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# GLOBAL TAX WEEKLY
## a closer look

ISSUE 136 | JUNE 18, 2015

**SUBJECTS** TRANSFER PRICING INTELLECTUAL PROPERTY VAT, GST AND SALES TAX CORPORATE TAXATION INDIVIDUAL TAXATION REAL ESTATE AND PROPERTY TAXES INTERNATIONAL FISCAL GOVERNANCE BUDGETS COMPLIANCE OFFSHORE

**SECTORS** MANUFACTURING RETAIL/WHOLESALE INSURANCE BANKS/FINANCIAL INSTITUTIONS RESTAURANTS/FOOD SERVICE CONSTRUCTION AEROSPACE ENERGY AUTOMOTIVE MINING AND MINERALS ENTERTAINMENT AND MEDIA OIL AND GAS

**COUNTRIES AND REGIONS** EUROPE AUSTRIA BELGIUM BULGARIA CYPRUS CZECH REPUBLIC DENMARK ESTONIA FINLAND FRANCE GERMANY GREECE HUNGARY IRELAND ITALY LATVIA LITHUANIA LUXEMBOURG MALTA NETHERLANDS POLAND PORTUGAL ROMANIA SLOVAKIA SLOVENIA SPAIN SWEDEN SWITZERLAND UNITED KINGDOM EMERGING MARKETS ARGENTINA BRAZIL CHILE CHINA INDIA ISRAEL MEXICO RUSSIA SOUTH AFRICA SOUTH KOREA TAIWAN VIETNAM CENTRAL AND EASTERN EUROPE ARMENIA AZERBAIJAN BOSNIA CROATIA FAROE ISLANDS GEORGIA KAZAKHSTAN MONTENEGRO NORWAY SERBIA TURKEY UKRAINE UZBEKISTAN ASIA-PAC AUSTRALIA BANGLADESH BRUNEI HONG KONG INDONESIA JAPAN MALAYSIA NEW ZEALAND PAKISTAN PHILIPPINES SINGAPORE THAILAND AMERICAS BOLIVIA CANADA COLOMBIA COSTA RICA ECUADOR EL SALVADOR GUATEMALA PANAMA PERU PUERTO RICO URUGUAY UNITED STATES VENEZUELA MIDDLE EAST ALGERIA BAHRAIN BOTSWANA DUBAI EGYPT ETHIOPIA EQUATORIAL GUINEA IRAQ KUWAIT MOROCCO NIGERIA OMAN QATAR SAUDI ARABIA TUNISIA LOW-TAX JURISDICTIONS ANDORRA ARUBA BAHAMAS BARBADOS BELIZE BERMUDA BRITISH VIRGIN ISLANDS CAYMAN ISLANDS COOK ISLANDS CURACAO GIBRALTAR GUERNSEY ISLE OF MAN JERSEY LABUAN LIECHTENSTEIN MAURITIUS MONACO TURKS AND CAICOS ISLANDS VANUATU

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# GLOBAL TAX WEEKLY
## a closer look

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## NEWS ROUND-UP

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## Consequences Of IRS Tax Compliance For Offshore Residents

by Mike DeBlis Esq., DeBlis & DeBlis

Since the time the Internal Revenue Service (IRS) announced the revised Offshore Voluntary Disclosure Program (OVDP), there has been a consistent restlessness among American expats. At the forefront of this change is the inclusion of the Streamlined Compliance Procedure Program, which is available to US individual taxpayers residing in the United States as well as those who live abroad.

The Streamlined Foreign procedures cater to those US citizens or lawful permanent residents – *i.e.*, expats – who satisfy the non-residency requirement. The non-residency requirement has two strands. First, the taxpayer must *not* have a US abode. And second, the taxpayer must have lived outside the US for at least 330 full days in at least one (or more) of the most recent three years for which the US tax return due date (or properly applied-for extended due date) has passed. Which year the taxpayer lived outside the US for the threshold number of days is meaningless so long as it occurred during one of the three years in the look-back period. Satisfying the latter requirement is easier said than done, especially for Canadian "snow birds" who migrate south of the border to Florida in the winter months to avoid the blistering Canadian winter. As an aside, with the Arctic blast that Mother Nature unleashed on the east coast this winter, where the mercury fell

below zero degrees Fahrenheit for the better part of the season, winter 2015 in Canada had nothing on winter in the States.

Since its implementation, the IRS's Offshore Tax Compliance has seen sharp criticism from different corners of the world, with more from countries with a sizeable American population. It is evident that a large chunk of the American population regularly pays their taxes. However, what about those who live abroad? Should they be paying equal taxes despite the fact they do not live on American soil? Do they enjoy the same perks and laurels as those who live in the country?

You may also ask whether the IRS is justified in asking expats to pay the same tax ratio. The answer to all of these questions is a simple "no," but not without explanation. First, let's look at what the expat tax is all about and why the IRS doesn't exclude expats from their tax database. Additionally, we will unveil the IRS's opinion in this regard and what their "company line" is when it comes to these new tax reforms.

## IRS And The Disclosure Of Expat Accounts

The IRS is the sole entity responsible for tax and deductible collection throughout the United States. The agency works autonomously, without carrying any external financial influences. Although the agency prepares tax collections and related documents to facilitate necessary deductions from all taxable incomes, the legal provisions give the IRS final authority to accumulate the taxable amount if a taxpayer refuses to do so.

Voluntary programs launched by the IRS are nothing new and have been going on since time immemorial (*i.e.*, the 1960s). The IRS established the Voluntary Compliance Initiative for taxpayers who had unreported accounts. Many of these accounts were found to have irregular or unreported tax liabilities and were using offshore payment cards for conducting financial transactions. To stop such activities, the IRS took necessary initiatives under regulation Proc. 2003-11, which plugged many foreign tax-related loopholes.

## The Consequences Of The Program

The new IRS Program was a mess from the beginning. Initially, many expat taxpayers were not sent notices, which was a grave mistake by the IRS. If that wasn't enough, there were approximately 2,000 taxpayers who never had a chance to reinstate their accounts in the tax net. Luckily, for such expats, the IRS reformed the Program and extended the deadline. This time around, they made sure all expats received notices well within the deadline. For this purpose, the IRS initiated the Offshore Voluntary Compliance Program (OVCP) under regulation Proc. 2003-11.

