FIRS appeared to agree that dividends paid from retained earnings should not be subjected to excess dividends tax. It submitted that The Appellant had not satisfactorily convinced the FIRS that tax had been paid on the retained earnings out of which the dividends were paid.

It also argued that the provisions of Section 19 were clear and unambiguous therefore they should be given their literal interpretation.

*The Decision*

The Tribunal, in interpreting Section 19, held that dividends paid from retained earnings, where there is no taxable profit or taxable profit is less than the dividends, should be taxed at 30 percent regardless of whether the earnings had been taxed previously. The Tribunal outlined four steps to be followed before subjecting a company to tax under Section 19.

According to the Tribunal, the first step was to ascertain why no tax was payable – which could either be due to no taxable profits or taxable profits less than dividend paid. The second step is to regard any such dividends paid as the taxable profits of the company. Thirdly, the actual taxable profit for the current year should be deducted from the dividend (deemed taxable profit) to determine the excess. The final step is to apply the tax rate of 30 percent to the excess established under step 3.

The Tribunal held that since the FIRS had complied with all the four steps The Appellant was rightly assessed to the additional tax. Although the judgment does not directly contradict the 2008 decision of the Federal High Court (FHC) between the same parties on similar facts, some of the inferences and deductions made by taxpayers from that decision have not been applied to this case by the Tribunal. In the 2008 case, it could be inferred that the import of the FHC decision was that dividends paid from retained earnings were not subject to excess dividends tax if such retained earnings had already been taxed in prior years. However, in this case, the four steps approach provided by the
Tribunal ignores that inference and specifically the Tribunal mentioned that reference to dividend being paid out of retained earnings is irrelevant.

The Takeaway

Before this decision, many companies had relied on the sentiment and inferences expressed in the FHC decision of 2008 in establishing that their dividends in excess of taxable profits were paid from retained earnings and should not be taxed twice. This judgment by the Tribunal questions some of the inferences reached in the earlier decision by the High Court.

The Tribunal’s decision also raised a couple of fundamental questions:

1. Why would the law seek to impose double taxation on companies for delaying their dividend distribution or simply reinvesting their profits?
2. Why did the Tribunal not consider some of the inferences from the earlier decision of the FHC which most taxpayers have been relying on as a basis for interpreting Section 19 of CITA?

Conclusion

Although we understand that this judgment has been appealed, it may be prudent for companies seeking to pay dividends out of their retained earnings to ensure that such dividends do not exceed their taxable profits for the relevant year pending the resolution of this dispute. Apart from the final judgment, it will also help immensely if the National Assembly can amend the law to make it clear that Section 19 is not applicable to profits which have already been taxed and those that are specifically exempted from tax.

Until then, the restrictive interpretation being given to Section 19 makes most of the income tax incentives in Nigeria redundant as they are taken away as soon as companies distribute dividends.
Having slapped itself on the back for publishing its first set of “deliverables” seemingly on schedule, the Organization for Economic Cooperation and Development (OECD) is confident that it’s on track to complete its base erosion and profit shifting (BEPS) agenda by the end of next year. Yet the September 2014 deliverables contain only a limited set of recommendations, and concerns are growing that the BEPS plan will create more problems than it solves. This article summarizes the background to the project, the new reports and recommendations and ongoing criticism of the proposals.

Background
The acronym BEPS now appears to be a permanent fixture in the glossary of international taxation. Yet it has a relatively short history. The first mention of it in our news coverage dates back to the G20 Summit in Mexico in November 2012, during which the British and German Governments issued a joint statement calling for “concerted international cooperation to strengthen international standards for corporate tax regimes.”

The OECD published its report "Addressing Base Erosion and Profit Shifting" on February 12, 2013, although the report was more a set of observations rather than describing potential solutions to the problem of BEPS. It was noted that due to imperfect interaction between nations’ tax regimes, multinationals have been permitted to legitimately structure their tax affairs using profit-shifting arrangements to pay tax on their profits at rates as low as 5 percent, against corporate tax rates of as high as 30 percent in place on fiscally immobile businesses in some OECD member states.

"Many of the existing rules which protect multinational corporations from paying double taxation too often allow them to pay no taxes at all," the report stated.

The report conceded however – amid widespread criticism of multinationals’ tax affairs – that the blame may not lie with businesses. It acknowledged a prevailing sentiment among business leaders that they have a responsibility towards their shareholders to legally reduce the taxes their companies pay.

"Some of them might consider most of the accusations unjustified, in some cases deeming governments responsible for incoherent tax policies and for designing tax systems that provide incentives for base erosion and profit shifting."
Furthermore, the report pointed out that multinationals often suffer at the hands of inadequate global tax rules, paying a greater share of taxes than should be required of them.

**BEPS Action Plan**

However, the OECD’s BEPS Action Plan, released in July 2013, concentrates almost entirely on perceived underpayment of tax by multinationals, rather than any problems associated with possible over-taxation.

The Action Plan, released in July 2013, lists 15 specific actions designed to give governments domestic and international mechanisms to prevent corporations from paying little or no tax. They include:

- **Action 1**: Address the challenges of the digital economy
- **Action 2**: Neutralize the effects of hybrid mismatch arrangements
- **Action 3**: Strengthen controlled foreign company rules
- **Action 4**: Limit base erosion via interest deductions and other financial payments
- **Action 5**: Counter harmful tax practices more effectively, taking into account transparency and substance
- **Action 6**: Prevent treaty abuse
- **Action 7**: Prevent the artificial avoidance of PE status
- **Action 8**: Assure that transfer pricing outcomes are in line with value creation: intangibles
- **Action 9**: Assure that transfer pricing outcomes are in line with value creation: risks and capital
- **Action 10**: Assure that transfer pricing outcomes are in line with value creation: other high-risk transactions
- **Action 11**: Establish methodologies to collect and analyze data on BEPS and the actions to address it
- **Action 12**: Require taxpayers to disclose their aggressive tax planning arrangements
- **Action 13**: Re-examine transfer pricing documentation
- **Action 14**: Make dispute resolution mechanisms more effective
- **Action 15**: Develop a multilateral instrument

OECD Secretary-General Ángel Gurría said that the Action Plan "marks a turning point" in the history of international tax cooperation. "It will allow countries to draw up the coordinated, comprehensive and transparent standards they need to prevent BEPS. International tax rules, many of them dating from the 1920s, ensure that businesses don’t pay taxes in two countries – double taxation. This is laudable, but unfortunately these rules are now being abused to permit double non-taxation. The Action Plan aims to remedy this, so multinationals also pay their fair share of taxes."

However, as many commentators have observed, bringing about change to the entire international tax framework is a huge undertaking, leading to doubts that it is achievable at all and worries that it could make a bad system worse if only partly implemented.

**September 2014 Deliverables**

After numerous consultations with affected parties, both in paper form and at the OECD’s headquarters in Paris, and the publication of several discussion drafts taking in the taxation of the digital economy,
transfer pricing, hybrid mismatch arrangements and tax treaty abuse, the OECD on September 16, 2014, released its first recommendations for "a co-ordinated international response" to BEPS.

This was heralded as a major milestone for the OECD on the path towards successful completion of the BEPS initiative. Said OECD Secretary-General Angel Gurría: "The G-20 has identified base erosion and profit shifting as a serious risk to tax revenues, sovereignty, and fair tax systems worldwide. Our recommendations constitute the building blocks for an internationally agreed and co-ordinated response to corporate tax planning strategies that exploit the gaps and loopholes of the current system to artificially shift profits to locations where they are subject to more favorable tax treatment."

Seven "deliverables" have been released, of a total of 15 that will be finalized by December 2015, which aim to:

- Ensure the coherence of corporate income taxation at the international level, through new model tax and treaty provisions to neutralize hybrid mismatch arrangements (Action 2);
- Realign taxation and relevant substance to restore the intended benefits of international standards and to prevent the abuse of tax treaties (Action 6);
- Assure that transfer pricing outcomes are in line with value creation, through actions to address transfer pricing issues in the key area of intangibles (Action 8);
- Improve transparency for tax administrations and increase certainty and predictability for taxpayers through improved transfer pricing documentation and a template for country-by-country reporting (Action 13);
- Address the tax challenges of the digital economy (Action 1);
- Facilitate swift implementation of the BEPS actions through the development of a multilateral instrument to amend bilateral tax treaties (Action 15); and
- Counter harmful tax practices (Action 5).

However, not all of the deliverables contain concrete recommendations. The 2014 BEPS package consists of two final reports (Action 1 and Action 15), one interim report (Action 5) and four reports containing draft recommendations (Actions 2, 6, 8 and 13) which are agreed and will be finalized with further work on implementation and interaction with the 2015 deliverables.

It was announced that the OECD's Committee on Fiscal Affairs will consider, in January 2015, a draft mandate for an international conference for the negotiation of a multilateral convention to streamline the implementation of the BEPS Action Plan. This responds to frequently aired concerns that unilateral policies from nations acting in their domestic self-interest could de-rail the success of the BEPS plan.

In an information brief on the proposals, the OECD said that implementation of the measures will go a long way in addressing some of the key BEPS challenges. It said that model rules to neutralize hybrid
mismatches will put an end to costly multiple deductions for a single expense or deduction in one country without corresponding taxation in another.

Meanwhile, the OECD’s proposed response to harmful tax practices would focus on the "distortionary influence" of tax on the location of service activities, with progress to be sought on the transparency of tax rulings and also the development of a methodology to assess substantial activity in intellectual property regimes and other preferential regimes.

Treaty shopping and other forms of treaty abuse will be countered by a global agreement that anti-treaty abuse provisions should be included in tax treaties.

Further, Action 8 (on ensuring transfer pricing outcomes are in line with value creation) will seek to apply tax to value creation activities under transfer pricing rules, beginning with a focus on intangibles. A consensus was reached among nations that the artificial shifting of profits to no- or low-tax jurisdictions, for example through cash boxes, "can no longer be tolerated."

The OECD said work on transfer pricing rules will continue, including under Actions 9 and 10, in 2015.

"These measures across seven areas of the Action Plan are an important step forward in fighting BEPS. Viewed together with the 2015 deliverables, and once implemented to double tax treaties and domestic laws, the measures will ensure the coherence of corporate tax systems in a cross-border environment, introduce substance requirements in the area of tax treaties and transfer pricing, and ensure transparency while promoting certainty and predictability," the OECD said.

The BEPS recommendations were a key item on the agenda when G-20 Finance Ministers convened on September 20-21, 2014, in Cairns, Australia.

OECD working groups will now focus on the eight remaining Action points, which the OECD has confirmed will be released in September and December, 2014:

- Action 3: on the design of effective controlled foreign company (CFC) rules, to provide countries with tools to tackle the large amounts of untaxed profits booked offshore;
- Action 4: regarding rules that limit base erosion via interest deductions and other financial payments;
- Action 5: to continue work on preventing harmful tax practices, with a specific focus on preferential intellectual property regimes;
- Action 7: on preventing the artificial avoidance of permanent establishment (PE) status – an issue highlighted by the OECD as of particular importance for developing and emerging economies;
- Actions 8-10: on ensuring outcomes from transfer pricing rules are in line with value creation, relating to intangibles, risks and capital, and other high-risk transactions;
- Action 11: on methodologies to collect data and carry out economic analysis on BEPS, including its spillover effects across countries;
- Action 12: on domestic rules requiring the disclosure of aggressive tax planning arrangements; and
- Action 14: to enhance the effectiveness of dispute resolution mechanisms among tax administrations.

Next Steps

In the short term, this first set of deliverables will be presented to G20 Finance Ministers in September 2014 and Leaders in November 2014. The OECD Committee on Fiscal Affairs (CFA), bringing together 44 countries (all OECD members, G20 and Accession countries), will deliver the 2015 outputs together with the resolution of pending technical issues and the completion of the implementation measures for the 2014 deliverables. Also, the adoption of the Report on the Digital Economy will result in extending the mandate of the Task Force on the Digital Economy to complete its work based on the outcomes of other actions to be finalized by 2015 which have a strong impact on it. A mandate would be drafted to be considered by the CFA in January 2015 for the negotiation of a multilateral convention to streamline the implementation of the BEPS Action Plan.

Once finalized, these measures are expected to become applicable via changes to bilateral tax treaties or through the multilateral instrument, through changes in domestic laws and with support from internationally agreed guidance.

Uncertainty

However, in a sense, the contents of the September 2014 deliverables have served to underline just how far away the OECD is from realizing its goals.

The OECD itself acknowledges that any proposals to reduce opportunities for multinationals to engage in BEPS should not create legal uncertainty, nor increase the risk of double taxation. Some policy issues have emerged, it adds, which will require "careful consideration" to make sure that no "collateral damage" emerges from the exercise which could affect legitimate transactions.

Yet the OECD has said that governments are free to start working on changes to their tax systems based on certain of the September 2014 recommendations while at the same time admitting that this first set of deliverables is not complete because they overlap with other areas of the Action Plan which are still being deliberated over and could therefore change. For instance, the work on the transfer pricing aspects of intangibles includes sections still bracketed as they cannot be finalized before Actions 9 and 10 are delivered. Hence, the OECD has released the new recommendations only in draft form, so that future changes can be incorporated. So we could see a multi-speed response to the recommendations straight off the bat, which is precisely what the OECD is anxious to avoid.

Furthermore, despite being scheduled to form part of the September 2014 deliverables, the OECD has chosen not to deal with taxation of the digital
economy because of the unique challenges involved in doing so. "It has been agreed that because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes," states the OECD’s explanatory statement.

It is expected that the other actions will address BEPS-related risks posed by the digital economy, but at the same time a number of specific issues have been identified by the OECD which will also be taken into account when it undertakes work in this area, including permanent establishment issues, the importance of intangibles and the use of data and the possible need to adapt CFC rules and transfer pricing rules to the digital economy.

However, as the OECD itself concedes, certain parts of the BEPS initiative have the potential to be economically damaging, particularly with regards to the treaty abuse work, and businesses have consistently warned that the outcome could be reduced volumes of international trade and investment – "collateral damage" as the OECD puts it.

The United States Council for International Business (USCIB) for example has expressed concerns about BEPS Action 6’s singular focus on treaty abuse, and has warned that the proposals do not go far enough to ensure predictable and certain tax treatment for law-abiding multinationals. It also expressed concerns that the review might make tax treaty benefits more challenging to obtain.³

Reiterating that the BEPS Action Plan must bring about certainty regarding international tax rules, the USCIB has warned that the recommendations on access to treaty benefits in the discussion draft are "overly restrictive," and advised against the introduction of "vague and subjective anti-abuse standards."

Despite the appearance of the first deliverables, business and tax advisers still remain unconvinced that the OECD will be able to pull off such a major feat as changing global tax rules over the space of a couple of years.

"In relation to the 2014 actions arguably the easy work is complete," observed Chris Morgan, Head of Tax Policy at KPMG in the UK. "The challenge is now whether, and to what extent, countries will adopt into local legislation the recommendations that have been made, particularly where the recommendations are, by the OECD’s own admission, not formally finalized. Whilst support at the G20 level is there, it is to be hoped that this translates into coordinated and consistent action."

"Whilst it is stated that countries will be able to start implementing certain of the recommendations now, it is unclear how far they will be able to go in the short term given the interdependency between the 2014 and 2015 actions and the need for the detailed guidance," Morgan added. "Whilst it is desirable that there is quick action, both to provide certainty and deal with public concern, there is a risk that hasty unilateral action could put a country
at a competitive disadvantage or require significant modification once the package is finalized”

Heather Self, Partner at international law firm Pinsent Masons, concurs, noting that: ”There is a lot of work still to do, and there are concerns that the overall package will not be coherent. The OECD recognizes this risk, but the extreme time pressure to complete everything by the end of 2015 means it will be hard to achieve consensus in some difficult areas.”

Frederic Donnedieu, Chairman of international tax advisers Taxand, said that whilst the OECD’s plans ”are undoubtedly a further step to tilt the balance of power further towards tax authorities, how they will be implemented and the form they will take is very much unknown.”

Those who have studied the BEPS project throughout its first phase have mostly drawn the conclusion that the end result could be a worse situation than we have now in terms of international tax complexity and uncertainty, but that time would tell us if the OECD had succeeded in its objectives. Time is telling us now however, that while the OECD might deliver on time, few people are sure what exactly is going to come out of the package.

ENDNOTES

3  http://uscib.org/docs/April_4_treaty_comments_final.pdf
Member States Must Apply Most Favoured Nation Treatment Under EU Law
by I M de Groot

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Abstract

According to case law from the Court of Justice of the European Union (CJEU), a Member State is not obliged to enact most Favoured nation treatment if a tax treaty prescribes a certain type of tax treatment (bilateral most Favoured nation treatment). In this article, the author discusses whether EU law does oblige a Member State to enact most Favoured nation treatment if national law prescribes a certain type of tax treatment (unilateral most Favoured nation treatment). The conclusions reached by the author are based on her analysis of the relevant CJEU case law on this issue.

1 Introduction

The right to Most Favoured Nation (MFN) treatment – also referred to as the prohibition on horizontal discrimination – means that a resident of an EU Member State is entitled to receive the same treatment that a resident of a most Favoured nation receives. The principle of MFN has been much discussed in the professional literature, in particular, in anticipation of the D case and after the judgment was rendered. Proponents of MFN argue that the legal basis for an MFN obligation is found in the general non-discrimination provision (Article 18 Treaty on the Functioning of the EU; TFEU) in combination with the fundamental freedoms. They also emphasize that such an obligation is in line with the objective of the fundamental freedoms:

2 Introductory Comments

As stated above, the principle of MFN has been much discussed in the professional literature, in particular, in anticipation of the D case and after the judgment was rendered. Proponents of MFN argue that the legal basis for an MFN obligation is found in the general non-discrimination provision (Article 18 Treaty on the Functioning of the EU; TFEU) in combination with the fundamental freedoms.
the creation of a "real" internal market without barriers (a teleological interpretation of the fundamental freedoms). As they point out, this is a strong motivating factor for harmonizing international tax law. Opponents point out that although EU law does prohibit discrimination, it does not contain a provision that explicitly obliges Member States to enact MFN. Other arguments put forward refer to the sovereignty of Member States, the principle of reciprocity that forms the basis for tax treaties, and the chaos that would ensue from MFN treatment.

I would like to briefly discuss the legal basis for the MFN obligation within EU law; a more detailed discussion of this subject matter can be found in the professional literature. First, the provision on the free movement of workers (Article 45 TFEU) prohibits "any discrimination based on nationality" and the provision on the free movement of capital (Article 63 TFEU) prohibits "all restrictions on the movement of capital between Member States and between Member States and third countries." However, the freedom of establishment (Article 49 TFEU) and the freedom to provide services (Article 56 TFEU) "only" require a domestic treatment. Although the formulation of some treaty freedoms is not broad enough to accommodate MFN treatment, a general non-discrimination provision is contained in Article 18 TFEU. Furthermore, the objective of the treaty freedoms is important: the creation of an internal market without barriers. In my opinion the teleological interpretation of the treaty freedoms in combination with the general non-discrimination provision can therefore form the legal basis for the right to MFN treatment. The fact that a right to MFN treatment is not explicitly laid down in the TFEU does not, in my view, detract from this. Relying on MFN treatment or arguing that one should not be treated less favorably amounts to the same thing: in both cases one wants to receive the same treatment as that accorded to the most favored. A correct formulation is only important when presenting these arguments to the CJEU.

Finally, I would like to comment on the parameters of my research. With regard to "general" CJEU case law (i.e., case law that does not deal with direct taxes), Van Thiel has concluded from cases such as Roders, Kortmann, Matteuci, and Gottardo that EU law appears to oblige EU Member States to enact MFN treatment. I have limited my research to CJEU case law on direct taxes, partly due to the constraints of space; with regard to other case law, please refer to Van Thiel. I have subdivided this article into CJEU case law on unilateral MFN treatment and case law on MFN treatment provisions in tax treaties or in combination with tax treaties. Although it has been established that a Member State is not obliged to enact bilateral MFN treatment (I refer to the Introduction), case law on this issue is indeed relevant for the question whether a Member State is obliged to enact unilateral MFN treatment.

3 Unilateral MFN Treatment

3.1 Cadbury Schweppes

The Cadbury Schweppes case concerned the CFC legislation in the United Kingdom. Pursuant to this legislation, the profits of a foreign controlled
company ("GVB") – i.e., a company more than 50 percent owned by a domestic company – that was subject to a "lower tax rate"19 were, in principle, attributed to the English parent company. A tax credit was granted in respect of the foreign tax the GVB had already paid. According to UK law, if the tax paid by the GVB was less than 75 percent of the tax that it would have paid had it been subject to tax in the United Kingdom, then this constituted a "lower tax rate." The CFC legislation was therefore not applicable to a domestic parent company that had incorporated a domestic subsidiary or a foreign subsidiary that was not subject to a lower tax rate.