For those unfamiliar with regulation Proc. 2003-11, it targets tax thieves and evaders - the "Al Capones" of the tax world. Specifically, it pertains to the deliberate underreporting of income by US expats to evade their tax liabilities. Very simply, the IRS introduced this regulation to bring US expats into the mainstream tax net.

However, so far the IRS has only included those expats who were required to pay their due taxes on their income within the desired deadline, after which the IRS would hold no responsibility nor provide any tax amnesty to such defaulters. Fulfilling on their promise, the IRS took action against 29,000 tax defaulting expats in 2014. By 2015, the IRS plans to include 30,000 more expats into the tax collection database, which is the largest number of taxpaying expats since the inception of this regulation.

## Who Is Affected?

The IRS tax compliance targets all expats who own an account at any foreign bank which reaches a high watermark balance of at least USD10,000 at any given point during the year. These users must complete the IRS form sent to them via e-mail and postal codes.

The form is marked as "IRS 1040 Schedule B," and has relevant information on why and how to register for the Offshore Voluntary Compliant Initiative

and how to become eligible for the benefits that accompany the Program by registering within due time. Not to be overlooked is the additional requirement that expats complete an "FBAR" (Foreign Bank Account Report) once a year; these are due on or before June 30 of the year following the year that the taxpayer had the foreign account.

If you deliberately avoid signing the form that the IRS has sent to you "sealed with a kiss," you qualify as a tax defaulter under IRS code sec. 1041 (1041 pertains to the Report for Foreign Banks and Financial Accounts, or "FBAR" for short). If this happens, you can face the wrath of the IRS, which has been known to bring many a taxpayer to the brink of insanity. The parade of horribles consist of any one of the following: onerous penalties that could leave you with nothing more than the shirt on your back to the possibility of a criminal referral to the Department of Justice, or both. Indeed, the stakes are high. The only ironclad way of avoiding this calamity is to be fully transparent by disclosing all of your foreign bank accounts on your FBAR and reporting any interest income generated by them – no matter how negligible – on your 1040.

Some taxpayers operate under the false belief that if the interest income generated by their foreign accounts is negligible or if they have already paid taxes on the interest generated by their foreign accounts to the foreign government in which they live (such that the foreign tax credit virtually eliminates any and all US tax liability due and owing to Uncle Sam), there is no point in filing an FBAR. In other words, these taxpayers take the position that filing an FBAR is a mere formality. This thinking could not be more wrong. To say that they are "living life on the edge" would be a complete understatement. As the IRS has said time and time again, no amount of interest income is too small to trigger an FBAR-reporting violation.

## Tax Deduction Ratio For Expats

The biggest concern before the new reforms were incorporated in the Program was the ratio of tax collection from foreign expats, among other things. Another question mark was that since expats were living abroad and were not benefitting from any of the federal perks, utilities and advantages, then what moral ground did the IRS have to tax their incomes?

There were hot and contentious debates on this issue a few months before the new regulation was implemented. Although valid arguments were raised by the expat community, the IRS came up with different answers for both.

The answer to the first question was the possible tax amnesty for expats who had been paying their taxes and showing proper incomes. Another incentive was provided to appease expats who challenged the *status quo* by questioning the need for a tax deduction from their foreign earned salaries when no US government facilities were ever used.

## Revised Terms Of The OVDP

No discussion of tax compliance *vis-à-vis* US expats would be complete without a discussion of the

IRS's Offshore Voluntary Disclosure Program. The revised terms of the OVDP call for an automatic offshore penalty of 27.5 percent of the highest year's aggregate maximum balance over an eight-year look-back period. The highest year's aggregate balance is determined by comparing the maximum aggregate balances for each year during the eight-year disclosure period and selecting the highest aggregate balance among those years.

That balance, in turn, becomes the base to which the 27.5 percent penalty applies. Many a taxpayer has asked the question: "Is the offshore penalty negotiable?" Unfortunately, the answer is "no." If a taxpayer has already submitted his OVDP letter and attachments and then wakes up the next morning feeling "buyer's remorse," the only way out from under the offshore penalty is to "opt out" of the Program. Even after opting out of the IRS's civil settlement structure, taxpayers should be reminded that they remain within Criminal Investigation's Voluntary Disclosure Practice. Therefore, taxpayers must still cooperate fully with the examiner by providing all requested information and records and must still pay or make arrangements to pay the tax, interest and penalties that are due. If the taxpayer does not cooperate and make payment arrangements, the case may be referred back to Criminal Investigation.

As if things couldn't get any worse, to the extent that the taxpayer has an account at any of the banks listed below, the offshore penalty automatically increases from 27.5 percent to 50 percent. Ouch!

Following is the list of banks:

(1) UBS AG
(2) Credit Suisse AG, Credit Suisse Fides, and Clariden Leu Ltd.
(3) Wegelin & Co.
(4) Liechtensteinische Landesbank AG
(5) Zurcher Kantonalbank
(6) Swisspartners
(7) CIBC First Caribbean International Bank Limited, its predecessors, subsidiaries, and affiliates
(8) Stanford International Bank, Ltd., Stanford Group Company, and Stanford Trust Company, Ltd.
(9) HSBC India
(10) The Bank of N.T. Butterfield & Son Limited (also known as Butterfield Bank and Bank of Butterfield).
(11) Sovereign Management & Legal, Ltd., its predecessors, subsidiaries, and affiliates (effective December 19, 2014)
(12) Bank Leumi le-Israel B.M., The Bank Leumi le-Israel Trust Company Ltd., Bank Leumi (Luxembourg) S.A., Leumi Private Bank S.A., and Bank Leumi USA (effective December 22, 2014)
(13) BSI SA (effective March 30, 2015)
(14) Vadian Bank AG (effective May 8, 2015)
(15) Finter Bank Zurich AG (in effect since May 15, 2015)

The IRS is further looking at formulating more incentives for taxpayers and expats who scrupulously follow their responsibilities and pay their taxes on time.