The referring court specifically asked the CJEU whether the situation in which an English parent company incorporates a subsidiary in a Member State with a lower tax rate is comparable to the situation in which an English parent company incorporates a subsidiary in the UK, or to the situation in which it incorporates a subsidiary in another Member State that does not have a lower tax rate (Finding 26). The CJEU did not explicitly answer this question, but implied that it does consider the distinction made in the legislation between the subsidiary in a Member State with a lower tax rate and the subsidiary in a Member State without a lower tax rate, relevant. The CJEU states in Finding 44: "Where, on the other hand, the controlled company has been incorporated and taxed in the United Kingdom or in a State in which it is not subject to a lower level of taxation within the meaning of that legislation, the latter is not applicable." The fact that the CJEU considered this distinction relevant does not, however, mean that the different treatment accorded to the domestic parent company, depending on, in which foreign country the subsidiary was incorporated, was of itself enough to consider the UK legislation to be contrary to the freedom of establishment applicable in this case. The CJEU dealt with both the distinction between a parent company with a subsidiary in a country with a lower tax rate, and a parent company with a subsidiary in a country without such a rate, and the distinction between a domestic subsidiary and a foreign subsidiary subject to a lower tax rate. The CJEU subsequently concluded that the fact that the domestic parent company does not pay more tax (as a result of the foreign tax credit) than it would have paid had the subsidiary been established in the UK, does not alter the fact that the parent company pays tax on the profit of another legal entity (Finding 45). There is therefore a timing benefit to incorporating a domestic subsidiary or a foreign company not subject to a lower tax rate. The CJEU concludes that there is not only a difference in the treatment accorded to the parent companies, depending on the foreign country in which they incorporate a subsidiary, but also in the treatment received by a parent company with a domestic subsidiary compared to a parent company with a foreign subsidiary. As far as I am concerned, implicit in these findings is the fact that a parent company with a foreign subsidiary subject to a lower tax rate and a parent company with a foreign subsidiary not subject to a lower tax rate are considered to be in objectively comparable situations. Had that not been the case, I believe the CJEU
would have had to state that the situations were not comparable and explain why not. The CJEU would not then have had to deal with the question whether the CFC legislation would give rise to a tax disadvantage (if the subsidiary was subject to a lower tax rate) compared to the situation in which the foreign subsidiary is not subject to a lower tax rate. After all, treaty freedoms are only violated if comparable situations are treated differently.  

In the Opinion issued in the *Columbus Container Services* case, Advocate General Mengozzi also dealt with the question whether the two above-mentioned elements being compared in the *Cadbury Schweppes* case were applied alternatively or cumulatively. The conclusion Advocate General Mengozzi draws from the opinion issued by Advocate General Leger in *Cadbury Schweppes* and Findings 44 and 45 of the CJEU judgment in *Cadbury Schweppes* is that a restriction on the freedom of movement appears to require no more than two cross-border situations that are treated differently. Advocate General Mengozzi notes that, in the Opinion issued by Advocate General Leger in *Cadbury Schweppes*, Leger does in fact assume that the different treatment accorded to the two cross-border situations is of itself enough to constitute a restriction on the freedom of establishment. According to Mengozzi, the CJEU’s use of "or" in Findings 44 and 45 of their judgment in *Cadbury Schweppes* appears to confirm that the CJEU has accepted the position taken by Advocate General Leger. I do not think such an assumption can be made. If we assume that the CJEU had used "and" instead of "or," then the sentence would have read: "Where, on the other hand, the controlled company has been incorporated and taxed in the United Kingdom and in a State in which it is not subject to a lower level of taxation within the meaning of that legislation, (...)". The sentence is now no longer grammatically correct: one and the same company cannot be established in multiple states: the CJEU’s use of "or" is therefore logical. The CJEU also uses "or" in Finding 45: "That is not the case for a resident company with a subsidiary taxed in the United Kingdom or a subsidiary established outside that Member State which is not subject to a lower level of taxation." Again, if "or" were to be replaced by "and," the sentence would not convey the CJEU’s intent. The CJEU would then be referring to a situation in which an English parent company has a subsidiary in the UK and a subsidiary established in another Member State that is not subject to a lower tax rate. And this is not the comparison the CJEU is making; the comparison is, on the one hand, between a parent company with a subsidiary in a Member State with a lower tax rate, and, on the other, a parent company with a subsidiary in the UK or with a subsidiary in a Member State that does not have a lower tax rate. In my view, Advocate General Mengozzi reads too much into the use of "or" in Findings 44 and 45 of the CJEU’s judgment in *Cadbury Schweppes*.
sufficient to constitute a restriction on the freedom of movement. The question that then arises is why the CJEU also refers to the different treatment accorded to the two cross-border situations. In my view, this argument lacks substance. It could simply be a case of the referring court explicitly requesting that this be considered, and therefore this argument does not justify the conclusion that the unequal treatment accorded to two cross-border situations is sufficient in and of itself.

3.2 Columbus Container Services

The *Columbus Container Services* case concerns "Columbus", a Belgian limited partnership whose participants are German residents. The partnership qualifies as transparent in Germany: from a German perspective, the income is therefore directly allocated to the participants and there is "only" a permanent establishment in Belgium. In Germany, the income of a permanent establishment is exempt unless it is generated by a passive foreign permanent establishment of which the income is subject to a tax rate of less than 30 percent. In that case – and notwithstanding the Germany-Belgium tax treaty – a switchover will take place, whereby the exemption regime will be replaced by a credit regime. Given the activities performed by Columbus, the participants in the partnership were faced with a switch to a credit regime. It should be noted that at the time the German tax rate was 30 percent; therefore the income of a transparent partnership/permanent establishment was always at least 30 percent. The income was either taxed abroad at a tax rate of at least 30 percent and exempt in Germany, or taxed at a lower tax rate with extra German tax being levied so that the tax paid equalled 30 percent.

According to the CJEU, there was a restriction on the freedom of movement in the *Cadbury Schweppes* case due to the unequal treatment accorded to a domestic and foreign permanent establishment, which was not present in the *Columbus Container Services* case. The CJEU more or less reiterates the conclusions reached in the *Kerckhaert Morris* case in respect of the avoidance of juridical double taxation: under German law, the income of both a German and a foreign partnership is taxed at 30 percent and any negative consequences of the German rules are therefore a result of the parallel exercise of the right to tax by the two Member States (Findings 39–43).

In Finding 51, the CJEU addresses the argument put forward by Columbus Container Services that German law negatively influences the choice a company has in deciding in which Member State to establish itself. The CJEU emphasizes that there are no harmonizing measures on the avoidance of double taxation in place in the EU and that the Member States therefore can exercise a certain degree of autonomy on this issue. According to the CJEU, this authority means that:

the freedom of companies and partnerships to choose, for the purposes of establishment, between different Member States in no way means that the latter are obliged to adapt their own tax systems to the different systems of tax of the other Member States in order to guarantee that a company or partnership that has chosen to establish itself in a given Member State is taxed, at national level, in the same way as a company or partnership that has chosen to establish itself in another Member State.
The conclusion the CJEU appears to draw from the absence of harmonization in the area of the avoidance of double taxation is that a Member State may tax the income of a company established in one Member State differently to the income of a company established in another Member State: an exemption may be applied in the one case, and a credit in the other. This is striking, because in other case law the CJEU ruled that, despite the fact that the rules on the avoidance of double taxation have not been harmonized and avoidance is not mandatory under EU law, Member States that do have rules on the avoidance of double taxation must take the freedoms prescribed by treaties into account. The initial impression appears to be that the CJEU does not consider two foreign partnerships that are treated differently in and of itself to conclude that the freedom of movement is being restricted. However, the facts of the case must be taken into account: because the switch over was by reference to the German 30 percent tax rate, the tax on the income remains in effect (at least) 30 percent. The income in Germany is exempt if the foreign tax rate is at least 30 percent; if the tax rate is less than 30 percent, additional tax is levied to bring the tax in line with the German tax rate. It was therefore inconceivable that the German law would result in the fragmentation of the internal market. The CJEU did not explicitly deal with this issue, but in concluding that "(...) a company or partnership that has chosen to establish itself in a given Member State is taxed, at national level, in the same way as a company or partnership that has chosen to establish itself in another Member State ..." it is possible that the Court was referring to the fact that – depending on the level of the foreign tax rate – additional tax is levied in Germany (but the total tax burden is nevertheless always 30 percent). In that case, the phrase used by the CJEU in Finding 51 was not intended as a green light for treating two cross-border situations differently. The CJEU may have concluded differently if, for example, the switch over had been based on a tax rate of 20 percent so it would be beneficial for a company to establish itself in a country with a tax rate of, for example, 21 percent. Be that as it may, the Court’s word choice is somewhat confusing; in my view it would have been better if the CJEU had ruled that Germany did not treat partnerships, transparent or otherwise, established in other Member States differently, because the total tax burden is always (at least) 30 percent.

4 MFN Provisions In (Combination With) A Tax Treaty

4.1 The D Case
The D case concerned the (now abolished) Dutch wealth tax. This tax was levied on the worldwide income of domestic taxpayers and on the Dutch assets of foreign taxpayers. Under the Dutch legislation, domestic taxpayers were entitled to a tax-free allowance. Belgian residents were also entitled to this tax-free allowance pursuant to the non-discrimination provision in the Netherlands-Belgium tax treaty (Article 25(3) the Netherlands-Belgium tax treaty (1970)).
The German resident D, who did not meet the Schumacker criterion, argued that he was being discriminated against, *inter alia* as a result of the Netherlands-Belgium tax treaty. The Den Bosch Court of Appeals requested a preliminary ruling not only on the difference between a domestic and foreign taxpayer (question 1), but also on the explicit distinction made in the Netherlands-Belgium treaty between a Belgian resident and another foreign resident (second question, see Finding 19). With regard to the first question, the CJEU ruled that, as with personal income tax, the situation of a resident and a non-resident are only comparable if the Schumacker criterion is met (Findings 34–43). On this point the legislation is therefore not contrary to the free movement of capital.

As in the *Columbus Container Services* case, the D case also examines whether the freedom of movement is restricted solely because two foreign taxpayers (a Belgian and the German D) are treated differently. With regard to this question, the CJEU emphasizes that "*no unifying or harmonizing measure for the elimination of double taxation had yet been adopted at Community level,*" "*the Member States are at liberty, in the framework of those conventions, to determine the connecting factors for the purposes of allocating powers of taxation,*" and "*a difference in treatment between nationals of the two Contracting States that results from that allocation cannot constitute discrimination contrary to Article 39 EC.*" (cf. also Gilly, Finding 30). The CJEU subsequently notes that the case in question does not concern the allocation of taxing rights between Member States that are party to one and the same treaty, but rather a comparison between the situation of one person who is a resident of a state that is a party to a treaty and another who is a resident of a state that is not a party to a treaty. While the Advocate General saw considerable similarities between the situation in the *D* case and the situation in the *Saint Gobain* case the CJEU did not. In the *Saint Gobain* case, a French company with a permanent establishment in Germany was deemed to be comparable to a German resident: this enabled the French company in *Saint Gobain* to claim the benefits arising from the treaties Germany had concluded with Switzerland and the United States. In this case, a foreign taxpayer (the German company *Saint Gobain*) wished to be treated as a *domestic taxpayer* in respect of a tax treaty. The CJEU apparently regards the situation in the *D* case, in which the comparison is between two foreign taxpayers, as a completely different situation. The CJEU therefore considered whether D’s situation could in fact be compared to that of a Belgian who, on the basis of the Netherlands-Belgium tax treaty, receives special treatment. In section 4, I will deal with the distinction – which the CJEU believes exists – between the *D* case and the *Saint Gobain* case. For now, I will discuss in more detail the objective comparability between the German D and the Belgian taxpayer.

As stated above, the CJEU explicitly deals with the issue of whether D’s situation is comparable to that of another non-resident who, on the basis of a tax treaty, is entitled to a tax-free allowance (Findings 58–62). As the CJEU notes in Finding 59:
Similar treatment with regard to wealth tax in the Netherlands of a taxable person, such as Mr. D., resident in Germany and a taxable person resident in Belgium requires that those two taxable persons are considered to be as in the same situation.

I believe this to be an implicit recognition of the CJEU that the different treatment accorded to two non-residents who are in an objectively comparable situation constitutes a restriction on the freedom of movement. This is even more obvious in the Orange European Small Cap Fund case, which I discuss in the following section.\(^{36}\) However, the CJEU ultimately concluded that the situations of the two foreign taxpayers are not comparable. The CJEU noted that: "(…) reciprocal rights and obligations apply only to persons resident in one of the two Contracting Member States (…)," and that this is inherent to bilateral treaties, and the right to a tax-free allowance/invoking the non-discrimination provision "cannot be regarded as a benefit separable from the remainder of the Convention, but is an integral part thereof and contributes to its overall balance."\(^{37}\) The CJEU does not, however, examine whether this tax-free allowance is actually reciprocated. This is noteworthy, given that Belgium does not have a wealth tax and therefore cannot grant a tax-free allowance; a point that was put forward by D (Finding 47). Although a state would obviously probably not "just" give away a benefit in a tax treaty without requiring some form of reciprocity, and in this case it concerns a non-discrimination provision (by definition reciprocal), the CJEU does not examine whether another type of benefit is actually given in exchange for the Netherlands granting the tax-free allowance.

Finally, I would like to note that the CJEU therefore does not distinguish between provisions in tax treaties that serve to allocate the right to tax from other types of tax treaty provisions.\(^{38}\) Prior to the judgment in the \(D\) case, the professional literature argued that, based on the Gilly case, provisions on the right to tax are not discriminatory, while the latter are.\(^{39}\) The \(D\) case concerned the allocation of a tax-free allowance based on a non-discrimination provision, which of course does not prescribe how the right to tax should be allocated, not even to avoid double taxation.

### 4.2 Orange European Smallcap Fund

The Orange European Smallcap Fund case ("OESF") concerned Dutch legislation on the refund of dividend withholding tax for fiscal investment institutions (Fiscale Beleggingsinstellingen; "FBIs") as referred to in section 28 Corporate Income Tax Act 1969. An FBI is subject to a zero tax rate and therefore it is not possible to credit Dutch dividend withholding tax or foreign withholding tax pursuant to a tax treaty. Under section 10(2) Dividend Withholding Tax Act 1965 (old), an FBI was entitled to a refund of Dutch dividend withholding tax.\(^{40}\) In addition, section 28(1)(b) Corporate Income Tax Act 1969 in conjunction with section 6 of the Decree on Investment Institutions (Besluit Beleggingsinstellingen; "BBIs") (old) entitled the FBI to a refund of foreign withholding tax. The latter refund was only granted insofar as the FBI had Dutch shareholders and could not exceed the tax that would have been able to be credited under a treaty or the Tax Regulations of the Kingdom (Belastingregel...
**Koninkrijk; “BRK”) in respect of direct investment by the Dutch shareholders. The rules were intended to ensure that the tax burden for investors in the FBI was more or less the same as in the case of direct investment. Therefore, the Dutch rules made a distinction based on the Member State from which the dividends were derived: in the case of direct investment, if there is an entitlement to credit withholding tax, then there is also an entitlement to have this withholding tax refunded; if this is not the case, then there is no entitlement to a refund. One of the questions raised in the OESF case was whether this distinction constituted a restriction on the free movement of capital.

The CJEU began by addressing the distinction made between domestic and foreign dividends. In line with its judgment in *Kerckhaert Morres* regarding jurisdictional double taxation, the CJEU concluded that the Netherlands did not tax foreign or domestic dividends received by FBIs and any tax disadvantage was the result of the parallel exercise of tax powers by the different Member States, in particular, the Source state’s choice to levy withholding tax on the dividend and the Dutch government’s decision not to tax the dividends (Findings 34–42).

The CJEU then dealt with the question whether a distinction based on the Member State from which the dividends were derived, constituted a restriction on the free movement of capital. The CJEU concluded that a Member State is not obliged to grant a concession in respect of the disadvantage of double taxation arising from the parallel exercise of the power to tax by the Member States, but Member States that decide to do so must take account of EU law (Finding 47). The CJEU subsequently reiterates that in the absence of any harmonizing measures on the division of the right to tax, Member States have the power to enact bilateral or unilateral measures. The *D* case is also discussed with regard to this point. In consonance with the opinion issued by the Advocate General, the CJEU concluded that the case in hand did not involve the automatic application of a tax treaty, but rather a unilateral decision on the part of the Netherlands to amend tax treaties to the benefit of FBIs. As far as the refund rules are concerned, unlike the *D* case, it cannot be concluded that this involves a benefit that is an inseparable part of a tax treaty and contributes to its overall balance. According to the CJEU, it should therefore be examined whether such a unilateral decision constitutes a restriction on the free movement of capital.

In this respect, the CJEU notes that the effect of the Dutch rules is such that investing in Member States where there is no entitlement to a withholding tax concession in respect of dividends, is made less attractive than investing in Member States where such a concession is available (Finding 56).

The CJEU subsequently concludes:

Such legislation is therefore liable to deter a collective investment enterprise from investing in the Member States in which the taxation of dividends does not give rise to the concession and accordingly constitutes a restriction on the free movement of capital prohibited in principle by Article 56 EC.
In my opinion, this makes even more explicit than in the D case that only a distinction between two cross-border situations constitutes a restriction on the freedom of movement. The question that once again needs to be answered is whether these two cross-border situations are indeed objectively similar (Findings 59–63). Given the objective of the rules, the CJEU concludes that this is not the case. It is namely the intention of the Dutch rules to treat investments made through an FBI no less favorably for tax purposes than direct investment. Where a shareholder is not entitled to credit foreign withholding tax on direct investments, investing through an FBI is not a less attractive option if the FBI is also not entitled to a refund of foreign withholding tax: the shareholder will also suffer juridical double taxation when making direct investments. Only if a tax treaty were to give the shareholder an entitlement to a credit in respect of direct investments would investing through an FBI – that was not entitled to a refund – be a less favorable option. Unlike the D case, the OESF case did not involve situations that were not objectively comparable on the basis of a provision in a tax treaty, but situations that were not objectively comparable on the basis of national rules combined with a tax treaty.

4.3 D And OESF As Compared With Columbus Container Services

Both the Columbus Container Services and OESF cases dealt with the avoidance of juridical double taxation. It is therefore remarkable that in the Columbus Container Services case the CJEU appears to conclude that the absence of harmonizing measures on the avoidance of double taxation means that a Member State can tax the income from a company established in one Member State differently to the income from a company established in another Member State (Finding 51). In contrast, in the above-mentioned Finding 47 of its OESF judgment the CJEU concluded that, if measures on the avoidance of double taxation are present, they must be in accordance with EU law. In the OESF case, the CJEU furthermore assumes that the different treatment accorded to cross-border situations in principle constitutes a restriction on the freedom of movement. The two conclusions appear to be contradictory. In my opinion, the only logical explanation for these contradictory conclusions is that under the German legislation at issue in the Columbus Container Services case the income from transparent partners is always taxed at a rate of (at least) 30 percent, while in the OESF case whether or not an FBI is entitled to a refund does in fact make a difference to the overall tax burden. Therefore, in the Columbus Container Services case, the German legislation cannot lead to a fragmentation of the internal market (see also under 3.2), while in the OESF case it can.

My overall conclusion is therefore that on the face of it the D and OESF cases would appear to be at odds with the Columbus Container Services case. However, Columbus Container Services is a special case, because the internal market cannot be fragmented as a result of the German legislation. Finding 51 of the Columbus Container Services case may
therefore have to be interpreted in light of the facts of this case and the fact that the CJEU did not intend it to be a green light for Member States to treat two cross-border situations differently.

4.4 Test Claimants In Class IV Of The ACT Group Litigation

The last case I will discuss is the Test Claimants in Class IV of the ACT Group Litigation. At issue in this case was the UK Advanced Corporation Tax ("ACT"). Under the ACT, the company distributing the dividend makes an advance payment of the mainstream corporation tax payable on the value of the dividend distribution at the time the dividend is distributed. I would like to stress that the ACT is therefore not comparable to Dutch dividend withholding tax, given that it is the company distributing the dividend that owes the ACT. A UK resident company that receives these dividends is subsequently entitled to a tax credit in respect of the ACT paid by the company distributing the dividends, which it can deduct from the ACT it must pay when distributing dividends itself. Finally, an individual resident in the United Kingdom can deduct the ACT paid by a UK resident company from the amount of personal income tax due. This regime provides for the profit to be taxed only once at the various companies, and personal income tax is only levied on the shareholder/individual if it exceeds the tax credit.