Additionally, the IRS is also looking to draw more incentives for such taxpayers, such as interest and tax reduction schemes, reduced penalties, and other forms of financial incentives. Under the new regulation, if approved by the Government, even tax default expats would be able to pay their taxes with minimum fuss.

# How Just Is The Retroactive Imposition Of MAT On FIIs: A New Look

by Padmini Khare, B.K. Khare & Co,
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The Indian Government's decision to impose the minimum alternate tax (MAT) on foreign institutional investors (FIIs) retrospectively was greeted with howls of protest. The Finance Minister, on the other hand, defended himself by pointing out that the issue of notices to them for payment of MAT was a ticklish legacy matter the Government had inherited. Its efforts were directed towards finding a solution within the framework of the law as it prevailed during the relevant year. This argument needs to be examined in detail.

But first the facts. Initially, FIIs applauded the current year's Budget for providing the much awaited clarity on their liability to pay MAT. With effect from April 1, 2015, announced the Finance Minister, the capital gains they made from transactions in securities invested in accordance with Securities and Exchange Bureau of India (SEBI) regulations would not be part of book profits for the purposes of MAT, and therefore would not attract this tax.

This must have been music to the ears of the investors concerned because this was exactly the kind of transparency in the provisions they were looking for. Little did they realize then that their happiness would be so short-lived. Because the relevant provision, section 115-JB, was not drafted with sufficient care and had given rise to conflicting interpretations, the Revenue seized upon one of these and began issuing notices for the levy of MAT on incomes alleged to have escaped assessment for earlier years. The move, as we shall see, was ill-conceived and poorly thought through. If it had not been challenged, it would have resulted in raising retroactive tax demands of the order of about INR40,000 crores (USD400bn).

Markets reacted nervously to the Ministry's announcement; *The Business Standard* of April 27 noted that the outflow of capital thus far had been of the order of INR817 crores. This is not a huge number. But much more than the quantum of flight of capital that had taken place thus far was the fact that confidence in the intentions of the Government stood severely dented. How could the Government raise taxes retrospectively, FIIs asked,

when the Finance Minister had earlier on a number of occasions promised that he would never resort to such measures?

The Government was clearly on the defensive, even though one important judicial decision, the ruling of the Authority for Advance Rulings in the case of *Castleton Investments Limited* (AAR 999 of 2010; TS-607-AAR-2012), a company resident in Mauritius, had gone in its favor. In this case, contradicting its earlier ruling on the subject, the Authority ruled *inter alia* – perhaps somewhat unfairly – that when the language of a provision of law is clear and unambiguous, it is irrelevant to turn to other extraneous documents, such as the speech of the Finance Minister, Notes on Clauses, or the Explanatory Memorandum to the Finance Bill, to find out the true intention of the Legislature. Section 115-JB(1) uses the word "company," and section 2(17), the relevant definitional provision, clearly lays down that for the purposes of the Act, the term "company" includes within its ambit companies incorporated both inside as well outside India. MAT is thus clearly exigible in the case of foreign companies, ruled the Authority.

This judgment sought to ignore the practical constraints inherent in trying to approach the legal issue in this narrow manner. While section 115-JB(1) seeks to levy MAT on companies, section 80-JB(2) stipulates that the starting point for the exercise would be the profit and loss account, prepared in accordance with Parts II and III of Schedule VI to the Companies Act, 1956.

The profit thus reported is then subjected to certain adjustments laid down under this provision. Now, domestic companies may not have much trouble complying with this requirement. FIIs, not subject to the Companies Act, however may find it very cumbersome to comply with it. While following the norms prescribed by their own countries for maintenance of accounts, they would find it difficult to isolate their Indian incomes and prepare separate accounts for the same, if they do not maintain a permanent establishment in India. The Authority for Advance Rulings merely shrugged aside these practical difficulties as if to say that if they existed so be it; it was not its job to deal with them.

The aforesaid ruling, it is submitted with respect, was erroneous on at least five counts.

First, while it is true that, in the absence of any ambiguity, a fiscal statute should be interpreted according to the plain meaning of the words used therein, there is another equally valid rule of interpretation which should not be lost sight of, particularly in conditions of complexity and ambiguity.

This rule of contemporaneous exposition comprises ascertaining the true intention behind the statute by examining contemporary documents – such as the Finance Minister's speech, the relevant Notes on Clauses, or the relevant Explanatory Memorandum to the Bill. These are important and must be referred to, to find out what the Government of the day intended to achieve. J. B. Kanga and N. A.

Palkhivala in their *Law Practice of Income Tax (10th Edition)* have opined thus at page 23:

> "In order to find out the legislative intent, or to ascertain the object or purpose behind the legislation, the speech made by the Minister or the prime mover of the Bill can be taken into consideration."

*Loka Shikshana Trust v. CIT* [1975] 101 ITR 234 (SC) supports this proposition; so does the House of Lord's decision in the case of *Pepper v. Hart* [1994] 210 ITR 156 (HL), wherein Lord Griffith observed:

> "… the days have long passed when the courts adopted a strict constructionist view of interpretation which required them to adopt the literal meaning of the language. The courts now adopt a purposive approach which seeks to give effect to the true purpose of legislation and are prepared to look at much extraneous material that bears upon the background against which legislation was enacted."

This modern approach to fiscal jurisprudence was also noticed in *Comet Radio Vision Services v. Farnell Trand Berg* [1971] 3 All ER 230. Goulding J. observed as follows:

> "The language of Parliament though not to be extended beyond its fair construction, is not to be interpreted in so slavishly literal a way as to stultify the manifest purpose of the Legislature."

In the present case, provisions relating to the levy of this tax were amended in 2002 and the Finance Minister's speech, the Notes to the Finance Act, 2002 and a subsequent circular issued by the Central Board of Direct Taxes (CBDT) all seem to indicate that the tax was to be raised from domestic companies only. In fact, in the case of *Timken*, 326 ITR 193 (AAR), an earlier judgment of the same Authority, after referring to these documents, held accordingly, in line with current principles of fiscal jurisprudence cited above. In the present case, however, the Authority chose to give up this preeminently sensible and practical approach.