Non-resident companies or individuals receiving dividends are only entitled to a tax credit pursuant to a tax treaty if the company or individual has to pay UK income tax on a dividend received from a UK resident company. The applicable tax treaty will determine which conditions apply to the tax credit, and the right to a full or partial refund is dependent on the tax rate that the UK can apply under the tax treaty. The treaty with the Netherlands also includes an LOB provision to avoid a Dutch company being interposed in order to obtain the tax credit. The tax credit will not be granted to Dutch companies owned by a company that would not be entitled to a tax credit.

With regard to the distinction made between resident shareholders entitled to a tax credit and non-resident shareholders not entitled to a tax credit, the CJEU ruled – to put it very simply – that it is up to the State of residence and not the Source state to grant a tax credit (see in particular Findings 56–72). According to the CJEU, as far as the Source state is concerned, the resident and non-resident shareholders are not, in principle, in a comparable situation. The CJEU subsequently deals with the distinction made between foreign shareholders depending on whether or not there is a tax treaty and the conditions applicable. The applicants in the proceedings explicitly emphasized that some tax treaties provide for a tax credit, while others do not (Finding 82); therefore they are critical of this difference in tax treaties. In Finding 83 the CJEU notes that in order to assess whether this different treatment is discriminatory it will need to be determined whether the non-residents in question are in an objectively comparable situation. I consider this to be a further acknowledgment of
the fact that MFN is not, in principle, permitted (unless it involves situations that are not objectively comparable). The CJEU reiterates its comments in the D case – that the scope of a tax treaty is limited to the individuals/legal entities referred to in the treaty. In contrast to the D case (see section 4.5 below), the CJEU subsequently explicitly addresses the question whether the tax credit is, in effect, an integral part of a tax treaty, or a benefit that is an inseparable part of that treaty. The CJEU concludes that the granting of a full or partial tax credit is indeed an integral part of the tax treaty and contributes to its overall balance (Finding 88). It thereby takes into account the fact that the granting of a full or partial tax credit is dependent on the UK being able to tax the dividend (Finding 85); the conditions under which a tax credit is provided vary according to the particular characteristics of the relevant national tax systems, the negotiation period, etc. (Finding 86) and in accordance with the relationship between the amount of the tax credit and the tax rate the UK can apply (Finding 87). The UK receives a reciprocal benefit for the benefit it grants, i.e., this appears to be indeed the result of treaty negotiations. Finally, the CJEU regards the LOB provision in the treaty with the Netherlands as a condition inseparable from the rest of the treaty (Findings 88–91).

4.5 The D And OESF Cases Compared With The Test Claimants In Class IV Of The ACT Group Litigation

What the D, OESF and Test Claimants in Class IV of the ACT Group Litigation cases have in common is that they all acknowledge that MFN is indeed contrary to the fundamental freedoms in objectively comparable cases. The problem in comparing this case law is the Test Claimants in Class IV of the ACT Group Litigation case explicitly looks into whether the relevant benefit is, in effect, an integral part of the tax treaty, while the OESF and D cases do not.

I have no doubt about the reason why the CJEU ignored this in the OESF case: the fact that an FBI may be entitled to a refund of withholding tax is not based on a tax treaty, but on a unilateral decision on the part of the Netherlands. According to the CJEU, the reason the OESF case does not involve objectively comparable situations is not due to a benefit that contributes to the balance of a tax treaty, but rather because the objective of the national rules (ensuring that the tax burden in cases of direct investment is the same as it would be if investment takes place through an FBI) means that the situations are not objectively comparable.

In contrast, the D case does involve a treaty provision. Consequently, the CJEU concludes that the situations are not objectively comparable, because the relevant benefit is an integral part of the treaty. Other than in the Test Claimants in Class IV of the ACT Group Litigation case, the D case did not explicitly deal with the differences between the various treaties. The questions posed by the referring court relate primarily to the distinction between a Belgian and another foreign taxpayer, and not to the differences between the treaty with Belgium (includes a deduction entitlement) and the treaty
with Germany (no deduction entitlement). It is therefore less likely that the CJEU would address the question whether the benefit is in fact related to the tax treaty. However, in the Test Claimants in Class IV of the ACT Group Litigation case, the referring court explicitly raises the issue of treaty differences (the entitlement to a tax credit is completely absent in some treaties, while other treaties provide for a partial entitlement, and still others for a full entitlement). As stated above, Finding 82 notes that these differences were also highlighted by the applicants. Consequently, in Finding 83 the CJEU considers whether such differences are discriminatory. Another explanation could be that the case concerned a non-discrimination provision (and is therefore reciprocal) and the Test Claimants in Class IV of the ACT Group Litigation case a unilateral benefit granted by the UK (tax credit). However, I consider the latter explanation to be lacking: the CJEU did not review whether this provision gave Dutch citizens an actual entitlement to certain Belgian personal tax deductions. Although this is probably the case, it is also hard to believe that a Member State would just give away an unilateral benefit.

5 Conclusions

All things considered, my review of the above case law leads me to the following conclusions:

(1) MFN is contrary to the fundamental freedoms in those cases involving objectively comparable situations.

(2) If the distinction between two cross-border situations is based on a provision in a tax treaty, then this does not, in principle, involve objective comparable situations (and is therefore not contrary to the treaty freedoms), because the treaty benefit is an integral part of the treaty and contributes to its overall balance.

(3) However, if the differences between the various tax treaties is explicitly questioned (one treaty grants a benefit, while the other only grants a partial benefit), the CJEU will consider whether the benefit is, in effect, an integral part of the treaty (is it separable from the treaty or is it the outcome of treaty negotiations?).

(4) If a benefit is granted on the basis of national legislation, in conjunction with a tax treaty, this can (involve cases that are not objectively comparable, depending on the objective of the rules).

As regards conclusion 4, I expect that the intent of the rules can mean that objective comparability is absent, even in those situations that are not related to a tax treaty. The conclusion of the CJEU in the OESF case reflects this in that it is based on the objective of the unilateral Dutch legislation. The CJEU explicitly concluded that – contrary to the D case – the tax treaty did not automatically apply, so that it also cannot be argued that the benefit in question was an integral part of the treaty: this is therefore not a decisive factor. The decisive factor is the intent of the rules, of which the right, whether or not present in a tax treaty, to a credit in respect of direct investments is but a part.
If it is accepted that EU law does create an obligation for MFN treatment, the question that then arises is when are two cross-border situations objectively comparable? That this needs to be assessed is obvious, given that the less favorable treatment accorded to a cross-border situation in comparison to a domestic situation is only contrary to treaty freedoms if the situations are not objectively comparable. The rule is, after all, that comparable cases must be treated equally. As stated above, objective comparability as it relates to MFN treatment is not present if the MFN treatment is based on a tax treaty (an exception could be if the allocated benefit is not a result of negotiations). The next question that arises is to what extent are these two situations comparable if this involves unilateral MFN treatment? My first inclination would be to argue that, as a rule, comparability between domestic and cross-border situations on the one hand, and two cross-border situations on the other, should be assessed on the same basis.\(^{49}\) The problem is that the CJEU does the opposite in cases involving treaty law, as the Saint Gobain case would appear to indicate.\(^{50}\) In this case, the CJEU ruled that the permanent establishment of a foreign company was also entitled to the international participation exemption allocated to a domestic company on the basis of a tax treaty with a third country. The CJEU concluded that the distinction between the domestic and foreign taxpayer was not relevant in this case: both the dividends received by the permanent establishment and those received by domestic companies were taxed in Germany (Finding 47). With regard to the treaty argument, the CJEU concluded in Finding 5g:

As the Advocate General points out in point 81 of his Opinion, the obligations which Community law imposes on the Federal Republic of Germany do not affect in any way those resulting from its agreements with the United States of America and the Swiss Confederation. The balance and the reciprocity of the treaties concluded by the Federal Republic of Germany with those two countries would not be called into question by a unilateral extension, on the part of the Federal Republic of Germany, of the category of recipients in Germany of the tax advantage provided for by those treaties, in this case corporation tax relief for international groups, since such an extension would not in any way affect the rights of the non-member countries which are parties to the treaties and would not impose any new obligation on them.

Despite the fact that both the D and Saint Gobain cases concerned the extension of a treaty benefit to a taxpayer to which the treaty had not originally applied, the CJEU concluded differently. In the D case, the CJEU ruled that the Belgian and German taxpayers were not comparable, because the rights and obligations only applied to individuals who were covered by the treaty and the relevant benefit formed a part of the overall balance of the treaty. In contrast, in the Saint Gobain case the CJEU regarded the permanent establishment of a foreign company and a domestic company as comparable for no other reason than the fact that the income in both cases was taxed in Germany. Had the CJEU examined, on the basis of treaty law, the comparison between domestic cross-border situations and two cross-border situations in the same way as in Saint Gobain, it would have had to conclude in the D case that the Belgian and the German taxpayers were objectively comparable because their assets were taxed in the Netherlands.\(^{51}\) Van Thiel also notes that it makes very little difference whether a business is carried on in another Member State through a permanent establishment or through the acquisition of
real estate.$^{52}$ As Van Thiel suggests, it is possible that the different conclusions reached in the D and Saint Gobain cases were due to the fact that the CJEU was weary of the chaos that might arise in treaty networks if a Member State had to extend the scope of a treaty concluded with one Member State to another Member State. Marres has attempted to provide a legal explanation for the difference between the D and Saint Gobain cases.$^{53}$ In his opinion, the scope of treaty benefits cannot be set arbitrarily: an arbitrary distinction is made if a resident and a permanent establishment are taxed in the same way (and are therefore comparable), but the latter is not entitled to treaty benefits (Saint Gobain). However, this does not mean that Member States have to extend the treaty benefits laid down in a treaty with country A to residents of country B (i.e., the German D), given that the scope of the treaty with country A was not arbitrarily laid down.

In my opinion, it cannot be conclusively argued that the objective comparability between two cross-border situations – in cases where national law makes a distinction – can be assessed in the same way as the comparability between a domestic and a cross-border situation.$^{54}$ If that is the case, then the objective comparability of, for example, the exemption/credit of profit tax in respect of incoming dividends, must be assessed in light of the objective of the rules (the avoidance of economic double taxation).$^{55}$ This would mean that the national law of EU Member State A would not be allowed to include a provision prohibiting the credit of profit tax imposed on dividends received from EU Member State B, while this would be possible in respect of dividends received$^{56}$ from Member State C. In this respect, of importance with regard to outgoing dividends is whether Member State A taxes the dividends distributed to both Member State B and Member State C; if that is the case, the tax levied on outgoing dividends must not be higher than that levied on outgoing dividends to Member State C, etc.$^{58}$ The question that must subsequently be answered is whether it is justified or appropriate, etc. Finally, I would like to note that, it is also self-evident considering the objective of the treaty freedoms that unilateral MFN treatment is required as would otherwise become completely fragmented.

6 In Conclusion

In this article, I have reviewed whether EU law obliges a Member State to enact unilateral most Favored nation treatment, thereby focusing on CJEU case law on direct taxes. My conclusion is that this case law does appear to oblige Member States to enact unilateral most Favored nation treatment. I believe this to be justified, given that the objective of the treaty freedoms is the creation of a barrier-free internal market. Of importance is that two cross-border cases must be objectively comparable: at issue is the fact that two comparable situations are treated differently, be they a domestic and cross-border situation or two cross-border situations. However, it remains uncertain whether this objective comparability should be determined in the same way that the CJEU determines whether a domestic and cross-border situation are objectively comparable. Future CJEU case law will have to provide the answer.
ENDNOTES

1  CJEU July 5, 2005, case no. C-376/03 (D).
2  CJEU December 12, 2006, case no. C-374/04 (Test Claimants in Class IV of the ACT Group Litigation).
3  The question is relevant for the Dutch 30 percent ruling. The Supreme Court recently requested the CJEU for a preliminary ruling on whether the 30 percent ruling complied with EU law (Supreme Court, August 9, 2013, case no. 12/05577). However, this article will deal with MFN in general.
4  Prior to the judgment in the D Case, the professional literature had drawn the conclusion from the Bachmann and Schumacker cases that EU law did not oblige MFN treatment. (Bachmann, CJEU January 28, 1992, case no. C-204/90; cf. E. Kemmeren, "The termination of the 'most favorite nation provision' dispute in tax treaty law and the necessity of a Euro Model Tax Convention," EC Tax Review Vol. 6 (1997), no. 3, p. 146); Schumacker, CJEU February 14, 1995, case no. C-279/93; cf. W.A. Vermeend, H.A. Kogels and H. Mees, Europees belastingrecht, third reprint, Deventer: Kluwer 2002, p. 81. However, various authors (Graaf, Weber, and Cordewener) have argued that such a conclusion cannot be drawn from these cases. I take the same position and refer thereby to the latter authors (cf. D.M. Weber, "Het niet stellen van prejudiciële vragen: gooit de Hoge Raad de sleutel voor de interne markt weg?," WFR 1998/223; S. Wolvers, "Belastingverdragsrechtelijke meestbegunstiging binnen de EG," WFR 2005/551 and A.C.G.A.C. de Graaf, "Nationale behandeling, horizontale discriminatie en meestbegunstiging. Wat betekent de uitkomst in de zaak D?," MBB 2005/12.01). The Gilly case (CJEU May 12, 1998, case no. C-336/96) provides at most a few clues as to how the CJEU would rule (cf. also De Graaf, loc.cit.).
6  Cf. for example S. van Thiel, "A Slip of the European Court in D case (C-376/03): Denial of the Most-Favored-Nation Treatment because of the Absence of Similarity?,” Intertax Vol. 33 (2005), no. 10.


According to this interpretation, the general non-discrimination provision applies where a situation is, in principle, covered by a fundamental freedom, but where the fundamental freedom does not prohibit discrimination between two cross-border cases (therefore, this aspect is in effect not covered by the specific fundamental freedom).

CJEU, August 11, 2005, joined cases C-367/93 through C-377/93 (*Roders Bv*).


CJEU, September 27, 1988, case no. C-235/87 (*Matteuci*).

CJEU, January 15, 2002, case no. C-235/00 (*Gottardo*).


CJEU, September 12, 2006, case no. C-196/04 (*Cadbury Schweppes*).

The UK legislation provided for a number of exceptions where the CFC legislation did not apply. This is not discussed in more detail in this article.

Advocate General Leger also argued that the fact that different tax rates applied in the countries where the subsidiaries were established was not enough in itself to justify regarding these two companies as being objectively different: this would lead to results completely at odds with the concept of an internal market (see the opinion of Advocate General Leger dated May 2, 2006, Finding 79 and 80).


This would also be the case in the French and English translations.

CJEU December 6, 2007, case no. C-298/05 (*Columbus Container Services*).

See J.L. van de Streek, "De nieuwe deelnemingsverrekening: verhouding tot Europees en internationaal belastingrecht (deel I)," *WFR* 2007/649.


Paradoxically, the CJEU based its conclusion on the fact that applying the credit method to foreign partnerships results in the income of foreign partnerships being taxed at the same rate (30 percent) as the income of domestic partnerships. Given that what is at issue here is *juridical* double taxation, I consider that the CJEU could (in line with, for example, *Kerkhaert Morres*) have sufficed by noting that the income of the foreign partnership is not taxed differently at the German participants, which makes crediting unnecessary. The above mentioned consideration of the CJEU is,
however, similar to case law on the avoidance of economic double taxation (cf. for example CJEU 12 Dec. 2006, case no. C-446/04 (FII in the Test Claimants Group Litigation)). Cf. the editorial in V-N 2007/59.8. 

28 Cf. for example CJEU December 12, 2006, FII in the Test Claimants Group Litigation, Finding 45, infra.


Based on the Schumacker case (CJEU February 14, 1995, case no. C-279/93) it is, in principle, up to the State of residence to take account of personal deductions, unless the taxpayer earns his/her income almost entirely in the Source state and his/her income in the State of residence is negligible, so that this State is not in a position to grant him the benefits resulting from the taking into account of his personal and family circumstances. CJEU May 12, 1998, case no. C-336/96 (Gilly).

33 CJEU May 12, 1998, case no. C-336/96 (Gilly).

34 CJEU, September 21, 1999, case no. C-307/97 (Saint Gobain).


36 CJEU May 20, 2008, case no. C-194/06 (Orange European Small Cap Fund NV).

37 The CJEU reaches the same conclusion in the Bujara case (CJEU October 27, 2005, case no. C-8/04), which concerned the Dutch Box 3 tax. At issue was the fact that the non-discrimination provision in the Netherlands-Belgium tax treaty gave a Belgian the right to tax-free capital, while this right was not available to a German. I do not consider it necessary to discuss this case here, given that the CJEU’s conclusion in this case is almost identical to that of the D case.


40 There was also an option to credit, subject to conditions, pursuant to Sec. 25 Corporate Income Tax Act 1969.

41 Strictly speaking, this is not double taxation, because the FBI is subject to a zero tax rate. Nevertheless, it is about the FBI being a taxpayer for foreign withholding tax purposes and therefore as such not about the crediting/refund of profit tax paid by the company distributing the dividends. Moreover, the rules relate to the avoidance of juridical double taxation in respect of shareholders who make direct investments.

42 The CJEU assumed that the refund of dividend withholding tax effectively boils down to the fact that the FBI is exempt from dividend withholding tax (cf. also Findings 85 and 86 of the Advocate General as referred to by the CJEU). The Netherlands argued that an actual dividend withholding tax exemption would involve too many administrative problems and that is why the current rules were created (see n. 28, Advocate General’s opinion).

CJEU December 12, 2006, case no. C-374/04 (Test Claimants in Class IV of the ACT Group Litigation).

The individual for whom the ACT payable exceeds the amount of personal income tax payable is even entitled to a refund.

Unless the Source state taxes the dividends received (Finding 68).

For a more detailed explanation please refer to P.J. Wattel's commentary on this judgment, BNB 2007/131.

The referring court also explicitly requested that this issue be addressed (Finding 29).

Assuming case law on objective comparability provides the appropriate basis for such comparisons: for example, the case law on Schumacker concerning personal deductions can only be used as a basis for comparing residents and non-residents.

CJEU, September 21, 1999, case no. C-307/97 (Saint Gobain).

This is less evident in the Test Claimants in Class IV of the ACT Group Litigation case, because the entitlement to a credit depended in part on whether, and to what extent, the UK taxed the dividends received by the foreign companies.


To the extent covered by case law (see also footnote 47).

As, for example, in Manninen (CJEU September 7, 2004, case no. C-319/02, Findings 33-37) and Meilicke (CJEU 6 Mar. 2007, case no. C-292/04, Findings 29–30).

This could also involve a disguised distinction, whereby the opportunity for a credit is dependent on the profit tax rate at the level of the dividend distributing company.

If the free movement of capital is applicable, this could obviously involve a third country.

Topical News Briefing: BEPS At The Crossroads
by the Global Tax Weekly Editorial Team

You’d think, given that the OECD has just released its first set of recommendations on how to change the world’s corporate tax rules, there’d be plenty to write about here. In fact, the 2014 "deliverables" package was a rather underwhelming way for the OECD to mark the half-way point of its base erosion and profit shifting (BEPS) initiative, and, if anything, underlines how much it has to do in what seems to be an impossibly short amount of time.

In fact, out of the seven reports released by the OECD on September 16, only four, relating to Actions 2 (hybrid mismatch arrangements), 6 (treaty abuse), 8 (transfer pricing and intangibles) and 13 (transfer pricing documentation), contained any recommendations at all, and these were hardly revelatory, basically rehashing the matters that had been discussed in the various consultation documents and discussion drafts. On Actions 1 (digital economy) and 15 (a multilateral instrument), final reports were delivered by the OECD, while on Action 5 (harmful tax regimes), a mere interim report was published.

The most concerning thing is that the OECD has deferred the publication of recommendations on the future taxation of the digital economy until next year, because it is impossible to make any definitive conclusions about it until other Actions are considered. Since digital tax issues are intertwined with so many other aspects of the BEPS project, this is not surprising. At the same time though, it is the rise of the digital economy, where traditional tax concepts like residence and permanent establishment have absolutely no relevance, that goes to the very heart of BEPS. And the OECD’s admission that more time is needed to examine proposals that could fundamentally change the international tax landscape just shows how ludicrously optimistic it is to expect everything to be wrapped up by December next year. And this is only going to be the beginning. We don’t really know yet when governments will be expected to have their tax systems aligned with the BEPS recommendations, but presumably it’s not going to happen overnight. And fears that governments will act on the recommendations unilaterally, or not at all, which could render the whole project a pointless exercise, have more or less been swept under the carpet by the OECD.

The OECD has, however, received praise from some sections of the business and advisory community for its BEPS work. Better for corporate tax planning that the Organization acts, rather than threatens to act, they say. On the other side of the coin, the release of the first batch of deliverables has only reinforced the view among critics of BEPS that uncoordinated action will make matters worse, while BEPS could also reduce tax competition by enforcing a "high-tax" agenda onto low-tax countries.

Possibly the most worrying thing for the OECD though is the hostility that BEPS is generating in
the United States, whose support for the project is going to be vital if it is going to work. Naturally, the Administration of President Obama, which has pursued aggressive anti-avoidance policies, is backing the OECD, and probably most Democrats in Congress would fall into line behind the Government. The Republicans however are never going to vote for tax changes foisted on the US by foreign powers, especially as they are designed to raise revenue. Indeed, key figures in the GOP have already spoken out against BEPS. The US business lobby has also shown itself to be very hostile towards the aims of the project. Not that this is likely to deter the OECD, but we could be about to enter a very uncertain period for cross-border business and investment.
FATCA... And Pensions?!?! No Rest For The Weary
by Kimberly Tan Majure and Monica L Zubler

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This article represents the views of the authors only, and does not necessarily represent the views or professional advice of KPMG LLP. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Introduction
By now we have heard quite a bit about FATCA: how FATCA is an information reporting rule (not a tax); how it can affect both financial and nonfinancial companies (though not necessarily to the same extent); and how the potential cost of noncompliance is a 30 percent penalty. You have marshaled company resources, created and delegated a multitude of work streams, and scrubbed the assets, income and activities of your global group. And just when you think you may finally have a handle on tracking your payments and documenting payees, and right as you are finalizing your payee classifications ... you hear something about FATCA and foreign pension funds.

Your reaction may resemble the various stages of grief – denial, anger and bargaining with higher powers.

Well, you are not alone. It’s hard to imagine why a regime dedicated to unearthing offshore tax evasion by high net worth US individual taxpayers would care about your Malaysian (or any other foreign) pension plan. In many ways, these two scenarios – hidden offshore financial accounts and foreign pension plan benefits – are worlds apart. But, as you know by now, FATCA casts a very broad net. And for better or worse, this reach includes foreign pension plans. Can foreign pension plans possibly avoid the brunt of the FATCA rules? Yes, because when it comes down to it, US and foreign governments acknowledge that pension and retirement funds are special cases. The limited participation, regulatory oversight, and various contribution and distribution restrictions make foreign pension plans less than ideal as tax evasion vehicles. As a result,
the FATCA regulations and various FATCA Inter-
governmental agreements ("IGAs") contain carve
outs for various types of foreign pension plans.

As with all sets of new rules, there are gaps between
concept and reality – including the basic assump-
tion that companies understand FATCA’s relevance
to their foreign pension plans. Given that, and the
widespread confusion we are seeing in this area, we
thought the most effective way to have a FATCA-and-
pensions discussion would be to highlight the relevant
issues in a series of FAQs. Below we address the most
common, though by no means the only, questions
that arise on the FATCA and pensions front.

**How does FATCA apply to my company’s foreign
pension plans?** Well, consider a typical structure
for a pension plan. An employer and/or employee
participants contribute funds into an entity – fre-
quently a complex trust – that invests these funds
in financial assets for the ultimate benefit of the
participants. Investment returns build in the entity,
sometimes within a lower level investment entity,
and are used to fund future distributions to plan
participants. At a high level, then, a foreign pension
plan is a collective investment vehicle. Which un-
der FATCA is generally considered a foreign finan-
cial institution (an "FFI"). Which sits right in the
eye of the storm as far as FATCA is concerned. Like
other FFIs, unless an exemption applies, a foreign
pension plan will need to register as a participating
FFI and satisfy due diligence and annual reporting
requirements in order to avoid the 30 percent pen-
alty on its US investment returns.

Once we make contributions to the pension plan,
the assets are entirely off balance sheet and we
have no ownership interests in the plan entity.
For that matter, we hire professional plan admin-
istrators to take care of everything. So why this
my concern? Imagine this scenario: Your foreign af-
fliate establishes a pension fund for its employees.
The fund invests in US assets, including US equities.
In preparation for a dividend, the issuer’s transfer
agent contacts the fund and requests information re-
garding its FATCA status (e.g., on an IRS Form W-
8BEN-E). The trustee, confused, ignores the request.
The transfer agent responds by treating the fund as a
non-participating FFI and withholding 30 percent
of the dividend amount. Maybe the fund is located
in a jurisdiction without a US tax treaty and, con-
sequently, is unable to file a claim for refund. Or
maybe the fund could claim tax treaty benefits but
won’t receive interest with its refund check. Either
way, the fund is worse off than it would have been
had the trustee not ignored, or being unable to com-
ply with, the transfer agent’s request.

How long do you think this can go on before your
foreign pensioners start asking questions? And how
long do you think your company can avoid respon-
sibility for the answers?

You will want to check with legal counsel, but as
a general matter, this scenario is what gets compa-
ies thinking about FATCA compliance for their
pension funds. Not all companies may feel it nec-
essary to take on the responsibility of FATCA clas-
sification for the funds. (After all, employers can be
significantly removed from the facts necessary for determining FATCA status.) However, companies may at least want to check in with their trustees or fund administrators, to ensure that FATCA classification is being considered at the fund level.

I have no US participants in my foreign pensions. Why is FATCA an issue? This is an issue because FATCA does not turn on or off based on whether an FFI has US account holders. FATCA requires FFIs to conduct due diligence with respect to all substantial account holders and determine their FATCA status, then report certain accounts. It simply doesn’t matter whether the foreign pension fund in fact has any US beneficiaries; what matters is that the pension fund engages in the necessary due diligence to identify any potential US beneficiaries. It’s the process – more than the end result – that counts for avoiding the 30 percent penalty.

Do I have to classify all of my company’s foreign pension plans? No. First, not all plans involve entities, and FATCA classification is relevant for entities. Plans involving accounts established with a broker, bank, life insurance company, or other financial institution (e.g., a retirement plan featuring accounts similar to US-style Individual Retirement Accounts), where the employer has no responsibility or liability beyond making contributions into the accounts, are not themselves classifiable. On the other hand, the financial institutions maintaining the retirement accounts are classifiable; they are likely to be registered as participating FFIs, and the retirement accounts they maintain may be subject to FATCA due diligence and reporting requirements. But the retirement accounts themselves generally don’t need to be classified unless they have features that would cause them to be treated as entities for US tax purposes (a fact pattern which, though uncommon, does occur).

Secondly, some countries prohibit pension funds from investing in offshore assets. Those pension funds simply won’t be exposed to the 30 percent penalty for noncompliance with the FATCA rules. In fact, unless their jurisdictions enter into IGAs that somehow make FATCA status relevant to them, the only reason those pension funds may need to determine their FATCA status is if asked by their own banks or financial intermediaries (likely fulfilling their own FATCA obligations). Be sure you understand whether a fund’s investment restrictions are permanent. Some restrictions originate at the fund level, and may be modified by the trustees at some point in the future. You will want to have plenty of notice if that day comes, so you can ensure that late-blooming FATCA issues are appropriately addressed.

Finally, not all contributions are made to entities over which your company will have any control. Take, for example, provident plans administered by a foreign government. Generally, employers will have little, if any, control over or even communication with the plan administrators. In that case, certain employers may feel safe leaving responsibility for a fund’s FATCA classification to the government administrators. 5
Don’t the FATCA regulations exempt foreign pension plans? Yes, that’s the idea. The FATCA regulations are meant to exempt foreign pension plans that meet generic parameters that, on a broad basis, reflect the features of U.S.-style plans. The regulations provide several specific exemptions that fall into two general buckets – exemptions based on the legal status of the plan, and those that are based on specific factual features of the plan.

The legal status bucket includes retirement funds that are U.S. tax treaty-benefited and funds that are formed pursuant to a plan similar to a section 401(a) plan (except for being foreign). Sound easy? Maybe, but maybe not. Not all US tax treaties permit pension funds to access treaty benefits; a tax treaty must include pension funds both within the definition of "resident" and the limitation on benefits provisions. In addition, demonstrating a foreign pension plan’s equivalence to a U.S. Section 401(a) plan may prove tricky in the absence of an IRS determination letter on the issue.

Plans not having treaty-benefited or 401(a)-equivalent status must turn to the fact/feature-based exemptions. The first two – for "broad" and "narrow" participation funds – apply based on the number of plan participants (any number for broad participation funds but fewer than 50 for narrow participation funds, so there is some overlap). At a high level, both exemptions focus on how the funds operate, although the two exemptions have slightly different requirements. Factors common to both include, but are not limited to, the following:

- Was the fund established to provide retirement, disability or death benefits to employees, former employees and their survivors?
- Is the fund subject to local regulation as a pension or retirement fund?
- If subject to local regulation, is the fund required to perform annual tax (not labor, etc., but tax) reporting with respect to beneficiaries?
- Are contributions limited by reference to earned income and compensation of the employee?
- Does the fund have beneficiaries entitled to significant distributions (based on a threshold percentage of the fund’s assets)?

A word of caution here: The various requirements appear to be formulated with defined contribution plans in mind, and it can be awkward applying them to defined benefit plans. (For example, how do you know whether a DB plan features contributions limited to employees’ earned income?) You may want to bring in a benefits specialist to help with the "translation" issues.

In addition to these carve outs, the regulations exempt investment vehicles that are established exclusively to earn income for the benefit of one or more retirement funds provided those retirement funds qualify for one of the exemptions described above; investment vehicles of entities or accounts otherwise blessed by an applicable IGA or the FATCA regulations; and retirement and pension funds of an "exempt beneficial owner" (e.g., a foreign government or international organization).
Are these exemptions "set and forget"? Very little, if anything, about FATCA is set and forget. Exemptions based on legal status, while not entirely worry-free, tend to be fairly reliable on a long-term basis. On the other hand, the feature-based exemptions may require some monitoring. For example, a fund with 40 plus participants should be monitored to ensure it doesn’t slip undetected out of the narrow participation exemption and need to be retested under the broad participation rules. In addition, we have seen a number of funds that fail or come close to failing the distribution requirements in a given year. Consider, for example, funds established in countries with relatively weak job markets, where executive participants may have higher compensation and lengthier tenures – and, consequently, significant pension distribution rights – as compared to other employees. So as you go through your pension fund analysis, we would recommend flagging the exemptions that may need a longer term look.

There is an IGA in effect where my pension fund operates. Does that fix things? Not exactly. It is true that an IGA can substantially expedite the exemption analysis. That’s the whole point of the IGAs. But getting there isn’t always easy.

Annex II of each IGA contains an IGA-specific list of local entities that will be considered "exempt beneficial owners" of FATCA payments, including forms of exempt retirement plans. The exemption requirements can, however, vary greatly from IGA to IGA. In some cases, Annex II will exempt funds established pursuant to specific local statutes. Annex II of the US–Belgian IGA, for example, includes an exemption for Belgian savings funds established under Article 145/16 of the Belgian Income Tax Code of 1992.

In other cases, e.g., Annex II of the US–Canada IGA, the IGA piggybacks off definitions incorporated in an income tax treaty the country has signed with the United States. And, increasingly in more recently signed IGAs, the Annex II pension provision may come full circle, merely restating certain tests (typically including the broad and narrow participation exemptions) from the FATCA regulations. In any case, while it is certainly worth starting your analysis with a review of a relevant IGA, don’t count on an IGA always making the determination easier.

Do I need to worry if I have a foreign investment entity owned by a US master trust? Oddly, yes. As strange as it seems, a U.S.-owned foreign investment entity falls outside the scope of the exemptions. While, as discussed above, there are exemptions available for foreign investment entities owned by, e.g., 401(a)-equivalent foreign funds, nowhere do the FATCA regulations contemplate investment entities owned by actual 401(a) funds. This may be a simple oversight, but unless the IRS issues clear guidance exempting these foreign investment entities, there is a risk that the entities may need to register as participating FFIs.

Once the fund registers as a participating FFI, am I done? Not so fast. Participating FFI status
triggers fund-level due diligence obligations and reporting requirements that may require coordination among multiple parties. Although the funds have very basic information regarding the beneficiaries – names, basic contact information, data related to contributions and distributions, they may not have sufficient information to determine a beneficiary’s tax residence. In all likelihood, the person with more access to information regarding the employees, former employees, and their survivors is … the employer. Consequently, the success of a pension fund’s FATCA compliance program on a going-forward basis could rely heavily on cooperation between the pension fund and the employer.

One thing that might help facilitate communications between the foreign fund managers and the employer: When a foreign pension fund registers with the IRS, it must designate a Responsible Officer as a primary contact with the IRS. It may also identify up to five additional points of contact (“POC”) who will receive copies of IRS correspondence. Make use of the POC option, to ensure that trustee(s), fund administrators, at least one person at the employer level (e.g., from the human resources department), and someone from the US tax group is kept in the loop.

**What is the practical deadline for registering non-exempt pension funds as participating FFIs?** With some exceptions, Notice 2014-33 effectively delays the start of FATCA withholding from July 1, 2014, to January 1, 2015. Let’s assume that the pension fund could receive its first withholdable payment on that date. As in the example discussed above, transfer and other withholding agents will need to determine the identity and FATCA status of foreign payees in advance of payment. The most current list of participating FFIs the agent would have available (to validate any Forms W-8BEN-E on which the filer is claiming participating FFI status) would be issued by the IRS at the beginning of December. It will take time – let’s assume about a month – for a newly registered participant to appear on the IRS’s list. Although some of these factors could change, e.g., there could be shorter lead time for registering an FFI that would appear on the December 2014 list of participating FFIs, this logic results in a practical deadline of early November 2014.

Now you have a brief overview of what is hopefully your final FATCA work stream. As you roll up your sleeves and begin sorting through your company’s pension plans, make sure you build in plenty of time. Because you are dealing with internal and external contacts in far flung reaches of the world, you will need to factor in the challenges created by disparate time zones and language differences, and the difficulties of translating convoluted FATCA requirements into understandable chunks for a non-tax audience. You will eventually get there, but – like all things FATCA – don’t count on a straight and easy path to completion.

This article represents the views of the authors only, and does not necessarily represent the views or professional advice of KPMG LLP. The information contained herein is of a general nature and based on
authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax advisor.

ENDNOTES

1 Kimberley Tan Majure and Mathew R. Sontag, FATCA: Myths, Mysteries, and Practical Perspectives, 64 The Tax Executive 4, 315 (Jul/Aug 2012); Kimberley Tan Majure and Christopher Riccardi, FATCA Myths and Mysteries (Part 2), 65 The Tax Executive 2, 101 (May/June 2013).

2 Treas. Reg. section 1.1471-3(f)(4) provides that a withholding agent that cannot reliably associate a valid withholding certificate or valid documentary evidence sufficient to determine the chapter 4 status of the entity receiving a payment must presume the entity is a nonparticipating FFI.

3 Treas. Reg. section 1.1474-5(a)(2).

4 Id.

5 Be careful not to confuse government "mandated" funds (i.e., funds required by foreign law but privately administered) with government "administered" funds that are both mandated and government-run.

6 Treas. Reg. section 1.1471-6(f)(1).

7 Treas. Reg. section 1.1471-6(f)(4).

8 Treas. Reg. section 1.1471-6(f)(2) and (3).

9 Treas. Reg. section 1.1471-5(b)(2)(i)(A); Treas. Reg. section 1.1471-6(f)(5).

10 Treas. Reg. section 1.1471-6(f)(6).

11 Among other entities, Annex II of the US–Canada IGA exempts "[a]ny plan or arrangement established in Canada and described in paragraph 3 of Article XVIII (Pensions and Annuities) of the Convention, including any plan or arrangement that the Competent Authorities may agree under subparagraph 3(b) of Article XVIII is similar to a plan or arrangement under that subparagraph."


13 See 1.1471-1(b)(116).

14 The notice accomplished this by changing the benchmark date of "pre-existing obligations". Consequently, obligations entered into and effective in 2014 are treated as pre-existing, and foreign persons receiving in-scope payments will not need to be documented for FATCA purposes—or subject to FATCA withholding and reporting—until July 1, 2016. In contrast, foreign persons receiving payments on "new" obligations entered into on or after January 1, 2015, will be subject to FATCA documentation, withholding and reporting requirements immediately.

15 This assumption is based on the "safe harbor" deadline for registration, May 5, for participating FFIs to appear on the IRS's list prior to the July 1, 2014, effective date. See IRS Announcement 2014-17, 2014-18 I.R.B. 1001.
OECD Proposes Fixes To Global Tax Rules

The Organisation for Economic Cooperation and Development (OECD), on September 16, 2014, released its first recommendations for "a co-ordinated international response to base erosion and profit shifting (BEPS)."

OECD Secretary-General Angel Gurría said: "The G-20 has identified base erosion and profit shifting as a serious risk to tax revenues, sovereignty, and fair tax systems worldwide. Our recommendations constitute the building blocks for an internationally agreed and co-ordinated response to corporate tax planning strategies that exploit the gaps and loopholes of the current system to artificially shift profits to locations where they are subject to more favorable tax treatment."

Seven "deliverables" have been released, of a total of 15 that will be finalized by December 2015, which aim to:

- Ensure the coherence of corporate income taxation at the international level, through new model tax and treaty provisions to neutralize hybrid mismatch arrangements (Action 2);
- Realign taxation and relevant substance to restore the intended benefits of international standards and to prevent the abuse of tax treaties (Action 6);
- Assure that transfer pricing outcomes are in line with value creation, through actions to address transfer pricing issues in the key area of intangibles (Action 8);
- Improve transparency for tax administrations and increase certainty and predictability for taxpayers through improved transfer pricing documentation and a template for country-by-country reporting (Action 13);
- Address the tax challenges of the digital economy (Action 1);
- Facilitate swift implementation of the BEPS actions through the development of a multilateral instrument to amend bilateral tax treaties (Action 15); and
- Counter harmful tax practices (Action 5).

It was announced that the OECD’s Committee on Fiscal Affairs will consider, in January 2015, a draft mandate for an international conference for the negotiation of a multilateral convention to streamline the implementation of the BEPS Action Plan. This responds to frequently aired concerns that unilateral policies from nations acting in their domestic self-interest could de-rail the success of the BEPS plan.

In an emailed information brief on the proposals, the OECD said implementation of the measures will go a long way in addressing some of the key BEPS challenges. It said that model rules to neutralize hybrid mismatches will put an end to costly multiple deductions for a single expense or deduction in one country without corresponding taxation in another.

Meanwhile, the OECD’s proposed response to harmful tax practices would focus on the
"distortionary influence" of tax on the location of service activities, with progress to be sought on the transparency of tax rulings and also the development of a methodology to assess substantial activity in intellectual property regimes and other preferential regimes.

Treaty shopping and other forms of treaty abuse will be countered by a global agreement that anti-treaty abuse provisions should be included in tax treaties.

Further, Action 8 (on ensuring transfer pricing outcomes are in line with value creation) will seek to apply tax to value creation activities under transfer pricing rules, beginning with a focus on intangibles. A consensus was reached among nations that the artificial shifting of profits to no- or low-tax jurisdictions, for example through cash boxes, "can no longer be tolerated."

The OECD said work on transfer pricing rules will continue, including under Actions 9 and 10, in 2015.

"These measures across seven areas of the Action Plan are an important step forward in fighting BEPS. Viewed together with the 2015 deliverables, and once implemented to double tax treaties and domestic laws, the measures will ensure the coherence of corporate tax systems in a cross-border environment, introduce substance requirements in the area of tax treaties and transfer pricing, and ensure transparency while promoting certainty and predictability," the OECD said.

The BEPS recommendations will be a key item on the agenda when G-20 Finance Ministers next convene on September 20-21, 2014, in Cairns, Australia.