Second, the *Castleton* case totally ignored the computational problems involved in extending the scheme of MAT to foreign companies not under any obligation to prepare their final accounts in accordance with the Companies Act. The Authority thus expected the FIIs concerned to shoulder an unreasonable burden, compelling the assessees concerned to prepare two sets of accounts – one of which would be exclusively for determining their liability under MAT, and one for other purposes. This is hardly a way to welcome foreign investment into the country.

The Authority should have taken cognizance of the consequences of its ruling – namely of flight of capital – before it delivered its order. It should also have noticed an earlier Supreme Court ruling in *CIT v. B.C. Srinivasa Setty*, 128 ITR 294 (SC) to the effect that even when a receipt falls within the ambit of the charging section, it cannot be brought to tax

if the machinery or computational provisions fail. The mere impossibility of extending the provisions of the Companies Act to foreign entities in no way governed by this legislation should have deterred the Authority from ruling that section 115-JB(1), the relevant provision for the imposition of MAT, extended to them.

Third, while relying on the definitional section – section 2(17) – to hold that the term "company" included a company incorporated outside India, the Authority should have, but did not, give enough weightage to the expression "unless repugnant to the context," which figures at the very outset of the aforesaid definitional section.

In the context of the very nature of the controversy relating to the imposition of MAT on FIIs, defining a company to include foreign companies is repugnant to the context for reasons more than one. The Finance Minister's Speech of 2002, the Notes on Clauses to the Finance Bill and other contemporary documents of that year seem to support this conclusion.

Fourth, there is a problem raised by the Delhi High Court in the case of *Linde AG, Linde Engineering Division and Another v. Deputy Director of Income-tax*, WP(C) No. 3914/2012 and CM No. 8187/2012. It seems the Authority for Advance Rulings has been departing from its past rulings and this tendency has been frowned upon by the High Court. In the *Castleton* case above, since there was already a well-considered ruling on the issue, the Authority would ordinarily have been expected to follow the same in keeping with spirit of Article 14 of the Constitution (see para 65 of *Linde AG*, above).

In fact, the Revenue had accepted this decision and all but given up its stand. By holding to the contrary in the *Castleton* case, the Authority reignited a controversy which had almost died a natural death. The Authority's approach, it is submitted with great respect, is hardly conducive to judicial discipline, which demands that judicial as well as quasi-judicial bodies respect past rulings. Not to do so is bound to lead to confusion in the minds of taxpayers and bring about even greater uncertainty within the tax system.

Finally, the Authority for Advance Rulings would also have done well to heed the Latin maxim, recently approved by the Supreme Court in *CIT v. Vatika Township Pvt. Ltd* 2014-TIOL-77-SC: *lex prospicit non respicit.* Ordinarily the law is presumed to have prospective rather than retrospective effect; it looks forward rather than backwards. An interpretation made today should not change the character of a past transaction. Nor should it modify an accrued right or impose an obligation or duty which did not exist earlier.

The story of the *Castleton* ruling is a classic case study of how not to impose a tax. However erroneous the ruling, the Government has to shoulder some blame for what happened subsequently. A tax bureaucracy will always try to maximize revenues;

that is the yardstick by which it is evaluated by the Government. A Finance Minister however should know better than to blindly follow such advice, no matter how tempting it may be for him to maximize revenues.

It is always better to follow a balanced well-argued ruling in line with the Government's own intention, rather than depend on one which appears to promote judicial indiscipline and confusion among taxpayers. When it comes to the crunch, it is the national interest that must prevail: there is very little point in trying to collect INR40,000 crores, if the long-term loss in revenues resulting from the flight of FIIs is likely to cost the Government far, far more.

It hardly does the credibility of the Government any good if because of protest from interest groups, in this case FIIs, it is seen to announce policy relaxations successively under pressure. First, it announced that treaty obligations, wherever applicable, would override this levy. Then it exempted certain incomes – such as interest income, technical fees and royalties – from MAT. Now it has decided to hold all measures in abeyance until the high-powered committee under Justice A. P. Shah delivers its report.

All this could have been avoided had the Government not issued notices in the first instance and allowed the Supreme Court to sort out the matter. The controversy could also have been eschewed had the relevant provision been drafted more sharply. The draftsman should not have used the word "company" when he actually meant "domestic company." The March Hare's advice to Alice in *Alice in Wonderland* was actually pretty good, and the Ministry might like to heed it: "… you should say what you mean," he told Alice. Alice's reply, was weak: "… at least I mean what I say." In law that is quite often not good enough.

# Assessing The Chances Of US Tax Reform

by Stuart Gray, Senior Editor, Global Tax Weekly

## Introduction: Unraveling The Code

Few people who have come into contact with the US tax code could refute the assertion that the tax system has grown in complexity since the last serious round of tax reforms took place in 1986, especially as numerous studies have attested to the fact that individuals and businesses in America are spending more and more time and money on complying with the code. Indeed, tax code complexity is cited as a major issue confronting taxpayers every year in the National Taxpayer Advocate's report to Congress, while business groups regularly point out in their public pleas for tax reform that the US has the highest statutory rate of corporate tax in the OECD at 35 percent, before state taxes. In fact, the US now only just makes the top 50 in PwC's Paying Taxes index, which measures how user-friendly tax systems are for an average medium-sized business in 189 countries, being placed 47th in 2015 with a total tax rate of 43.8 percent.

One of the latest reports on tax code complexity was released in April 2015 by the National Taxpayers Union Foundation (NTUF), which found that it cost taxpayers a total of USD233.8bn to comply with the complex tax code.[1] That total cost consisted of 6.1 billion hours of lost productivity at the average hourly wage for an estimated value of USD202.1bn, and USD31.7bn on tax software and other out-of-pocket expenses.

Additionally, a new analysis of the impact of the Affordable Care Act (ACA) on the tax code's complexity found 3,322 pages of legal guidance related to the ACA added to the IRS website, including regulations (1,077), Treasury decisions (1,377), notices (669), revenue procedures (100), and revenue rulings (12). This overlaps partially with 1,865 pages of new ACA regulations.

The NTUF's report also highlights complexity issues related to the Foreign Account Tax Compliance Act, heavier paperwork burdens, taxpayer service challenges, and identity theft. It is noted that, with paid preparers and tax preparation software accounting for 94 percent of returns, "it is nearly impossible for any taxpayer to file without assistance."