OECD working groups will now focus on the eight remaining Action points, which the OECD has confirmed will be released in September and December, 2014:

- Action 3: on the design of effective controlled foreign company (CFC) rules, to provide countries with tools to tackle the large amounts of untaxed profits booked offshore;
- Action 4: regarding rules that limit base erosion via interest deductions and other financial payments;
- Action 5: to continue work on preventing harmful tax practices, with a specific focus on preferential intellectual property regimes;
- Action 7: on preventing the artificial avoidance of permanent establishment (PE) status – an issue highlighted by the OECD as of particular importance for developing and emerging economies;
- Actions 8-10: on ensuring outcomes from transfer pricing rules are in line with value creation, relating to intangibles, risks and capital, and other high-risk transactions;
- Action 11: on methodologies to collect data and carry out economic analysis on BEPS, including its spillover effects across countries;
- Action 12: on domestic rules requiring the disclosure of aggressive tax planning arrangements; and
- Action 14: to enhance the effectiveness of dispute resolution mechanisms among tax administrations.
US Business Shows Continuing Concern Over BEPS

While there has been little new public comment from leading lawmakers in Congress regarding the first set of recommendations issued recently by the Organization for Economic Cooperation and Development (OECD) on its base erosion and profit shifting (BEPS) initiative, the Business Roundtable (BR) has expressed its concern at the "disproportionate adverse impact" the initiative could have on United States multinationals.

The BR is an association of CEOs from leading US companies with USD7.4 trillion in annual revenues and comprising more than a third of the total value of the US stock market. In a letter to Treasury Secretary Jack Lew on September 18, Louis R. Chênevert, the Chair of its Tax and Fiscal Policy Committee, confirmed that "the US business community has been particularly concerned that the BEPS project risks increasing costs, uncertainty, and barriers to trade and investment, such as duplicative taxation."

While Chênevert appreciated "the Treasury's willingness to listen to the concerns of the business community regarding key issues in the OECD's 2014 deliverables, … the BR is aware that some of the more contentious issues of 2014 have been reserved and that these and a number of other contentious issues remain to be addressed in 2015."

"These issues present the same challenges for the US business community and again risk double taxation, increased compliance costs, and the disclosure of proprietary operating information to competitors," it added, "all of which result in greater uncertainty and lower returns to cross-border business investment."

To increase the likelihood of success, the BR believes it is essential that, for example, "there is a focus on improving dispute resolution mechanisms and obtaining adherence to them by all participants. Better dispute resolution mechanisms are not a panacea, however; the best dispute resolution is clear rules that prevent disputes from occurring."

However, it also particularly recommended that "the release of company specific information provided under country by country reporting [which could obligate corporate taxpayers to disclose data by jurisdiction on their global profit allocation principles in relation to their business activities] is controlled under treaty arrangements to maintain its confidentiality."

Finally, the BR stressed that "the Treasury must bear in mind that the US tax system with its singularly high rate and worldwide system is badly out of line with international norms. Until reform occurs, however, measures aimed at restricting base erosion – e.g. limits on deductions or income inclusions – will have a disproportionate adverse impact on US-based companies and US operations."

In fact, while the Treasury is still negotiating at the OECD, there have been doubts expressed that it could ever agree to an international agreement
that, in the previous words of House of Representatives Ways and Means Committee Chairman Dave Camp (R – Michigan) and Orrin Hatch (R – Utah), the Senate Finance Committee’s Ranking Member, "is now being used as a way for other countries to simply increase taxes on American taxpayers."

While the BR had also seen the BEPS project as "being used by some governments for the purpose of imposing extraterritorial taxes on US business income," Camp and Hatch insisted that "the focus needs to return to BEPS – not on ways foreign countries can raid the American Treasury."

They warned that, "when foreign governments – either unilaterally or under the guise of a multilateral framework – abandon long-standing principles that determine taxing jurisdiction in a quest for more revenue [before a consensus has been reached], Americans are threatened with an un-level playing field. Such actions put pressure on the US Government to respond by asserting taxing authority over foreign activity generating US-source income on similar grounds."

In its September 18 letter, the BR therefore requested that "countries commit to roll back actions they have taken that are inconsistent with the consensus achieved."

G-20 Commits To Progress International Tax Agenda

On September 20-21, 2014, Finance Ministers and Central Bank Governors from the Group of Twenty (G-20) nations met in Cairns, Australia, where they welcomed progress on the Organization and Economic Cooperation and Development’s (OECD’s) base erosion and profit shifting (BEPS) Action Plan and committed to support the completion of its work in 2015.

To ensure that the BEPS work is inclusive, in a communiqué released after the meeting, the G-20 urged the OECD, the International Monetary Fund, and the World Bank Group to engage more deeply with developing countries and report back on these efforts at the G20 Leaders’ Summit, to be held on November 15-16, 2014, in Brisbane, Queensland.

The G-20 agreed to take practical steps to assist developing countries preserve and grow their revenue bases and to stand ready to help those that wish to participate in automatic information exchange. The G-20 also urged the OECD and the World Bank to explore ways to support ongoing efforts to improve the availability of quality transfer pricing comparability data for developing economies.

Next, the G-20 endorsed the global common reporting standard for the automatic exchange of tax information on a reciprocal basis, which, it was said, will create a "step-change" in countries’ ability to tackle and deter cross-border tax evasion. It was agreed that countries should begin exchanging information automatically by 2017, subject to the completion of necessary legislative procedures. The G-20 said the OECD’s Global Forum on Transparency and the Exchange of Information for Tax Purposes should continue to work with international
and regional organizations (and the World Bank in particular) in this regard.

The Global Forum was called on to submit a report in November to its meeting on:

- Progress made by jurisdictions in relation to exchanging tax information on request;
- How the Financial Action Task Force’s work on beneficial ownership has been incorporated into the Global Forum’s standards; and
- A detailed report on the status of commitments by Global Forum members to implement the common reporting standard for automatic exchange of information for tax purposes.

Last, the G-20 urged the OECD to consider tougher penalties on those members that fail to implement the Global Forum’s standards on the exchange of tax information on request. A progress report was requested for 2015.
The OECD's Digital Tax Proposals Explained

The Organization for Economic Cooperation and Development (OECD) on September 16, 2014, released its report on the tax challenges of the digital economy. Of the seven base erosion and profit shifting (BEPS) deliverables released so far, this report is unique in that it deals squarely with both direct and indirect tax matters. It aims to provide a foundation for the development of several other Actions, forming a fundamental element of the OECD’s Action Plan.

At its press conference to announce the first batch of recommendations, the OECD pointed out that the report has received unanimous political backing from all high-level BEPS stakeholders – unlike other deliverables released on September 16; but it is also a work in progress. Many of the recommendations are not final, but they do, meanwhile, provide a glimpse into policymakers’ intentions on what future global tax rules for the digital economy should look like.

A supplementary progress report is to be released in December 2015, to coincide with the completion of the BEPS project. The Task Force on Digital Taxation, after completing its report, will now act in an advisory capacity to other BEPS working groups in the development of their proposals into next year.

Introducing its report, the OECD said: "The spread of the digital economy poses challenges for international taxation [and] because the digital economy is increasingly becoming the economy itself, it would not be feasible to ring-fence the digital economy from the rest of the economy for tax purposes."

"Certain business models and key features of the digital economy may exacerbate BEPS risks. These BEPS risks will be addressed by the work on the other Actions in the BEPS Action Plan, which will take the relevant features of the digital economy into account."

The report is divided into direct and indirect tax segments, which aim, on the one hand, to ensure tax accrues to the location where economic activities are undertaken and value is created, and, on the other, to enable countries to effectively administer goods and services tax/value-added tax (GST/VAT) on goods and services sold or rendered to consumers online.

On the VAT front, the report highlights that very few base erosion and profit shifting issues actually arise with regards to VAT; BEPS issues are generally limited to cases where countries have yet to implement the OECD’s place of taxation Guidelines for business-to-business (B2B) supplies of services and intangibles, the OECD said, and the report therefore recommends that countries adopt this framework.
However, the report acknowledges, more generally, that global tax rules have failed to keep pace with technological advances, and highlights a number of circumstances in which it is presently impossible for countries to effectively administer GST/VAT, regardless of domestic tax frameworks. It says, in particular, that "the collection of VAT in business-to-consumer (B2C) transactions is a pressing issue that needs to be addressed urgently to protect tax revenue and to level the playing field between foreign suppliers relative to domestic suppliers."

VAT rules that were introduced before the advent of the internet provide for concessionary treatment for online suppliers to foreign consumers to the detriment of domestic sellers. These supplies are generally either exempt, if the supply is of low value, or taxed in the place where that supplier is based, under the "origin principle," which has in turn encouraged multinationals to establish operations in jurisdictions with a low rate of, or no VAT.

Meanwhile, on direct tax, the report highlights the importance of tax rules on the digital economy in its work on Action 7 of the BEPS Action Plan (preventing the artificial avoidance of PE Status), as well as several Actions concerning transfer pricing and controlled foreign corporation (CFC) rules.

A resounding message in the whole report is the need for enhanced rules on the taxation of, and allocation of revenues from intangibles. It agrees the urgent need to agree on the characterization of digital supplies for tax purposes, and for policy makers to respond more quickly to new business plans and structures as they emerge.

"Many BEPS structures adopted by participants in the digital economy involve the transfer of intangibles or rights to intangibles to tax-advantaged locations," the report says. "It is then often argued that these contractual allocations, together with legal ownership of intangibles, justify large allocations of income to the entity allocated the risk, even if it performs little or no business activity." These issues will be tackled by measures to resolve issues related to nexus, data, and characterizations, it says.

The report proposes a number of solutions to be further debated and investigated before December 2015, which again can be divided into direct tax and indirect tax matters.

On VAT, the report says the first challenge regarding the collection of VAT arises from the growth that has occurred in e-commerce and, in particular, online purchases of physical goods made by consumers from suppliers in another jurisdiction:

"Countries with a VAT collect tax on imports of goods from the importer at the time the goods are imported using customs collection mechanisms. Many VAT jurisdictions apply an exemption from VAT for imports of low value goods as the administrative costs associated with collecting the VAT on the goods is likely to outweigh the VAT that would be paid on those goods. The value at which the exemption threshold is set varies considerably from
country to country but regardless of the threshold value, many VAT countries have seen a significant growth in the volume of low value imports on which VAT is not collected. Challenges arise from the ability of businesses to deliberately structure their affairs to take advantage of a country’s low value thresholds and sell goods to consumers without the payment of VAT."

The report suggests that: "If tax authorities were to make significant improvements to the efficiency of processing such low value imports and of collecting the VAT on such imports, Governments would be in a position to lower these thresholds and address the issues associated with their operation. This could notably be achieved by requiring non-resident vendors of low value parcels to charge, collect, and remit the tax on the imports of these goods in the importing jurisdiction."

It says: "Compliance by non-resident suppliers with their tax obligations in the country of importation would need to be facilitated through simplified registration and compliance mechanisms, using the possibilities offered by new technologies (for example, online registration and filing, electronic payment)."

"The second challenge regarding collection of VAT," it continues, "arises from the strong growth in cross-border B2C supplies of remotely delivered services and intangibles."

"The digital economy has increasingly allowed the delivery of such products by businesses from a remote location to consumers around the world without any direct or indirect physical presence of the supplier in the consumer’s jurisdiction. Such remote supplies of services and intangibles present challenges to VAT systems, as they often result in no or an inappropriately low amount of VAT being collected and create potential competitive pressures on domestic suppliers."

"The supplies are made mainly to consumers who can access the digital content through their computers, mobile devices, and televisions that are connected to the Internet. If the supplier is resident in the same jurisdiction as its customers, it would be required to collect and remit that jurisdiction’s VAT on the supplies. However, if the supplier is a non-resident in the consumer’s jurisdiction, issues may arise."

Discussing the distortions caused by the origin principle – under which supplies are taxed in the location of the supplier, rather than the consumer – the OECD says countries should look to the destination-based system being rolled out in the European Union to tax B2C sales in the location of the recipient from 2015 and initiatives such as its mini One Stop Shop, which allows for VAT registration and administration in a single country.

The report states: "It is recognized that requiring non-resident suppliers to register and account for VAT in as many foreign jurisdictions as they have consumers of remotely delivered services and intangibles may impose compliance burdens on these suppliers, which may weigh particularly heavily on
small and medium enterprises. Countries should therefore ensure that simplified registration mechanisms are sufficiently clear and accessible, so that non-resident vendors... may easily comply, thereby eliminating the need for registration thresholds.”

"Improved international co-operation between jurisdictions will be required to address these challenges. This should include enhanced exchange of information, assistance in recovery, and simultaneous audits. The Convention on Mutual Administrative Assistance in Tax Matters, which was developed jointly by the Council of Europe and the OECD, also covers VAT matters and provides a useful platform for developing such improved international co-operation."

Concluding its chapter on indirect tax matters, the OECD said that a Working Party in charge of releasing OECD International VAT/GST Guidelines has already begun work with respect to reforming rules on remote digital supplies to consumers. It said that, in parallel to this work, the Working Party will be tasked with addressing issues concerning the exemption for imports of low value goods.

In his opening remarks at the press conference to announce the OECD’s first batch of base erosion and profit shifting (BEPS) recommendations, Ángel Gurría, OECD Secretary-General, said: "We increasingly 'live online;' we shop there, we work there, and many products and services cross borders and oceans without ever touching a physical building. This is the digital world, and we can't ring-fence it. Not in reality, and as our work has found, not for tax purposes either."

"So we've taken a big step forward towards a common stance on this issue: that it is not possible to craft special tax rules for the digital economy."

"This means that the BEPS issues which are exacerbated in the digital economy are going to be tackled within the other work areas of the BEPS Project. Mechanisms will be set up to ensure the collection of VAT where consumption takes place, and once that work is completed, the Task Force will be able to assess whether additional measures are required to tackle any remaining challenges raised by the digital economy."

The OECD’s report confirms consideration of a total of five options concerning direct tax, which it considers may support a longer term solution. These are: modifications to the exemptions from PE status; a new nexus based on significant digital presence; replacing PE with a significant presence test; creating a withholding tax on digital transactions; and introducing a bandwidth or "Bit" tax. Each have been considered by the Task Force
charged with developing the digital economy recommendations, and a supplementary report is due in December 2015 on their final conclusions – in line with the scheduled date for the conclusion of all BEPS recommendations.

The first "potential option" – modifications to the exemptions from PE status – would involve amending paragraph 4 of Article 5 of the OECD Model Tax Convention. A review would in particular look at the modern-day relevance of exceptions for the activities described in subparagraphs (a) through (d). The OECD has said where the exceptions to the PE definition contained in paragraph 4 no longer serve their intended purpose as a result of the evolution of the digital economy, they should no longer be available. It says several variations of this potential option could be considered. One possible option would be to eliminate paragraph 4 entirely. Other possible options would be to eliminate certain subparagraphs, or make their availability subject to the condition that the character of the activity conducted be preparatory or auxiliary in nature, rather than one of the core activities of the enterprise in question. Another would eliminate the word "delivery" in Article 5(4)(a) and (b) in order to exclude from these subparagraphs certain types of warehouses.

The next option under consideration is a new nexus based on significant digital presence. The OECD said that establishing an alternative nexus would look to address situations in which certain business activities are conducted wholly digitally. Under such a proposal, an enterprise engaged in certain "fully materialized digital activities" could be deemed to have a taxable presence in another country if it maintained a "significant digital presence" in the economy of that country. The Task Force also considered a new tax nexus for cases in which the entity does a significant business in the country using personal data obtained by regular and systematic monitoring of internet users in that country – a proposal put forward to capture some businesses that rely heavily on data and user participation to generate income.

The next proposal under consideration concerns replacing the concept of permanent establish with a significant presence "test," which is intended to respond to the changing nature of customer relationships in the digital economy, while continuing to rely in part on physical presence. The paper discusses how such a test would be achieved, looking also at different digital economy business models.

The fourth proposal under consideration is the creation of a withholding tax on digital transactions. This has been suggested to address challenges related to nexus. A final withholding tax would be levied on certain payments made by residents of a country for digital goods or services provided by a foreign provider. To avoid requiring withholding by individual consumers, one potential option that is to be considered is placing a requirement on financial institutions involved with those payments. It is proposed that, if such an approach were taken, to boost compliance rates, taxpayers providing digital
goods and services covered by the withholding tax could file returns in order to ensure that they were ultimately taxed on a net basis.

Last, the OECD is said to be considering a bandwidth or "Bit" tax, which it said had been proposed in public comments. It would be levied on websites' bandwidth use. Such a tax would be based on the number of bytes used by the website, although, in order to introduce an element of progressivity, different tax levels would apply depending on the enterprise size or the turnover. For administrative purposes, such a tax would apply only to businesses that exceed minimum threshold of annual bandwidth used. In order to maintain equity between digital businesses and traditional businesses, the proposed bandwidth tax would be creditable against corporate income tax.

European Court Okays Cut-Rate VAT For Books In Digital Form

In a ruling that could have far-reaching consequences for e-book sellers, the European Court of Justice has agreed that a reduced rate of value-added tax may be applied to books that are provided in digital form.

The case concerned a publishing company that sought a preliminary ruling from the Finnish Central Tax Board (Keskusverolautakunta). It asked, in essence, whether books published on 'physical supports' other than paper – such as CDs, CD-ROMs, USB keys, or other equivalents – could be subject to a reduced rate of value-added tax, consistent with the typical treatment in the EU of tangible books.

The Keskusverolautakunta responded that only books printed in paper form or produced by comparable means could be regarded as a "book" for VAT purposes. On appeal, the Supreme Administrative Court (Korkein hallinto-oikeus) decided to stay the proceedings and sought guidance from the European Court of Justice.

In its ruling in K Oy (Case C-219/13), the ECJ highlighted that, "as regards the principle of fiscal neutrality, it should be recalled that [the EU VAT Directive] precludes similar goods or services which are in competition with each other [from] being treated differently for VAT purposes."

"To determine whether goods or services are similar, account must be taken primarily of the point of view of a typical consumer. Goods or services are similar where they have similar characteristics and meet the same needs from the point of view of consumers – the test being whether their use is comparable," which it said is satisfied if "the differences between them do not have a significant influence on the decision of the average consumer to use one or the other of those goods or services."

In reaching its decision, it highlighted the amendment made on June 1, 2009, in Directive 2009/47, to amend Annex III of the VAT Directive referring to the supply of books. This amendment changed the wording in point 6 of Annex III to include, in the list of goods and services capable of benefiting from a reduced rate of VAT, the 'supply … of books on all physical means of support.'
Drawing on the significance of this change, the Court said: "The question therefore arises whether, as a result of that amendment, a member state which has chosen to subject the supply of books printed on paper to a reduced rate of VAT is thereby compelled to extend the application of the reduced rate also to supplies of books on all physical supports other than paper."

"On this point, it must be noted, as the European Commission also observed at the hearing, that neither the wording of Directive 2009/47, nor the legislative history of that Directive, indicates that the EU legislature intended by amending point 6 of Annex III to the VAT Directive to compel member states to apply an identical reduced rate of VAT to all books, whatever the physical support on which they are published."

Nonetheless, the Court said that: "Since point 6 of Annex III to the VAT Directive confines itself to referring to the supply of books on all physical means of support, it is for the member states, subject to compliance with the principle of fiscal neutrality inherent in the common system of VAT, to determine the physical supports to which the reduced rate of VAT is to apply."

In the case at hand, the Court said it is for the referring court to determine whether the supplies are different with reference to the market penetration and uptake of such technologies: "As the 'average consumer’s assessment' is liable to vary according to the different degree of penetration of new technologies in each national market, and the degree of access to the technical equipment enabling the consumer to make use of books published on physical supports other than paper, it is the average consumer in each member state who must be taken as a reference."

"In those circumstances, it is for the referring court to ascertain whether books published in paper form and books published on other physical supports are goods which are liable to be regarded by the average consumer as similar. For that purpose, it will have to assess whether those books have similar characteristics and meet the same needs, using the criterion of whether their use is comparable, in order to ascertain whether or not the differences between them have a significant or tangible influence on the average consumer’s decision to choose one or other of those books."

"If what matters for that consumer is essentially the similar content of all books, regardless of their physical support or characteristics, the selective application of a reduced rate of VAT is not justified."

The decision may pave the way for member states to expand their reduced rates to cover books supplied in digital form. This ruling is expected to have a considerable impact on the ongoing cases brought by the European Commission against Luxembourg and France for their reduced rates on e-books, which it considers contravene EU law.