"Americans face a rising tax complexity burden that essentially prevents anyone from being able

to comply without assistance," the study's author, NTUF Policy Analyst Michael Tasselmyer, said. "This year's study gives an indication of future challenges, revealing the additional complications the ACA will add to the tax code and filing."

The report concluded that, "between 2009 and 2011, the cost of tax complexity spiked from under USD150bn per year to well over USD200bn per year. It has not fallen below that threshold since, and 2015's estimates are nearly USD10bn higher than last year, showing complexity costs are back on the rise."

Growing tax code complexity is something that the IMF regularly picks up on in its annual reports on the US economy. And so it was, again, in its 2015 Article IV Consultation with the US,[2] when it reiterated its longstanding advice that changes be made that should focus on "simplifying the system by capping or eliminating personal income tax deductions; removing tax preferences exclusions and deductions from the business tax; and changing the tax treatment for multinationals to limit base erosion and profit shifting."

However, the IMF observed that a lack of action to fix the tax code is a symptom of a wider problem, which it termed the "current fiscal policy dysfunction," rooted in the partisan divide that has paralyzed Congress on a regular basis for a large part of President Obama's terms in office. This situation, the IMF warned, has more fundamental implications for the US economy.

"The inability of the Congress and the Executive Branch to collectively pass a budget and corresponding appropriations bills creates a level of fiscal uncertainty that is damaging to the US economy," the IMF observed. "The potential for disruption from either a government shutdown or a stand-off linked to the federal debt ceiling represent important (and avoidable) downside risks to growth and job creation which could move to the forefront, once again, later in 2015."

"Public finances in the US remain on an unsustainable path," the IMF said. "The federal debt and deficit are expected to decline during the next few years, but under the current constellation of policies this downward trajectory will not last."

Ironically, it would be quite difficult to find a member of Congress who disagreed with the IMF's assessment. Yet, even though most agree that the current situation, which sees the Government lurching from one funding crisis to another, is damaging both the US economy and its international reputation, a solution in the form of comprehensive reform of the way the federal Government taxes and spends cannot be found. Why? Because Democrats and Republicans disagree quite fundamentally on what the outcome of tax reform should be.

## Tax Reform Principles

The divide was illustrated vividly when Democrats and Republicans released their respective tax reform principles for the new Congress in January 2015.

Senate Democrats said that reform should make the tax system "more progressive than current tax policy" and that the "existing differential between capital and wage income is too large, and reform must be fair to both."[3] Above all, it was said, tax reforms "should be focused on providing a revenue base that is adequate to meet the country's needs for investing in infrastructure, protecting retirement security for today's senior citizens and future generations."

Senate Democrats also stressed a requirement for the exercise of fiscal prudence, by not "gambling with our fiscal health by relying on unproven revenue-estimating methods and budget gimmicks, such as one-time revenue or timing shifts. Accordingly, we believe that comprehensive tax reform should raise real and permanent revenue over the next ten years and beyond to help reduce our national debt."

In his turn, Committee Chairman Orrin Hatch (R – Utah) set out seven principles that will guide Republican efforts on tax reform, namely: economic growth; fairness, through broadening the tax base; a simpler tax code, to reduce compliance costs; permanence, to avoid the large number of tax provisions that expire regularly; competitiveness, by reducing the high tax rates on businesses and reforming the US international tax system; the promotion of savings and investment; and "revenue neutrality."

In fact, Democrats would probably agree with most of Hatch's principles. However, it is the sixth principle – revenue neutrality – that is the major sticking point, with President Obama insisting that tax reform must raise revenue for deficit reduction, preferably from the nation's wealthiest taxpayers and corporations. However, on this point, Hatch responded: "If we're scouring our tax code looking for additional revenues to pay for government spending, we're not engaging in tax reform; we're raising taxes."

"Any attempt to use tax reform as an excuse to raise taxes on businesses or hardworking taxpayers is a needless distraction," he argued. "I don't know any reasonable person who would publicly argue that the American people are under-taxed. We need to remember that as we work toward reform."

### Attempts At Compromise

Although both sides are firmly dug in to their respective positions on tax reform, there have been plenty of attempts to find middle ground during President Obama's term in office. From 2011 to 2013, the tax-writing committees of the House of Representatives and the Senate held about 30 hearings apiece examining problems with the current tax code. Then, in 2013, the respective chairmen of the committees – Dave Camp (R – Michigan) and Max Baucus (D – Montana) – came together to promote tax reform, launching a new website and embarking on a national tour to advance the idea of change. Baucus subsequently presented four discussion drafts on tax reform, including one on international tax reform,[4] towards the end of 2013, but his project was left largely incomplete by his nomination to and subsequent acceptance

of the post of US Ambassador to China. Camp issued a single comprehensive tax reform discussion draft[5] in February 2014, although its proposals differed from Baucus's ideas in many ways, and in the end these drafts merely served to re-emphasize the differences between Democrats and Republicans on tax.

In one of his last pieces of legislative business before retiring from Congress, Camp introduced his discussion draft as a formal bill, entitled the Tax Reform Act of 2014,[6] in December last year. As this took place just a few days before the "lame-duck" session concluded, it was something of a symbolic act, perhaps designed to keep the tax reform debate from dying.

In the new Congress, which commenced in January 2015, Hatch and Ron Wyden (D – Oregon) have established five bipartisan Finance Committee Tax Working Groups, with the intention of boosting congressional comprehensive tax reform efforts. Each group was tasked with analyzing current tax law and examining policy trade-offs and available reform options within its designated topic area – individual income tax; business income tax; savings and investment; international tax; or community development and infrastructure. Each group is be co-chaired by one Republican and one Democrat member. A public consultation designed to provide additional data and information to the working groups was launched in March and by April 15 had received 1,400 submissions.

The goal is to have a final comprehensive report, featuring recommendations from each of the five categories, which will then serve as a foundation for the development of bipartisan tax reform legislation.

"Republicans and Democrats agree the American tax system is too complicated, unfair, and is hurting economic growth," said Hatch. "With the launch of these working groups, members will have an opportunity to thoroughly examine the code and put forward smart ideas that will help lay the groundwork for a bipartisan tax overhaul that will provide bigger paychecks, better jobs, and more opportunity for all Americans."

## President Obama Versus Congress

However, while tax reform initiatives in the present Congress and in past sessions have generated plenty of heat and light, actual progress has been virtually non-existent. And this is because, when it comes to the crunch of actual legislative proposals, neither side seems capable of ceding ground or recognizing the other party's red lines.

President Obama has been particularly obstinate, especially since the Republicans gained control of both arms of Congress following the 2014 congressional elections. His federal Budget for 2016 [7] not only contained many revenue-raising proposals presented in earlier budgets that had already been roundly rejected by Republicans, but also proposed new taxes on businesses that were only going to provoke an angry reaction from the GOP and stand no chance of approval while the current stalemate

persists. These included a 14 percent one-time tax on the USD2 trillion in previously untaxed foreign income that US companies have accumulated overseas, and a 19 percent minimum tax on the foreign income of US multinationals, reduced (but not below zero) by 85 percent of the effective foreign tax rate imposed on that income – a move designed to address the incentives under the current system to locate production overseas and to shift and maintain profits abroad.

Predictably the proposals were traduced by the Republicans, with House Ways and Means Chairman Paul Ryan (R – Wisconsin) responding that "for six years, the President has pursued higher taxes and higher spending, and our economy has paid the price. This Budget is simply more of the same. USD2.1 trillion in new taxes. This is simply unacceptable."

Obama had already raised Republican hackles in the new Congress by proposing to raise the top rate of tax on capital gains and dividends for couples with incomes over USD500,000 to 28 percent from 23.8 percent, as part of his State of the Union address,[8] which included other measures aimed at raising more revenue from the rich and from the financial sector. In doing so, he crossed another Republican red line, that no tax shall be increased, whether it affects the rich, the poor, the middle class, or businesses. Ryan called the measures "a USD320bn tax hike on savings and investment, largely to fuel more Washington spending – and make the tax code even more complex."

However, the Republicans seem to have been equally as stubborn, approving tax legislation that isn't even revenue neutral, let alone contributing to deficit reduction.

In February, for instance, the House approved, largely along party lines, a permanent expansion of the Section 179 business expensing tax deduction, while approving extensions for selected "tax extenders" that expired at the end of 2014.[9] These additional measures included permanently extending the reduced five-year recognition period for the built-in gains of S corporations and permanently extending a temporary provision that allows S corporation shareholders to reduce the basis of their shares by the adjusted basis of charitable contributions of property, rather than the fair market value of the property.

Importantly, the bill did not contain revenue offsets, prompting Rep. Sander Levin (D – Michigan), the senior Democrat on the Ways and Means Committee, to say that the bills are "contrary to the approach of finding common ground on tax reform."

Then, in May, the House passed legislation that would simplify and strengthen the temporary research and development (R&D) tax credit, renewed more than 20 times since its introduction in 1981, and permanently enshrine it in the US tax code.[10] Again however, the bill lacked revenue offsets, and in a Statement of Administration Policy released on May 19, the Government said that it "strongly opposes" legislation that it said would add to long-run deficits.[11] "By

making the R&D credit permanent without offsets, [the legislation] would add USD180bn to the deficit over the next ten years," the statement argued.

In the knowledge that their slim Senate majority is not substantial enough to get contentious legislation out of Congress, and with the threat of Obama's power of veto looming large, perhaps these legislative efforts were, like Camp's Tax Reform Act, largely intended as symbolic acts, rather than credible attempts to change US tax law for the better.

## Doors And Windows Closing On Tax Reform?

Certainly, a large swathe of the business community seems to have given up on seeing tax reform take place before 2016. According to the Ninth Annual Tax Policy Forecast Survey by legal firm Miller & Chevalier and the National Foreign Trade Council, while tax reform remains a top priority for the US business community, there is a distinct lack of optimism that they will see a tax reform bill reach Obama's desk. Almost half (49 percent) say they expect that tax reform will not be enacted until 2017 after the next presidential election.

The view from the survey is that even with a Republican majority, the present US Congress appears headed for an impasse on tax reform. When asked how far they expect tax reform to go in the Senate and the House of Representatives, respondents said they only expected to see, at most, "discussion drafts."

Of the respondents, 53 percent believe the most important issue to address will be the high US statutory tax rates, if and when tax reform happens. Nevertheless, businesses are concerned that policymakers may seek to enact tax revenue offsets without adoption of a competitive tax system and/or competitive tax rates. More than one-quarter (28 percent) of respondents cited this as their top tax concern.

Marc Gerson, former majority tax counsel to the House of Representatives Committee on Ways and Means, said: "The business community tells us that the high US statutory tax rates are a major drag on international competitiveness relative to foreign-based businesses, and serve as a signature barrier to the US as an investment location. Additionally, in an increase of almost 10 percent from last year, nearly a quarter of respondents have told us that taxation of international operations is their highest US concern in 2015."

Even Congress seems to be finally admitting that tax reform is simply implausible while the divisions between the legislature and the Administration exist.

In a June 7 interview with Morning Consult, Senate Majority Leader Mitch McConnell (R – Kentucky) confirmed that comprehensive US tax reform will not be part of the Senate's agenda this year in view of the ongoing impasse on the matter. Referencing the Administration's unwillingness to compromise, McConnell remarked that "we're certainly not going to be able to be doing big, comprehensive tax reform with this President."

"The President is not interested in revenue neutrality, and he's not interested in treating all taxpayers

the same, so I don't think we'll get there on comprehensive [tax reform]," he added.

In fact, the diminishing prospect of comprehensive tax reform taking place in the remainder of Obama's term was recognized several months ago by Ryan, who suggested in remarks to the media in February that there was an opportunity for tax reform this year, but it will be difficult to achieve in the current congressional session if no progress is made before "the end of summer."

So as we approach the mid-point of 2015, it seems fairly obvious that that window is now rapidly closing, and given the ongoing political impasse in Washington, it probably won't open again until President Obama's successor has his or her feet under the desk in the Oval Office.