In its ruling, which allows Finland to prove that it may continue to levy its headline rate of VAT on
e-books, the ECJ stated: "It follows from all the above considerations that the answer to the questions is that the first subparagraph of Article 98(2) of, and point 6 of Annex III to the VAT Directive must be interpreted as not precluding – provided that the principle of fiscal neutrality inherent in the common system of VAT is complied with, which is for the referring court to ascertain – national legislation under which books published in paper form are subject to a reduced rate of VAT and books published on other physical supports, such as CDs, CD-ROMs or USB keys, are subject to the standard rate of VAT."
US Treasury Presents Its Anti-Inversion Proposals

On September 22, Treasury Secretary Jack Lew presented non-legislative measures put forward by the Obama Administration to deter US multinationals from using corporate inversions to move their tax residence abroad.

At a press conference to announce the measures, Lew said: "Treasury is announcing targeted action to meaningfully reduce the economic benefits of corporate inversions, and when possible, stop them altogether," he said. "This action will significantly diminish the ability of inverted companies to escape US taxation. For some companies considering deals, today’s action will mean that inversions no longer make economic sense."

The proposed measures are contained in a formal notice from the Internal Revenue Service and Treasury, which are aimed at restricting or preventing the use of certain transactions to circumvent liability to US tax.

First, the Notice will prevent inverted companies from accessing a foreign subsidiary’s earnings while deferring US tax through the use of "hopscotch" loans. Under current law, US multinationals owe US tax on the profits of their controlled foreign corporations (CFCs), although they do not usually have to pay this tax until those profits are repatriated. Profits that have not yet been repatriated are known as deferred earnings. Under current law, if a CFC tries to avoid this dividend tax by investing in certain US property – such as by making a loan to, or investing in the stock of its US parent or one of its domestic affiliates – the US parent is treated as if it received a taxable dividend from the CFC. However, some inverted companies get around this rule by having the CFC make the loan to the new foreign parent, instead of its US parent. This "hopscotch" loan is not currently considered US property and is therefore not taxed as a dividend.

The notice removes the benefits of these "hopscotch loans" by providing that such loans are considered to be "US property" for the purposes of applying the anti-avoidance rule. The same dividend rules will now apply as if the CFC had made a loan to the US parent prior to the inversion.

The next measure will prevent inverted companies from restructuring a foreign subsidiary in order to access the subsidiary’s earnings tax-free.

After an inversion, some US multinationals avoid ever paying US tax on the deferred earnings of their CFC by having the new foreign parent buy enough stock to take control of the CFC away from the former US parent. This "de-controlling" strategy is used to allow the new foreign parent to access the deferred earnings of the CFC without ever paying US tax on them. Under the notice, the new foreign parent would be treated as owning stock in the former US parent, rather than
the CFC, to remove the benefits of the "de-controlling" strategy. The CFC would remain a CFC and would continue to be subject to US tax on its profits and deferred earnings.

The final measure aims to close a loophole to prevent an inverted company from transferring cash or property from a CFC to the new parent to completely avoid US tax.

These transactions involve the new foreign parent selling its stock in the former US parent to a CFC with deferred earnings in exchange for cash or property of the CFC, effectively resulting in a tax-free repatriation of cash or property bypassing the US parent. The action is said to prevent the use of this strategy by:

- Making it more difficult for US entities to invert by strengthening the requirement that the former owners of the US entity own less than 80 percent of the new combined entity:

- Limiting the ability of companies to count passive assets that are not part of the entity’s daily business functions in order to inflate the new foreign parent’s size and therefore evade the 80 percent rule – known as using a "cash box." Following the issuance of the Notice, US authorities will disregard the stock of the foreign parent that is attributable to passive assets in the context of this 80 percent requirement. This would apply if at least 50 percent of the foreign corporation’s assets are passive. Banks and other financial services companies would be exempted.

- Preventing US companies from reducing their size pre-inversion by making extraordinary dividends, also known as "skinny-down" dividends. These pre-inversion extraordinary dividends would be disregarded for purposes of the ownership requirement, thereby raising the US entity’s ownership, possibly above the 80 percent threshold.

- Preventing a US entity from inverting a portion of its operations by transferring assets to a newly formed foreign corporation that it spins off to its shareholders, thereby avoiding the associated US tax liabilities, a practice known as "spinversion." This strategy takes advantage of a rule that US authorities intended to permit purely internal restructurings by multinationals. Under the notice, the spun-off foreign corporation would not benefit from these internal restructuring rules with the result that the spun off company would be treated as a domestic corporation, eliminating the use of this technique for these transactions.

The measures will not have retroactive effect (contrary to previous suggestions), applying only to deals closed on or after September 22.

Lew explained that the Administration is "taking initial steps that we believe will make companies think twice before undertaking an inversion to try to avoid US taxes." He prefaced his remarks with the caveat that "comprehensive business tax reform that includes specific anti-inversion provisions is the best way to address these transactions," but he said, "it is now clear that Congress won’t act before the lame duck session."
Lew concluded that: "these first, targeted steps make substantial progress in constraining the creative techniques used to avoid US taxes. Treasury will continue to review a broad range of authorities for further anti-inversion measures as part of our continued work to close loopholes that allow some taxpayers to avoid paying their fair share."

Following Lew’s announcement, Senate Finance Committee Chairman Ron Wyden (D – Oregon) and its Ranking Member Orrin Hatch (R – Utah) confirmed that they are still actively examining a variety of legislative measures.

Wyden opined that what is needed from Congress is "a series of stopgap reforms to the tax code that siphon the economic juice out of inversions." Hatch’s comments were more circumspect. He said: "America’s tax system is broken to the point that it’s putting our nation at a competitive disadvantage around the globe. That Treasury has opted to move forward with guidance to curb the recent uptick in corporate inversions only further underscores this monumental challenge."

Meanwhile, House of Representatives Ways and Means Chairman Dave Camp (R – Michigan) dismissed the package, stating: "Until the White House gets serious about tax reform, we are going to keep losing good companies and jobs to countries that have or are actively reforming their tax laws. A few campaign-style speeches and stop-gap measures from Treasury won’t do it – it hasn’t worked in the past, and even Secretary Lew admits the only real solution is tax reform."

**US House Passes Republican 'Pro-Jobs' Tax Changes**

By a vote of 253 to 163, the United States House of Representatives has passed the Jobs for America Bill of 2014, which includes the permanent extension of a selected list of the "tax extenders" that expired at the end of 2013, as well as a repeal of the Affordable Care Act’s (ACA) medical device tax.

More than 50 tax relief provisions expired at the end of last year, after which the Democrat-led Senate Finance Committee has proposed a renewal of virtually all of them for the next two years, while House Ways and Means Committee Chairman Dave Camp (R – Michigan) has concentrated on the permanent extension of a few measures, seen as important to jobs and economic growth, and having some bipartisan support.

The provisions selected by Camp, and forming part of the Jobs for America Bill, include the simplified credit for research and development expenses; increased expensing under Section 179 (full deduction on cost of qualifying equipment) for which the limit fell from USD500,000 to USD25,000 at the end of 2013; the reduced recognition period for the built-in capital gains of S corporations; and the rules regarding basis adjustments to the stock of S corporations making charitable contributions of property.

In addition, the bill would repeal the 30-hour threshold for classification as full-time employee for purposes of the ACA’s employer mandate, and
its replacement with 40 hours. According to Camp, the lower threshold is causing employees to have their work hours reduced and jobs to be cut.

The bill would also repeal the 2.3 percent medical device tax, which, since the beginning of last year, has been levied on the gross sales receipts in excess of USD5m of manufacturers, importers and producers of devices, such as artificial hips, MRI scanners and cardiac defibrillators.

When introduced, it was projected that the tax would raise nearly USD28.5bn in additional revenue over the 10 years to 2022, but it was also feared that it would represent a heavy burden for the 8,000 companies in the USD140bn medical devices industry, and could lead to the loss of up to 43,000 jobs and reductions in research and development.

Camp pointed out that, "according to a survey by AdvaMed, the medical device tax has already resulted in 14,000 jobs lost in the industry and prevented 19,000 jobs from being created. This tax is contributing to lackluster job creation and hampering medical innovation."

However, while 32 Democrats in the House voted for the Jobs for America Bill, which is projected to cost some USD570bn over a 10-year period, it is unlikely to be picked up by the Senate after the election. During the lame duck session before the end of the year, Democrats in the Senate are likely, instead, to return to their proposal for a short-term extension of as many tax extenders as possible.

Wyden Pushes For US Tax Extenders' Renewal

On September 15, United States Senate Finance Committee Chairman Ron Wyden called for congressional action to renew the package of more than 50 "tax extenders" that expired at the end of last year.

For individuals, the expired tax provisions include mortgage tax relief; the deduction for state and local sales taxes; and education tax deductions. For businesses, they include increased expensing under Section 179, the 50 percent bonus depreciation; the work opportunity tax credit; the credit for research and development expenses; and tax breaks promoting renewable energy.

"Today, American businesses of all sizes are making their required quarterly tax payments to the IRS and trying to chart their path forward for 2014 and beyond," Wyden noted. "At a time when entrepreneurs and innovators should be identifying investments to support their business strategies and pursuing growth opportunities, Congress’s failure to renew expired tax provisions is forcing these companies to make ‘no interest loans’ to the federal government through higher taxes."

"It’s unacceptable," he added, "that inaction by Congress is denying American business the clarity and certainty they need to plan for tomorrow. … With taxes due, continuing inaction on renewing expired tax provisions is diverting business
investment, driving unnecessarily higher taxes, and slowing economic growth. We cannot let this uncertainty drag on."

He pointed out that, earlier this year, the Finance Committee approved the Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act, which would extend virtually all of the tax extenders until the end of 2015. He said that "now is the time to revive [it] and renew these important tax provisions while we push ahead on comprehensive reform."

However, the EXPIRE Act is part of a wider dispute between the Republican-led House of Representatives and the Democrat-led Senate over how to handle the tax extenders. The House Ways and Means Committee is picking individual provisions that are seen to be important to economic growth and making them permanent, while Wyden is looking to extend virtually all of the tax extenders, but for only two years.

US House Majority Supports Cash Accounting Retention

In like manner to a letter signed by 46 bipartisan United States senators last month, a bipartisan majority of the House of Representatives – 233 members – have signed a letter urging the House leadership to preserve the cash method of accounting for tax purposes, rather than a forced change to the accrual method for some businesses.

The members' September 11 letter to the House Speaker John Boehner (R – Ohio) and other members of the House leadership, pointed out that a transition to the accrual method in tax reforms would "have a severely detrimental impact on thousands of businesses in our districts."

"Those who use the cash method of accounting include many of our local job creators and professionals, including accountants, architects, attorneys, dentists, engineers, farmers, physicians and financial service professionals," the lawmakers explained. "Importantly, the cash method of accounting is the foundation upon which these businesses have built their business models for decades."

The House letter also noted that the cash method of accounting is a simple method in which income is recognized when it is collected. By comparison, the accrual method of accounting recognizes income when a service is performed, regardless of when cash is collected.

"If forced to pay taxes before income is received, as would be required under the accrual method, less money would be available to small businesses for growth and job creation," the lawmakers added. "Additionally, cash flow management becomes far more complex as a result, and will likely trigger the need for additional outside financing. These factors alone would have a significant negative impact on our local economies."

"While we believe reforms to the tax code should provide a simpler and fairer tax system, requiring the use of the accrual method for entities currently using the cash method will not achieve these goals,"
the letter concluded. "We strongly urge you to preserve the cash method of accounting."

Currently, sole proprietors; pass-through entities (e.g. partnerships and S corporations), whose income is taxed directly on their owners' individual tax returns; entities that engage in a farming business; professional services corporates; and entities that satisfy a USD5m gross receipts test (and do not maintain inventory) are generally permitted to use the cash method of accounting in the US.

On the other hand, C corporations are usually not allowed to use the cash method, and a taxpayer who purchases, produces, or sells merchandise must also use the accrual method of accounting.

Congressional tax reform drafts in both the House and the Senate have proposed, however, that, while the limit could be raised so that all businesses with average annual gross receipts of USD10m or less could use cash accounting, all businesses that did not meet that new gross receipts threshold would have to adopt the accrual method of accounting, including partnerships and S corporations and those engaged in farming and professional services business.

The American Institute of Certified Public Accountants has been a leading opponent of those proposed reforms. Its President and CEO Barry C. Melancon, commented that "more than half of the House and nearly half of the Senate – from both parties and every state – have voiced their opposition to a proposal that unfairly penalizes CPA firms, among other businesses. The accrual accounting mandate is bad tax policy that should be abandoned by the House and Senate."
EU Member States To Shift Focus To Labor Tax Reforms

European Union policymakers have called for a renewed focus on cutting the tax burden on labor to support economic recovery.

Eurozone finance ministers recently met in Milan to discuss common principles for collective tax policy action. They acknowledged that the overall tax burden in the Eurozone on labor is above the Organization for Economic Cooperation and Development average and is a “clear impediment” to the smooth functioning of labor markets.

According to a joint statement issued after the meeting, by reducing the tax burden on labor, Governments could stimulate labor supply and employment through tax cuts. Measures to reduce this burden could improve Europe’s competitiveness and European firms’ profitability, and ultimately increase demand and support job creation.

Ministers agreed that member states should be guided by a set of common principles when exploring their options for reform.

Challenges faced by member states should be addressed on a country-by-country basis and should look at the relative weakness of each member state’s tax regime. Measures should be accompanied by either a compensatory reduction in (non-productive) expenditure or a shift toward taxes that are less detrimental to growth, such as increases to value-added tax and consumption tax burdens, they agreed.

The Eurogroup will review the situation when it discusses members’ draft budgetary plans in November. It will monitor the implementation of any such reforms in spring 2015.

UK Biggest Loser From ECJ Skandia Judgment, Says KPMG

The European Court of Justice’s (ECJ’s) judgment on VAT grouping rules in Skandia America Corp. v. Skatteverket (C-7/13) could cost UK financial institutions, and potentially other VAT-exempt businesses, hundreds of millions of pounds annually, KPMG UK has said.

The case concerned the VAT treatment of a cross-border intra-company transfer of IT services from a US parent to a branch with a permanent establishment (PE) in Sweden, which was part of a VAT group, and the supply of services thereafter by the Swedish PE to connected parties both inside and outside that VAT group.

Similar circumstances were considered in the case of FCE Bank Plc (C-210/04). In this case the court ruled that transactions between a UK bank and a branch in Italy, both in the same VAT group, were outside the scope of VAT, mainly because the branch was deemed not to have performed an economic activity because it did not itself bear the
economic risks related to the exercise of the activity of the company to which it belonged. It was therefore concluded in *FCE Bank* that a branch is not a separate legal entity from the company to which it belongs, and should not be regarded as an independent subject of this company.

The circumstances in *Skandia America Corp. v. Skatteverket* were similar but for the location of the head office in the United States. In this case, under Swedish law, the US company had been included in the VAT group comprising companies in the European Union. This allowed the US head office to make supplies to its Swedish branch outside the scope of VAT, which otherwise could have been liable to VAT under a reverse charge. When the Advocate General’s (AG’s) opinion was issued in May, the AG said this was an “undesirable” outcome and proposed four possible revisions to Swedish rules to enable VAT to be levied. It opined that the onward supply within the VAT group by the Swedish branch was outside the scope of VAT.

Leaning on the ruling in *FCE Bank*, Skandia America Corporation had said that its Swedish branch "does not have sufficient autonomy to act on its own account under its own responsibility and bear the economic risk of its activities in such a way that creates VAT revenues between it and the parent institution." The AG suggested that it had been wrong to allow the US head office within the VAT group, and noted provisions in the EU VAT Directive on VAT groups that member states may employ to challenge such unintended tax consequences.

The ECJ, however, ruled that, where a VAT group is operated in a member state and it receives services into a branch within the VAT group from its main establishment located outside the EU, that service should be subject to VAT.

Commenting on the outcome of the case, Richard Iferenta, Head of Financial Services, Indirect Tax at KPMG UK, said that, for the financial sector and other VAT-exempt businesses, this additional incidence of VAT represents a significant additional cost, since a consequence of being VAT-exempt is that they are largely unable to recover VAT which they incur: "What this ruling does is – at a stroke – add hundreds of millions of pounds to the annual cost of financial institutions doing business in the UK and other EU member states."

"It’s clear that if the UK takes the most restrictive interpretation of the judgment, any transactions with a branch that is in a VAT group will be impacted. Furthermore with the UK’s position as a global financial services center, and the consequential level of inward investment into the UK by foreign financial services business that flows from that, the financial impact of the judgment may be felt hardest in the UK."

"What is surprising here is that the final judgment issued by the Court runs somewhat contrary to the earlier 'Opinion' issued by the Advocate General in this case, when typically the Opinion is indicative of the likely final decision."
"The UK Government had argued strongly that the UK’s position on this issue, which included targeted anti-avoidance rules to prevent any abuse, was consistent with EU law and that there was no need to change the status quo. The Advocate General appeared to largely agree with this in their earlier opinion, so this change of stance by the full court was unexpected."

Iferenta concluded: "Financial institutions are likely to examine their VAT grouping arrangements and which services they are buying in from outside the EU. Some may decide to change their existing models as a result."

In its ruling delivered on September 17, 2014, the ECJ ruled:
- "Articles 2(1), 9 and 11 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax must be interpreted as meaning that supplies of services from a main establishment in a third country to its branch in a Member State constitute taxable transactions when the branch belongs to a group of persons whom it is possible to regard as a single taxable person for value added tax purposes in that Member State, that group, as the purchaser of those services, becomes liable for the value added tax payable."

**Switzerland Seeks To Relieve Double Tax On PEs**

The Swiss Federal Council has launched a consultation on changes to the flat-rate tax credit, which seeks to ensure double tax relief for permanent establishments of companies that are located in Switzerland.

The proposed change affects permanent establishments in Switzerland that are part of a company domiciled in a country with which Switzerland has signed a double tax agreement (DTA).

If these permanent establishments receive revenue from dividends, interest, or royalty payments from a third state with which Switzerland also has a DTA and a non-recoverable withholding tax (residual tax) is levied on this revenue by the third state, cases of double taxation can arise under current law (that is, residual tax is levied on the revenue and it is also taxed in Switzerland if it is attributed to the permanent establishment).

If the company’s country of domicile eliminates the profits of the permanent establishment in Switzerland (that is, exempts them from taxation – the so-called exemption method), it cannot credit the residual taxes from third countries to its own taxes, as it does not levy any tax on the revenue in question.
In such circumstances, a flat-rate credit of the residual tax from third countries has not been possible in Switzerland to date, as foreign companies' permanent establishments are considered as non-established persons under DTAs. Only persons established in Switzerland can claim the flat-rate tax credit at present.

In the future, the granting of the flat-rate tax credit to foreign companies' permanent establishments in Switzerland will be conditional on a DTA existing between each of the countries involved (that is, Switzerland, the third country, and the country of domicile of the company to which the permanent establishment belongs). Likewise, the permanent establishment must be taxed as normal in Switzerland.

In its commentary to the Model Tax Convention, the Organization for Economic Cooperation and Development recommended that member states use bilateral or domestic law solutions to solve the problem of no credit possibility for withholding taxes from third states. The proposed change carries out this recommendation.

European Union, Canada Complete FTA Negotiations

Negotiators have completed their work on a free trade agreement between the European Union and Canada (CETA), but the European Parliament has raised concern about certain provisions.

EU Trade Commissioner Karel De Gucht said: "The Agreement is crucial for the credibility of our trade agenda, because it confirms that we can do deals – even very good deals – and in this case with a developed economy with its own established approach and regulatory framework. Hence the challenging times during the negotiation."

Under the CETA, both sides will eliminate most tariffs but some sensitive agricultural products will remain protected. The agreement, which will be made public shortly, also provides for improved market access for services and investment and affords EU companies significant access to Canada's public procurement market.

The CETA also sets a new standard for investor-to-state dispute settlement procedures. Members of the European Parliament (MEPs) have called for the removal of a provision, however, that would allow investors to sue Governments over policies perceived as harmful to businesses. Some have argued that this clause should not be necessary in a deal between two countries with mature judicial systems and warned that it could be abused. De Gucht told MEPs that negotiators were aware of these concerns and said that the agreement "directly addresses all the concerns that have emerged so far."

EU President Jose Manuel Barroso and Canadian Prime Minister Stephen Harper will announce the formal conclusion of negotiations at an EU-Canada Summit on September 26, 2014. De Gucht expects that the signature and the tabling of the agreement before the European Parliament will not take place until "well into 2015."
The CETA is projected to deliver a boost to bilateral trade in goods and services worth an estimated EUR25.7bn (USD33bn).

**Italy Should Lower Marginal Tax Rates, IMF Says**

The International Monetary Fund (IMF) has said that Italy should make its tax system more growth-friendly by lowering marginal tax rates.