## Endnotes

1 http://ntu.org/foundation/policy-paper/a-complex-problem-the-compliance-burdens-of-the-tax-code

2 http://www.imf.org/external/np/ms/2015/060415.htm

3 http://www.finance.senate.gov/imo/media/doc/Tax%20Principles%20Letter%20to%20Chairman%20Hatch.pdf

4 http://www.finance.senate.gov/imo/media/doc/Chairman's%20Staff%20International%20Discussion%20Draft%20Common.pdf

5 http://waysandmeans.house.gov/camp-releases-tax-reform-plan-to-strengthen-the-economy-and-make-the-tax-code-simpler-fairer-and-flatter/

6 https://www.govtrack.us/congress/bills/113/hr1/text

7 https://www.whitehouse.gov/omb/budget

8 https://www.whitehouse.gov/the-press-office/2015/01/17/fact-sheet-simpler-fairer-tax-code-responsibly-invests-middle-class-fami

9 https://www.congress.gov/bill/114th-congress/house-bill/636/text

10 https://www.govtrack.us/congress/bills/114/hr880/text

11 https://www.whitehouse.gov/sites/default/files/omb/legislative/sap/114/saphr880r_20150519.pdf

## Topical News Briefing: Putting Dubai On The Financial Map

by the Global Tax Weekly Editorial Team

The Dubai International Financial Centre (DIFC) has grand ambitions. It plans to triple in size over the next decade and break into the top-ten global financial centers in terms of size and stature. And with the way things are done in Dubai, one might be foolish to wager against such an eventuality.

It seems scarcely believable that the DIFC was created just over ten years ago, yet Dubai now boasts that it is a key link in the global financial chain, having established itself as the principle financial center between the European and Asian time zones. But when the authorities in Dubai and the other United Arab Emirates set their mind to something, they generally follow through with results. Dubai's spectacular skyline, its impressive feats of civil engineering like the six-runway Al Maktoum International Airport, and mind-boggling offshore residential developments such as the Palm Island, are testament to this can-do attitude.

So when Dubai set out to create a financial center, there were no half measures; it established a free zone – the DIFC – within which companies enjoy zero percent corporate tax guaranteed for 50 years, in addition to unrestricted foreign ownership and repatriation of profits, no exchange controls, and a separate and brand new legal framework. And it is not surprising that the DIFC has already experienced rapid growth. In March 2015, the DIFC reported that the number of active registered companies operating within the zone increased 18 percent year-on-year to 1,225 in 2014. The total workforce also rose, by 14 percent during 2014, to 17,860 people.

The DIFC expects to keep growing. Last November, the free zone said it plans to be home to 1,700 firms and 20,000 employees by 2018. Additional investment is being lined up to accommodate these new clients, and a fourth business center, which will add 11,000 square feet of office space, is under development. The DIFC also said that in the coming years it will focus more on China and Africa by "investing heavily to better serve these critical emerging economies," with the zone's growth over the last decade primarily driven by companies from the US and Europe.

To achieve its longer-term goals of housing 1,000 active domiciled financial firms (of which there were 362 in the DIFC last year) and a total workforce of 50,000, it is going to take substantial additional investment. Given Dubai's recent history, the authorities are unlikely to hold back if new infrastructure is needed. Yet, to get to the level of established global financial centers like Hong Kong, Singapore, London and New York in terms of size and importance, Dubai has a long way to travel. In fact, according to the 2015 Global Financial Centers Index from Z/Yen, Dubai isn't even the best financial center in the Middle East. That accolade goes to Riyadh, which was placed 14th in the 82-city index. Dubai

comes in at 23rd, roughly level with Abu Dhabi and Doha in terms of competitiveness.

This is quite impressive given Dubai's relative youth as a financial center, but surprisingly low given the DIFC's favorable tax and legal regime. The index is an indication of how much more work is required to build up Dubai and sell its offerings globally. However, projects of such magnitude have rarely scared the authorities in Dubai.

# DLA Piper Global Stock Options Overview: The Middle East And South Africa

by Dean Fealk, DLA Piper, San Francisco

Many companies today aim to scale their businesses globally and into multiple countries simultaneously. In order to help clients meet this challenge, DLA Piper has compiled a Guide To Global Equity Stock Options. In the last article in the series, we examine the tax, compliance and other requirements in relation to equity stock options in four countries in the Middle East and South Africa.

## Egypt

**Securities:** In order to avoid securities law requirements, the subsidiary should not administer the option plan and the underlying shares must not be listed on the Cairo or Alexandria Stock Exchanges.

**Foreign Exchange:** An Egyptian bank must handle any transfer of funds.

**Tax:**

***Employee:*** If the parent company is reimbursed by the subsidiary for the cost of the option benefits, an employee generally is taxed on the spread at exercise. If there is no reimbursement, any tax on the spread generally is deferred until the shares are sold. Upon the sale of shares, any gain is also subject to tax.


***Employer:***

- *Withholding & Reporting:* Withholding and reporting requirements generally apply.
- *Deduction:* It is uncertain whether the subsidiary may claim a local tax deduction.

**Social Insurance:** The spread is not subject to social insurance obligations.

**Data Protection:** Employers are advised to make disclosures to employees about processing personal data. Obtaining employee consent is recommended for the processing and transfer of personal data.

**Labor Issues:** Although it is not common, option benefits may be considered part of the employment relationship and may be included in a severance payment if options are repeatedly granted to an employee. In order to reduce the risk of employee entitlement claims, the award agreement signed by an employee should provide, among other things, that the award of an option is not employment compensation, that vesting of an option ceases upon

termination of employment, and that the plan and any awards under it are discretionary.

**Communications:** Although not required, it is recommended that plan documents be translated. Any filings with the government are required to be translated.

## Israel

**Securities:** Options generally are subject to securities restrictions. However, in most cases, exemptions are available.

**Foreign Exchange:** Options are not subject to any specific foreign exchange restrictions.

**Tax:**

***Employee:*** Tax is imposed at the time the shares are sold, generally based upon the difference between the sale price and the exercise price.

***Employer:***

- *Withholding & Reporting:* Withholding and reporting are required.
- *Deduction:* A tax deduction may be available for an approved trustee plan if a written recharge agreement is in place.