The government reduced the personal income tax (PIT) for low earners by about 0.5 percent of gross domestic product (GDP) in 2014 (roughly EUR1,000 or USD1,288 per household). However, at 48 percent, the country’s labor tax wedge is well above the Organization for Economic Cooperation and Development (OECD) country average of 36 percent.

According to the IMF report, further tax cuts should be achieved by lowering social security contributions, rather than cutting personal income tax rates, to better support employment levels.

The IMF recommended financing the tax cuts by reducing tax expenditures and raising taxes on wealth, including inheritance taxes. It also said that further efforts to curb tax evasion would generate savings and raise the fairness of fiscal consolidation.

Italian Prime Minister Matteo Renzi recently said that the 2015 Budget will include some cuts to taxes on employment. He said that the Government would fund the cuts through a EUR20bn decrease in spending.

**Tax A Top Threat To Irish Growth, Says Survey**

84 percent of Irish private and family businesses see an increasing tax burden as the greatest economic and policy threat to business growth, according to a new survey.

The latest CEO Pulse Survey, conducted by professional services firm PwC, reveals that 87 percent of firms regard Ireland’s economic outlook favorably. 85 percent expect revenue growth, 73 percent anticipate profit growth, and 60 percent plan to expand their workforce.

However, tax is an area of concern for a large majority. 64 percent of companies agree that the current international tax system is in need of reform, but just 44 percent believe that the Organization for Economic Cooperation and Development (OECD) will be able to reach the consensus needed to achieve substantial reform.

The high marginal personal tax rate and the number of new taxes introduced in recent years are also major issues, with employees now bearing a very high personal tax burden. 78 percent of firms feel that rising labor costs represent the top business threat to growth prospects.

47 percent of businesses say that they would like to see the Government prioritize plans to reduce personal tax and/or expand thresholds. Finally, amid international pressure over Ireland’s tax policies, 24 percent say that the Government should continue to promote Ireland as having a transparent and competitive tax regime.
South Korea's 2015 Budget Seeks Wider Tax Base

South Korea has released its 2015 Budget, which includes plans to maintain expansionary fiscal policies, funded by a review of tax incentives and measures to boost compliance.

Given the fragile economic recovery being experienced in South Korea, with growth projections recently revised down to 3.7 percent from 4.1 percent, the 2015 budget proposals are said to focus on "investment in job creation, domestic consumption, and the creative economy, in order to achieve sustainable growth."

The country's fiscal deficit is projected to increase "temporarily" from 1.7 percent to 2.1 percent of gross domestic product (GDP), with the Government "confident that fiscal soundness will continue to improve in the mid- to long-term." The fiscal deficit is now projected to be cut to one percent of GDP by 2018.

Total government revenues are budgeted to increase by 3.6 percent next year, down from a forecast of 6.2 percent in the 2013-2017 national fiscal management plan. Tax revenue is expected to rise by just 2.3 percent.

Individual income tax collections are forecast to rise by 5.7 percent, but both corporate and value added taxes are expected to increase only marginally due to the weak economic recovery, by 0.1 percent and 0.8 percent, respectively. In addition, import duty collections are budgeted to fall by 5.1 percent in 2015, caused in part by lower tariffs under free trade treaties.

Finance Minister Choi Kyung-hwan had confirmed recently that South Korea would maintain its stimulus measures, including a "no tax increase" policy for the foreseeable future, in particular for personal and corporate income taxes.

Proposed tax measures are few and far between. It is merely stipulated that those tax credits and exemptions that are found to be no longer effective will be "reformed," except for tax breaks to support small- and medium-sized enterprises and lower- and middle-income households. The Government also plans to increase tax transparency and continue to work on revising and enacting laws to combat tax non-compliance, in particular with regards to overseas tax evasion.

The Ministry is scheduled to submit the Budget draft to the National Assembly for approval later this month.

Canada, South Korea Sign Landmark Free Trade Deal

Nine years after negotiations began, Canada and South Korea have signed a free trade agreement (CKFTA) that will eliminate duties on nearly all tariff lines.
The deal was inked on September 22 by the Canadian Prime Minister, Stephen Harper, and the South Korean President, Park Geun-hye.

Upon the CKFTA’s entry into force, South Korea will immediately remove duties on 81.9 percent of tariff lines. By the time the agreement has been fully implemented, South Korea will have eliminated duties on 100 percent of Canadian non-agricultural exports and 97 percent of agricultural exports. Canada will remove duties on approximately 99.9 percent of South Korea’s exports to the country.

Average South Korean tariffs are three times higher than Canada’s, at 13.3 percent compared with 4.3 percent. Tariffs are particularly high for Canadian beef exports (40 percent), and South Korean car exports (6.1 percent).

The CKFTA covers trade in goods and services, investment, government procurement, intellectual property, and environment and labor cooperation. It also contains provisions to reduce or end non-tariff barriers to market access for exporters and investors, and also contains dispute resolution clauses. The investment provisions are designed to create a more predictable, rules-based climate for trade and investment. New government procurement rules will place Canadian firms on an equal or better footing relative to competing nations, the Canadian Government said.

The Canadian Government said it expects a wide range of sectors to benefit from the CKFTA, including the industrial goods, agricultural and agri-food products, fish and seafood products, and forestry and value-added wood products sectors. The deal is projected to boost Canada’s annual gross domestic product (GDP) by CAD1.7bn (USD1.5bn) and increase annual exports to South Korea by more than 30 percent.

Talks were put on hold in 2008 after South Korea maintained an import ban on Canadian beef, but the ban was lifted in January 2013. The terms of the CKFTA were eventually agreed in March of this year.

In a joint declaration published after their meeting, Harper and Park describe the CKFTA as "an historic initiative that will strengthen our trade and investment ties across the Pacific, increase the prosperity of both countries and result in job creation and enhanced opportunities for Korean and Canadian businesses, particularly small and medium enterprises, as well as investors, workers, and consumers."

The agreement must now be ratified by lawmakers in both countries.
Brazil Cuts Tax Rate On Manufacturers' Overseas Income

The Brazilian Government revealed on September 15, 2014, that it will offer a nine percent tax credit to all manufacturing companies on income derived from their overseas subsidiaries.

The credit, which is already enjoyed by the food and drink and construction industries, will be extended to manufacturing companies from October, reducing the tax rate on the overseas profits of Brazilian companies’ subsidiaries from 34 percent to 25 percent.

According to Finance Minister Guido Mantega, the measure will not have any fiscal impact because it will result in a fall in the number of disputes going before Brazil’s courts involving challenges to Brazil’s taxing rights, he said.

Mantega also said that exporters will receive a tax credit worth three percent of the value of their exports next year under the program known as Reintegra, up from 0.3 percent currently. It was recently announced that exporters of sugar and ethanol will also be included in the program.

He added that the government will maintain the reduced rates of tax on industrialized products (IPI) for construction materials.

South Africa Clarifies Additional Investment Tax Reliefs

The South African Revenue Service (SARS) has issued a detailed draft interpretation note that provides guidance on the tax deduction of additional investment and training allowances from the income of a company carrying on an "industrial policy project."

The South African tax code allows for the deduction from taxable income of the cost to a taxpayer of machinery or plant used directly in a process of manufacture at a rate of 40:20:20:20 over four years, and also for an additional deduction of ZAR30,000 (USD2,700) in respect of any registered learning agreement entered into between each learner and an employer.

However, an additional investment allowance and an additional training allowance has also now been introduced with the aim of supporting the main objectives of the South African Government’s policy "to diversify the country’s industrial output, support a knowledge-based economy, and nurture labor intensive industries."

These incentives are aimed solely at benefiting projects within the manufacturing sector. An "industrial project" is defined "as a trade carried on solely or mainly for the manufacture of products, goods,
articles, or other things," with the exception of alcohol or tobacco products. The Minister of Trade and Industry is responsible for determining what constitutes the more important specification of an "industrial policy project," looking in particular at the amount invested.

A company that has been approved as fulfilling an industrial policy project may – in addition to any other deductions that may be allowable – deduct an additional investment allowance equal to 55 percent of the cost of any new manufacturing asset used in an industrial policy project, or 100 percent if the project is located within an industrial development zone.

In addition to any other deductions allowable, a company may also deduct the full cost of any training incurred by the company as an "additional training allowance." This additional allowance must be claimed in the year of assessment during which the cost of training is incurred.

Comments on the interpretation note are due by no later than November 14, 2014.
ESTONIA - MOROCCO

Ratified
Estonia passed a law ratifying its DTA with Morocco on September 9, 2014.

JAPAN - SWEDEN

Ratified
The DTA Protocol between Japan and Sweden was ratified on September 12, 2014, and will enter into force on October 12, 2014.

LUXEMBOURG - SAUDI ARABIA

Into Force
The DTA between Luxembourg and Saudi Arabia entered into force on September 1, 2014.

NORWAY - CYPRUS

Into Force
Norway recently announced that its DTA with Cyprus entered into force on July 8, 2014.

SWITZERLAND - BELGIUM

Forwarded
Switzerland confirmed on September 19, 2014 that it had forwarded the DTA Protocol signed with Belgium to the Federal Assembly for the approval of both houses as part of the nation’s domestic ratification procedures.
A guide to the next few weeks of international tax gab-fests (we’re just jealous - stuck in the office).

**THE AMERICAS**

**MEXICO TAX UPDATE**

BNA Bloomberg

Venue: Manchester Grand Hyatt, One Market Place, San Diego, CA 92101, USA

Key Speakers: Gabriel Andrade (KPMG LLP USA), Liliana Galindo CKPMG LLP USA), Bruce Stelzner (KPMG LLP USA), Damian Cecilio (Deloitte USA), among numerous others.

9/29/2014 - 9/30/2014

http://www.bna.com/mexico_sandiego/

**US TAX ASPECTS OF INTERNATIONAL ACQUISITIONS & REORGANIZATIONS**

Bloomberg BNA

Venue: Bloomberg BNA Conference Center, 1801 S. Bell Street, Arlington Virginia 22202, USA

Key speakers: TBA

9/29/2014 - 9/30/2014

http://www.bna.com/acqandreorgs_dc2014/

**US INTERNATIONAL TAX REPORTING & COMPLIANCE**

Bloomberg BNA

Venue: Manchester Grand Hyatt, One Market Place, San Diego, CA 92101, USA

Chair: James Hemelt (Bloomberg BNA)

9/29/2014 - 9/30/2014

http://www.bna.com/uploadedFiles/Content/Events_and_Training/Live_Conferences/Tax_and_Accounting/Conferences_-_Seminars/September2014.pdf

**IFRS FOUNDATION CONFERENCE: MEXICO**

IFRS

Venue: Camino Real Polanco, Mariano Escobedo 700, Anzures, Miguel Hidalgo, 11590 Ciudad de México, Distrito Federal, Mexico
Chair: Hans Hoogervorst (IASB)

10/6/2014 - 10/7/2014

http://www.iiribcfinance.com/event/IFRS-Foundation-Conference-Mexico

THE 21ST WORLD OFFSHORE CONVENTION 2014

Offshore Investment

Venue: The New York Athletic Club, 180 Central Park S, New York, NY 10019, USA


10/14/2014 - 10/15/2014


PRIVATE WEALTH LATIN AMERICA AND THE CARIBBEAN FORUM

Latin Markets

Venue: InterContinental Miami, 100 Chopin Plaza, Miami, FL 33131, USA

Key speakers: David Darst (Chief Investment Strategist, Morgan Stanley Smith Barney (US)), Ernest Dawal (Chief Investment Officer, SunTrust Banks & GenSpring Family Offices), among numerous others.

10/23/2014 - 10/25/2014


INTRODUCTION TO U.S. INTERNATIONAL TAX

Bloomberg BNA

Venue: Baker & McKenzie LLP Conference Center, 300 East Randolph Street, 50th Floor, Chicago, IL 60601, USA


10/27/2014 - 10/28/2014

http://www.bna.com/intro_chicago2014/

INTERMEDIATE U.S. INTERNATIONAL TAX UPDATE

Bloomberg BNA

Venue: Baker & McKenzie LLP Conference Center, 300 East Randolph Street, 50th Floor, Chicago, IL 60601, USA

10/29/2014 - 10/31/2014

http://www.bna.com/inter_chicago2014/

2014 INTERNATIONAL UPDATE: U.S. - MEXICO - CANADA CROSS-BORDER TAX ISSUES

Procopio International Tax

Venue: Joan B. Kroc Institute for Peace & Justice, 5998 Alcala Park, San Diego, CA 92110-2492, USA

Chair: TBA

10/30/2014 - 10/31/2014


8TH TAX PLANNING FOR THE INTERNATIONAL CLIENT

Federated Press

Venue: Courtyard by the Marriott, 475 Yonge Street, Toronto, Ontario, M4Y 1X7, Canada

Chairs: Grace Chow (Cadesky and Associates LLP), Greg Kanargelidis (Blake, Cassels & Graydon LLP)


INTRODUCTION TO U.S. INTERNATIONAL TAX

Bloomberg BNA

Venue: Hilton Boston Downtown, 89 Broad Street, Boston, MA 02110, USA


http://www.bna.com/intro_boston2014/

PRINCIPLES OF INTERNATIONAL TAX

Bloomberg BNA

Venue: Bloomberg LP, 731 Lexington Avenue, New York, NY 10022, USA

Chairs: Mark Leeds (Mayer Brown), Daniel Mayo (KPMG LLP)
11/17/2014 - 11/19/2014

http://www.bna.com/principles_newyork_2014/

INTERMEDIATE U.S.
INTERNATIONAL TAX UPDATE

Bloomberg BNA

Venue: Hilton Boston Downtown, 89 Broad Street, Boston, MA 02110, USA


11/19/2014 - 11/21/2014

http://www.bna.com/inter_boston2014/

2014 CORPORATE TAX DEVELOPMENTS – THE YEAR IN REVIEW: NEW YORK

Bloomberg BNA

Venue: Baker & McKenzie, 452 5th Ave, New York, NY 10018, USA

Key Speakers: Maja Arcyz (KPMG), Paul Bagratuni (McGladrey), Bart Bassett (Morgan Lewis), June Anne Burke (Baker & McKenzie), Fred Chilton (KPMG), Rob Clary (McDermott Will & Emery), William F. Colgin (Morgan Lewis), among numerous others

11/20/2014 - 11/21/2014

http://www.bna.com/yearreview_newyork2014/

7TH TAX PLANNING FOR R&D

Federated Press

Venue: Courtyard by the Marriott, 475 Yonge Street, Toronto, Ontario M4Y 1X7, Canada

Chair: David W. Regan (KPMG LLP)


INTRODUCTION TO U.S. INTERNATIONAL TAX - SAN JOSE

Bloomberg BNA

Venue: PricewaterhouseCoopers, 488 S Almaden Blvd #180, San Jose, CA 95110, USA

Chair: TBA

12/1/2014 - 12/2/2014

http://www.bna.com/intro_sanjose2014/

INTRODUCTION TO U.S. INTERNATIONAL TAX - WASHINGTON DC

Bloomberg BNA

Venue: Bloomberg BNA Conference Center, 1801 S. Bell Street, Arlington Virginia 22202, USA

Chair: TBA

12/1/2014 - 12/2/2014


INTERMEDIATE U.S. INTERNATIONAL TAX UPDATE - SAN JOSE

Bloomberg BNA

Venue: PricewaterhouseCoopers, 488 S Almaden Blvd #1800, San Jose, CA 95110, USA

Chair: TBA

12/3/2014 - 12/5/2014

http://www.bna.com/inter_sanjose2014/

INTERMEDIATE U.S. INTERNATIONAL TAX UPDATE - WASHINGTON DC

Bloomberg BNA

Venue: Bloomberg BNA Conference Center, 1801 S. Bell Street, Arlington Virginia 22202, USA

Chair: TBA

12/3/2014 - 12/5/2014

http://www.bna.com/inter_dc2014/

U.S. INTERNATIONAL TAX PLANNING

Bloomberg BNA

Venue: The Houstonian Hotel, 111 North Post Oak Lane, Houston, TX 77024, USA

Key Speakers: Martin Euson (Ernst & Young LLP), Mitra Ghaemmaghami (Ernst & Young LLP), James Howard (Gardere Wynne Sewell LLP), Chris Lallo (Ernst & Young LLP), among numerous others

12/1/2014 - 12/3/2014

http://www.bna.com/taxplanning_houston2014/
Chair: TBA

12/3/2014 - 12/5/2014

http://www.bna.com/inter_dc2014/

U.S. INTERNATIONAL TAX REPORTING AND COMPLIANCE

Bloomberg BNA

Venue: 731 Lexington Avenue, New York, NY 10022, USA

Key Speaker: Kyle Bibb (K. Bibb LLC, TX), Eytan Burstein (McGladrey, NY), Victor Gatti (KPMG, NY), James Hemelt (Bloomberg BNA, VA), Marcellin Mbwa-Mboma (Ernst & Young LLP, NY), Mitchell Siegel (McGladrey, NY)

12/15/2014 - 12/16/2014

http://www.bna.com/reportingandcompliance_newyork2014/

ASIA PACIFIC

DEALING WITH DIGITAL ASSETS IN DECEASED ESTATES

The Society of Trust and Estate Practitioners Queensland

Venue: Queensland Law Society, Law Society House, Level 2, 170 Ann Street, Brisbane 4000, Australia

Key speaker: Peter Worrall (Worrall Lawyers)

10/7/2014 - 10/7/2014


STEP ASIA CONFERENCE 2014

STEP

Venue: Grand Hyatt Hotel, Hong Kong, 1 Harbour Rd, Hong Kong

Chair: Samantha Bradley (Chair, STEP Hong Kong)

10/8/2014 - 10/9/2014

http://www.step.org/asia2014

11TH INTERNATIONAL TAX CONFERENCE

ASSOCHAM Events

Venue: Hotel Le Meridien, Windsor Pl, New Delhi, DL 110001, India

Key Speakers: Shri Shaktikanta Das (Ministry of Finance), Shri K. V. Chowdary (Central Board of Direct Taxes), Dr. Rana Kapoor (ASSOCHAM), among numerous others.
10/9/2014 - 10/10/2014

http://www.assocham.org/events/showevent.php?id=1039

**68TH CONGRESS OF THE INTERNATIONAL FISCAL ASSOCIATION**

IFAFinal

Venue: NCPA Marg, Nariman Point, Mumbai, Maharashtra 400021, India

Chairs: T P Ostwal, Pranav Sayta

10/12/2014 - 10/17/2014

http://www.ifaper2014mumbai.com/

**CENTRAL AND EASTERN EUROPE**

**5TH ANNUAL INTERNATIONAL TAXATION IN CEE**

GCM Parker

Venue: TBA, Prague, Czech Republic

Key Speakers: TBC

10/16/2014 - 10/17/2014

http://www.gcmparker.com/gcm-conference-listing?menuid=0&conferenceid=74

**MIDDLE EAST AND AFRICA**

**THE 6TH ANNUAL PRIVATE WEALTH MIDDLE EAST 2014**

Private Wealth Middle East

Venue: Conrad Dubai, PO Box 115143, Sheikh Zayed Road, Dubai, UAE

Key Speakers: Shaykh Haytham Tamim (Sharia Solutions), Reshmi Manekporia (Berwin Leighton Paisner), Yann Mrazek (M/Advocates of Law), Tim Casben (Lawrence Graham), among numerous others.

10/16/2014 - 10/17/2014

http://www.iiribcfinance.com/event/Private-Wealth-Leaders-Middle-East

**WESTERN EUROPE**

**UPDATE FOR THE ACCOUNTANT IN INDUSTRY AND COMMERCE, OXFORD**

CCH UK

Venue: Oxford Thames Four Pillars Hotel, Henley Rd, Sandford-on-Thames, Sandford on Thames, Oxfordshire OX4 4GX, UK

Key speakers: Ralph Tiffin (Principal, McLachlan and Tiffin and author of Complete Guide to
International Financial Reporting Standard), Paul Gee (Co-author, Financial Reporting for Smaller Companies, and Interpreting Company Reports and Accounts), Stephen Hill (Managing Director, Snowdrop Consulting Ltd and Trustee Director of the ICAEW Fraud Advisory Panel), Toni Trevett (Director, CompleteHR Ltd), Chris Burns (Tax Consultant), Tony Grundy (Author and Lecturer, Strategy and Corporate Finance, Henley Business School), Louise Dunford (former Associate Senior Lecturer, University of Portsmouth)

**10/7/2014 - 10/8/2014**


**GLOBAL TAX FOR SHIPPING FORUM**

Informa Maritime Events

Venue: Le Meridien Piccadilly, 21 Piccadilly, London, W1J 0BH, UK

Key Speakers: Holger Schildt (Hapag-Lloyd AG), David Evans (Ernst & Young), Harrie van Duin (KPMG Meijburg), Oyvind Hatlestad (Viking Supply Ships), among numerous others.

**10/15/2014 - 10/16/2014**

http://www.informamaritimeevents.com/event/Tax-for-Shipping-Seminar

**STEP ANNUAL TAX CONFERENCE SERIES 2014, EDINBURGH**

STEP

Venue: The Caledonian (A Waldorf Astoria Hotel), Princes Street, Edinburgh, EH1 2AB, UK

Key Speakers: John Barnett TEP (Burges Salmon LLP), Amanda Hardy (15 Old Square), Paul Howard (Gabelle LLP), Robert Jamieson (Mercer & Hole Accountants), Oliver Marre (15 Old Square), David Rees TEP, Paula Tallon (Gabelle LLP), Chris Whitehouse TEP, John Woolley TEP (Technical Connection).

**10/16/2014 - 10/16/2014**


**THE ITPA'S JERSEY MEETING**

The International Tax Planning Association

Venue: L’Horizon Hotel, La Route de la Baie, St Brelade, Jersey JE3 8EF

Key speakers: Paolo Panico (Adjunct Professor, University of Modena, Italy), Jonathan Conder (Macfarlanes), Marc Guillaume (Appleby), among others

**10/19/2014 - 10/21/2014**

https://www.itpa.org/?page_id=9574
ASSET TRACING — STRATEGIES TO ATTACK & DEFEND TRUSTS

IBC

Venue: St James’ Court Hotel, 45-51 Buckingham Gate, London, SW1E 6AF, UK

Chair: Graeme Kleiner (Partner, Speechly Bircham)

10/20/2014 - 10/20/2014


TAXATION IN THE POST-BEPS ENVIRONMENT 2014

IBC

Venue: Grange Tower Bridge Hotel, 45 Prescot St, London E1 8GP, UK

Key Speakers: Melinda Brown (Transfer Pricing Advisor, OECD), Paul Morton (Head of Group Tax, Reed El Sevier Group), Peter Cussons (Partner, PwC), Matthew Whipp (Director, KPMG), Anne Fairpo (Barrister), among numerous others.

10/21/2014 - 10/21/2014


UPDATE FOR THE ACCOUNTANT IN INDUSTRY AND COMMERCE, LEEDS

CCH UK

Venue: Thorpe Park Hotel and Spa, Thorpe Park, 1150 Century Way, Leeds, West Yorkshire LS15 8ZB, UK

Key speakers: Ralph Tiffin (Principal, McLachlan and Tiffin and author of Complete Guide to International Financial Reporting Standard), Paul Gee (Co-author, Financial Reporting for Smaller Companies, and Interpreting Company Reports and Accounts), Stephen Hill (Managing Director, Snowdrop Consulting Ltd and Trustee Director of the ICAEW Fraud Advisory Panel), Toni Trevett (Director, CompleteHR Ltd), Chris Burns (Tax Consultant), Tony Grundy (Author and Lecturer, Strategy and Corporate Finance, Henley Business School), Louise Dunford (former Associate Senior Lecturer, University of Portsmouth)

10/21/2014 - 10/22/2014


STEP ANNUAL TAX CONFERENCE SERIES 2014, LONDON

STEP

Venue: Park Plaza Westminster Bridge London, 200 Westminster Bridge Road, London, SE1 7UT, UK
Key Speakers: John Barnett TEP (Burges Salmon LLP), Amanda Hardy (15 Old Square), Paul Howard (Gabelle LLP), Robert Jamieson (Mercer & Hole Accountants), Oliver Marre (15 Old Square), David Rees TEP, Paula Tallon (Gabelle LLP), Chris Whitehouse TEP, John Woolley TEP (Technical Connection).

10/24/2014 - 10/24/2014


INTERNATIONAL TAX AUDIT FORUM 2014

International Tax Center

Venue: BMW Welt, Am Olympiapark 1, 80809 München, Germany

Chairs: Professor Dr. Rudolf Mellinghoff, Dr. Giammarco Cottani, Professor Dr. Heinz Jirousek

11/19/2014 - 11/21/2014

http://www.taxauditforum.eu/

TAX PLANNING FOR NON-DOMICILIARIES CONFERENCE

IIR & IBC Financial Events

Venue: TBC, London, UK

Key Speakers: Jonathan Burt (Harcus Sinclair), Richard Frimston (Russell Cooke), John Barnett (Burges Salmon), Michael Sherry (Temple Tax Chambers), among numerous others.


http://www.iiribcfinance.com/event/Tax-Planning-For-Non-Domiciles

CAPITAL GAINS TAX CONFERENCE 2014

IBC

Venue: TBC, London, UK

Chair: David Kilshaw (EY)

12/2/2014 - 12/2/2014

http://www.ifcreview.com/eventsfull.aspx?eventId=199

OFFSHORE TAXATION CONFERENCE

IIR & IBC Financial Events

Venue: TBC, London, UK

Key Speakers: Patrick Soares (Field Court Tax Chambers), Emma Chamberlain (Pump Court
Tax Chambers), Patrick Way QC (Field Court Tax Chambers), Philip Baker QC (Field Court Tax Chambers).

12/3/2014 - 12/3/2014

http://www.iiribcfinance.com/event/offshore-tax-planning-conference
United States  

The United States Tax Court heard the case of a Chinese citizen who received income tax refunds while living in the US due to the double tax treaty between the US and China. After he became a resident alien he received a tax refund plus accrued interest, but did not declare the interest as income earned.

The IRS objected to the refund interest not being included in the income tax return, and the taxpayer brought the dispute before the Tax Court, arguing either that the interest would have been offset in an earlier year without any tax liability if the IRS had processed his tax return correctly, or that the interest was exempt from tax because it was based on a refund resulting from the application of a treaty exemption. If these arguments failed to convince the Court, then the taxpayer wanted the interest to be taxed at the 10% treaty rate as received by a resident of China.

The Tax Court stated that it was the responsibility of the taxpayer to show that the IRS had erred in demanding the interest income be included in the tax return, despite the taxpayer’s attempt to rely on statutory law to pass the burden of proof onto the IRS. The first argument was immediately dismissed, as the taxpayer had submitted an amended tax return years after the one relevant to the refund, and therefore was not in any position to suggest that the IRS had processed his initial tax return incorrectly.

The second argument also failed because the taxpayer could not provide any evidence to support his claim that since the refund was tax exempt the interest was also exempt and not required to be included in the tax return; the court also reported that "interest is generally taxable as income to the recipient, including interest resulting from a tax refund."

Since both of his arguments failed, the taxpayer sought to have the interest taxed at 10% under the US-China tax treaty, claiming that he was a resident
of China during the relevant tax year on the basis that his permanent home was in China, and that the tax rate reduction applied whether or not he was considered a resident of the US.

The court rejected the notion that the taxpayer was a resident of China, since he had provided no evidence or relied on any Chinese tax law as required by the treaty to demonstrate so. Regarding the question of whether his US residency had any relevance to the tax rate, the court noted the difference in tax treatment between resident and non-resident alien individuals. The IRS pointed out that the taxpayer was physically present and employed in the US, and that he himself acted as a resident alien during the tax years. The court therefore concluded that he was a US resident and therefore "the interest income was ordinary income in 2009 and taxable under the appropriate graduated tax rate."

The judgment was delivered on August 26, 2014.


Tax Court: Zhengnan Shi v. Commissioner (T.C. Memo. 2014-173)

ASIA PACIFIC

Australia

The full court of the Federal Court of Australia heard the case of an Australian company which made payments to a Canadian company according to a distribution agreement. The paying company argued that the payments were not royalties subject to withholding tax, due to the application of an exemption regarding the right to use software source code in the double tax treaty between the two countries (source code was briefly mentioned in the agreement between the companies). The Commissioner intended to impose a penalty on the paying company for failing to account for the withholding tax, since the payments would be considered royalties if the exemption did not apply.

The court identified two conditions according to the tax treaty for the exemption to apply; the payments were consideration for the supply of or right to use source code, and the source code "had to be limited to such use as is necessary to enable effective operation of the program by the user".

The distribution agreement outlined the rights and supplies the paying company received, and because "source code" was expressly defined but not included in the list that specified what exactly the paying company had the right to or use, it was clear to the court that the company could not rely on the treaty withholding tax exemption. The company's assertion that their right to use computer software extended to the source code was dismissed.

Because the paying company had no right to use source code under the distribution agreement, and therefore it could not prove how much of the consideration paid to the Canadian company was made to acquire such a right, the court ruled that
the payments were subject to withholding tax as royalties since the treaty exemption did not apply.

The judgment was delivered on September 5, 2014.


Federal Court: Task Technology Pty Ltd v. Commissioner of Taxation (FCAFC 113)

WESTERN EUROPE

Sweden

The European Court of Justice (ECJ) was asked for a preliminary ruling concerning a company which distributed IT services as a member of an international group of companies. The company operated a Swedish branch which processed the IT services purchased outside the group, to be distributed to other members some of which were not part of the same VAT group as the company and the branch.

The Swedish tax authority was of the opinion that the company should be taxed on the supply of the IT services to the branch, and also that the branch should be subject to tax as the Swedish representative of the company. The company objected, and the referring national court approached the ECJ for an interpretation of EU law regarding the tax treatment of transactions within a VAT group, where they occur between a company inside and a company outside of the EU.

The ECJ recognized that one of the companies in question is a branch of the other, and that supplies of services are taxable "only if there exists between the service supplier and the recipient a legal relationship in which there is a reciprocal performance".

Upon considering whether the branch was carrying out its business independently and therefore bearing the risk, the ECJ concluded that a branch could not be considered a taxable person because it was owned by and belonged to another company. However, as a member of a VAT group, the branch is not the receiver of the supplied services but rather the group is, since the group is a taxable person according to EU law.

Therefore, the ECJ concluded that transactions made with a branch in another country are taxable when the branch is a member of a VAT group.

Following on from this conclusion, the ECJ then deliberated over whether the VAT group as the receiver of the services was liable for VAT. It was accepted that the company making the supplies was established outside the EU, and therefore according to EU law, the receiver is liable for VAT when the supplier is not in the relevant Member State. The ECJ ruled that the VAT group was liable for the VAT on the services supplied to it by a member which constituted a separate taxable person in a third country.

The judgment was delivered on September 17, 2014.
European Court of Justice: Skandia America Corp. (USA), Filial Sverige v. Sweden (C-7/13)

United Kingdom

The European Court of Justice (ECJ) was asked for a preliminary ruling concerning a company primarily dealing with the lending of cars bought from dealers at the request of its customers. Both the purchase and lending of the cars were transactions subject to VAT, but when a customer defaulted on its payments the hire purchase company would repossess the vehicle and sell it at an auction, which was not considered a supply of goods or services subject to VAT.

However, according to a national court decision in the UK, legislation which initially applied to the willful termination by a customer of an agreement with the company that resulted in the car being sold may be interpreted in such a way as to apply to auctioned vehicles. Therefore the company claimed for bad debt relief equivalent to the amounts not paid by the defaulters which had not been recompensated by the auction proceeds, and when the company appealed the court accepted that the Commissioners’ rejection of the claim was unjustified under EU law. The Commissioners appealed and the second court approached the ECJ for an interpretation of EU law regarding the applicable VAT legislation to each transaction.

The ECJ recognized that the court was concerned about the company benefiting from both national law and EU law resulting in a tax advantage which neither provided for, and that the former might not be compatible with the latter. The ECJ stated that the relevant EU law has direct effect, in that it applies despite an attempt by a member state to implement it, and therefore it can be relied upon "to reduce the taxable amount whenever, after a transaction has been concluded, part or all of the consideration has not been received by the taxable person".

The UK Government failed to argue that the law does not have direct effect, or that the consideration provided by the customer to the company was not the basis for its VAT liability. The ECJ accepted that because national law did not treat the sale at auction of the vehicles as either a supply of goods nor services, the company should not be prevented from relying upon EU law to reduce its tax liability in the case of defaulted agreements and non-paying customers.

The UK Government then attempted to argue that a company which can choose to apply either national law or EU law in respect of different transactions concerning the same goods is abusing the system; the ECJ pointed out that it was for the national court to decide whether the company in the present case had done something abusive, based on the available evidence, and on the premise that a transaction made solely to obtain a tax advantage contrary to the legal provisions that apply to it would be considered an abusive practice.
However, a company may choose a method of doing business that results in a tax advantage without that method being abusive, since the choice depends on a variety of factors other than tax. Nevertheless, the ECJ ruled that a company can rely on an EU legal provision with direct effect despite the availability of a similar national law, even though the application of both may result in a tax advantage which neither provides for.

The judgment was delivered on September 3, 2014.

European Court of Justice: UK v. GMAC UK plc (C-589/12)

**United Kingdom**

The UK's First-tier Tribunal (FTT) has ruled in favor of the appellant in an appeal concerning VAT default surcharges sought by HM Revenue and Customs (HMRC).

In *Scrimsign (Micro-Electronics) Ltd v Revenue & Customs* [2014] UKFTT 866 (TC), the judge agreed that the recession and related circumstances were the cause of the company's failure to pay VAT, which he said constituted a "reasonable excuse" for late payment of VAT under section 71(1)(a) of the VAT Act.

The appellant argued that the company would have had to cease trading had it paid the VAT debt on time. The company's owner said the shortage of working capital was attributable to the lending attitude of banks — one of the factors, owing to the recession, cited by the company to explain its inability to pay.

In ruling in favor of the taxpayer, the judge considered the precedent set in *Dollar Land (Feltham) Ltd & Anr v CEC*[4].

In *Dollar*, the tribunal, after considering *Steptoe* [1992] STC 757 (CA), took the view that there was no reason in principle why the length and depth of a recession should be incapable of giving rise to a reasonable excuse, provided that it was clearly shown that the recession was the real cause of the shortage of funds and that the resultant lack of funds was not reasonably avoidable.

The judge agreed that "the underlying cause of the Appellant's inability on occasion to pay the VAT due from time to time was the long-term effects of the recession, which has endured for much longer than many businesses predicted."

The appellant's appeal against the default surcharge was therefore ruled to be permissable.

The judgment was delivered on September 3, 2014.


UK First-tier Tribunal: UK v Scrimsign (Micro-Electronics) Ltd [2014] UKFTT 866 (TC)
Dateline September 25, 2014

Those who might have dismissed the Scottish independence debate and last week’s referendum as a rather localized, parochial sort of issue were mistaken. Many parts of the world took a great interest in the outcome of the plebiscite. In the final hours of the campaign, President Barack Obama took to twitter to express his hope that a key ally remained strong and united. And the Scottish question has been keenly watched in Europe, where there have been pockets of nationalist pressure waiting to burst forth on the back of a "Yes" vote, notably in Spain, Belgium and France (Corsica). Even in Germany, seemingly the most settled of countries, the impending referendum was front-page news, given the potential of Scottish independence to destabilize an already unsteady European Union. One paper even reported a spike in sales of whisky in Germany and other EU countries, with those fond of a little scotch worried that their favorite tipple might in future be subject to new customs duties. And we saw how the markets reacted to the possibility of an independent Scotland as traders dumped sterling and UK stocks and ratings agencies warned of downgrades for a truncated UK, whatever the new country would have been called (Lesser Britain perhaps?). Although one suspects they would have got used to the idea pretty quickly.

With the referendum all over bar the shouting (and there has been plenty of that by all accounts) and a fairly decisive victory had by the "No" camp (although the 45 percent who voted "Yes" represents a substantial minority), these concerns are no longer pressing. But it can also be said that this is just the end of round one. Regardless of whether Scotland went independent or not, Edinburgh is going to get more powers over Scottish affairs, including taxation, under the Scotland Act. And in a desperate last-minute bid to save the Union, Chancellor George Osborne announced shortly prior to the referendum vaguely-defined plans to give Scotland even more freedom over taxation north of the border. A new constitutional settlement between Scotland and the rest of the UK will also have to be negotiated to stop Scottish MPs in Westminster having a say on affairs in England when their Right Honourable English friends can no longer vote on many Scottish issues. I neglected to mention Wales and Northern Ireland in this negotiation, which is apt because they are now feeling rather ignored by London and its deference to Scottish sensitivities. Why not a Welsh income tax too? And shouldn’t businesses in Belfast be able to compete on a level playing field with less fiscally-restrained firms in the Republic paying corporate tax at 12.5 percent? Even the possibility of an English parliament is now supported by supposedly pro-union Conservatives and federalist liberals alike. Given the shaky foundations of the Scottish National Party’s economic plans – in essence an expanded welfare state bankrolled by oil and gas reserves which are already substantially depleted – and the uncertainties surrounding other vital economic issues like currency and EU membership, the result is probably the best one for the UK overall. Then again, if you’re sitting...
on the outside and contemplating a major investment in the UK, the prospect of what could turn out to be an unholy mess in terms of tax and regulation can hardly be doing wonders for your confidence. See what nationalism does? It might be a cathartic force for some, but overwhelmingly it’s a negative one. Perhaps the only winners so far in all of this are the distillers. A wee dram anyone?

While too much change too quickly can unsettle investors, so too can change happening at a snail’s pace. Or less than a snail’s pace in the case of Costa Rica. I’m struggling to think of another country that has taken so long to attempt to put into law a package of fiscal reforms. There is India of course, but you can sort of understand why that is if you are familiar with the country’s numbing bureaucracy. But investor-friendly Costa Rica? The answer to this conundrum lies with Costa Rica’s legislature, which is often its own worst enemy, tending to paralyze when any issue of national significance is put before it. We saw this with the Central American Free Trade Agreement, which was ratified by Costa Rica years after it was approved by its other members. And for over a decade now, the Legislative Assembly has been incapable of passing a fiscal reform package drawn up as far back as 2002. These reforms aren’t exactly good news for Costa Rica; they are designed to increase tax revenues in order to tackle the country’s budget deficit and rising debt, which is largely the result of previous governments’ spendthrift ways. But the impasse is just fueling uncertainty and in the meantime piecemeal tax rises have taken place, making the tax system steadily less attractive. And since 2008, public debt has jumped alarmingly from 25 percent of GDP to 40 percent. Worryingly, since May, the country has been led by a President with no previous political experience (on second thoughts maybe that’s not such a bad thing) who wants to raise taxes, although not for the first two years and, confusingly, has also pledged an overhaul of the tax system. Perhaps the problem is that there are too many checks and balances in the legislative system. Costa Rica was recently praised by Moody’s for its "entrenched democratic tradition," but almost in the same breath the ratings agency said this was an obstacle to law-making and consensus building. Consequently, it downgraded the country’s credit rating to junk status due the failure to deal with its mounting fiscal problems. Nonetheless Costa Rica remains one of the most favorable countries in Latin America for foreign investors. Although labor costs are relatively high, the territorial income tax regime is a major draw, and recent administrations have set about diversifying the economy away from agricultural staples like bananas and coffee towards hi-tech manufacturing by creating free zones and passing laws to create a small but thriving financial services sector. However, with the downgrade and the closure of Intel’s microchip assembly operation – a significant contributor to the country’s exports – things are starting to look quite gloomy for Costa Rica unless the clunky legislative machinery can find another gear.

One way in which Costa Rica’s President Solis plans to raise revenue is through a crackdown on
tax evasion, which represents something of a "go
to" policy these days for any government in need
of revenue. Refreshing then, that not too far to the
north, Mexico is taking the opposite tack: offer-
ing small companies tax breaks for registering their
workers with the tax authorities. It follows the tak-
ing of another unusual but sensible step by Presi-
dent Enrique Peña Nieto earlier this year when he
signed a Tax Certainty Agreement, which commits
to keeping Mexico’s tax system unchanged through-
out the remaining period of his administration, un-
til November 30, 2018. Mexico’s taxes aren’t the
lowest or the easiest to follow – anyone who has
tried to get their head around the Maquiladora in-
centive regime would probably attest to that. But

investors hate uncertainty, and while this means
there is little prospect of taxes being cut, at least
they won’t increase or change at short notice. I can
sympathize somewhat with the view that taxpayers
attempting to flout the system shouldn’t be offered
bribes to comply with it. But there is far too much
use of the stick by tax authorities these days, and
not enough of the carrot. Dogs that are encouraged
to be well behaved by the giving of rewards by their
masters usually make the most docile and compli-
ant companions. Beat him every time you think he
has stepped out of line, and he might one day turn
around and bite you.

The Jester