**Tax-Favored Treatment:** Under Section 102 trustee plans, preferential tax rates may apply. Options must be held by a local trustee for a two-year period from the grant date.

**Social Insurance:** Portions of the taxable amount are subject to social insurance contributions, depending on whether granted through an approved trustee plan.

**Data Protection:** Employee consent for the processing and transfer of personal data is recommended. In certain situations, the employer may be required to register its database with the data protection authorities.

**Labor Issues:** Although not common, option benefits may be considered part of the employment relationship and may be included in the calculation of severance or retirement payments. To reduce the risk of claims, employees should expressly agree in writing that: (i) participation in the option plan is discretionary; and (ii) termination of employment will result in the loss of unvested rights. The chances of an employee making a successful claim are also reduced if the award is contingent upon, for instance, the performance of the employee or the company.

**Communications:** Translation of plan-related materials may be required to satisfy securities requirements, if applicable. Any government filings are required to be translated.

## Saudi Arabia

**Securities:** Any securities offer, including the grant of an option, may be subject to securities law requirements. In many cases, exemptions to such requirements are available if filings are made with local securities authorities.

**Foreign Exchange:** In general, option plans are not subject to any specific foreign exchange restrictions.

**Tax:**

***Employee:*** There is no tax imposed on option benefits.

***Employer:***

- *Withholding & Reporting:* Withholding and reporting are not required.
- *Deduction:* A subsidiary typically is unable to deduct the cost of the benefit (*e.g.*, the spread) from its income taxes.

**Social Insurance:** Generally, the spread is unlikely to be subject to social insurance contributions.

**Data Protection:** Obtaining employee consent for the processing and transfer of personal data is recommended.

**Labor Issues:** Although unlikely, in order to reduce the risk of employee claims, the award agreement signed by an employee should provide, among other things, that vesting of an option ceases upon termination of employment and that the plan and any awards under it are discretionary. Option benefits could possibly be characterized as salary for damages calculations in the event of unlawful termination.

**Communications:** Although not legally required, it is recommended that documents regarding employee option plans be translated. Any filing with the government must be translated.

## South Africa

**Securities:** Public offers of securities are subject to prospectus requirements but exemptions are available under certain circumstances.

**Foreign Exchange:** A tax clearance certificate from the Exchange Control Department of the South African Reserve Bank is required for the purchase of shares overseas. The approval of the Exchange Control Department of the South African Reserve Bank is necessary for employees that exceed their offshore investment allowance limit of ZAR4m. This limit is the aggregate of all amounts transferred out of South Africa by the employee at any time. Approval is required whether or not the employees intend to use a cashless exercise method.

**Tax:**

***Employee:*** The spread is taxable upon exercise. The gain on the sale of shares generally is taxed.

***Employer:***

- *Withholding & Reporting:* Withholding and reporting are required.
- *Deduction:* If the subsidiary reimburses the parent company for the cost of offering the options, subject to South African Reserve Bank approval, a tax deduction will be available.

**Social Insurance:** The spread generally is subject to social insurance contributions.

**Data Protection:** Obtaining employee consent for the processing and transfer of personal data is recommended.

**Labor Issues:** In order to reduce the risk of employee claims, the award agreement signed by an employee should provide, among other things, that

vesting of an option ceases upon termination of employment and that the plan and any awards under it are discretionary.

**Communications:** Although not legally required, it is recommended that documents regarding employee option plans be translated. Any government filings must be translated.

# The EU's New Digital Single Market For Europe

by Gavin Adie, Global Tax Weekly

## Introduction

After eight years of build-up that culminated in the recent introduction of new value-added tax (VAT) rules for electronically supplied services in the EU – changes that small firms are still struggling to come to terms with – the European Commission is set to introduce substantially broader reforms, and more quickly, under plans recently announced for its Digital Single Market for Europe.

## The Digital Single Market

The Digital Single Market agenda, announced on May 6,[1] is intended to ensure a level playing field for small firms compared with large international players; remove barriers to cross-border trade; ensure adequate supply of qualified staff; and improve digital firms' access to funding. Numerous VAT measures have been put forward, forming one key part of this agenda.

Already, from the beginning of this year, the EU overhauled the way that broadcasting, telecommunications and electronic (BTE) services are taxed in the EU.[2] The objective of those reforms was to move towards a definitive VAT regime – one centered on the destination principle, that goods and services should be taxable in the location of the consumer.

This reform now means that business-to-consumer (B2C) supplies of BTE services are uniformly taxable in the location of the consumer.

The Digital Single Market proposals will take this agenda further, expanding the mini one stop shop (MOSS) scheme that was introduced to simplify compliance with the 2015 place of supply changes, to enable member states to tax cross-border online sales of physical goods more effectively and remove abuse-prone tax relief provisions for low-value consignments.

The Digital Single Market also includes proposals for enhanced cooperation between member state authorities, such as through their participation in single audits of digital firms.

The Commission has promised that, under the reforms, tax compliance will become significantly simpler for digital enterprises, as taxable persons will only be required to deal with a single tax administration. It has proposed that there will be

uniform VAT rates on goods ordered from websites in third countries, from other member states, or from the domestic market, and the Commission will introduce clearer rules for businesses engaging in cross-border e-commerce.

Alongside the announcement of these measures, the Commission said, in response to inquiries about the future taxation of e-books and other e-publications, that it will explore how to address the tax treatment of digital books and online publications in the context of the work being done on the adoption of a definitive VAT regime. A Communication setting out the main features of this regime will be adopted next year, it said.

Finally, the Commission also intends to undertake a review of the changes to place of supply rules put in place at the start of the year, to ensure that they are functioning as intended and to limit the administrative burden placed on businesses.

While it is clear that the place of supply changes have increased revenues for EU member states – and more equally distributed these revenues among them – they have caused upheaval for smaller firms, with some being forced to switch off their online operations.

In response, the Commission has put forward a proposal for an exemption threshold for small firms, below which traders would be exempt from the requirement to collect VAT on B2C electronically supplied services.

## The European Digital Forum

Commission Vice-President Andrus Ansip introduced businesses to the new reforms at the European Digital Forum held in Brussels on June 1.[3] He announced that:

> "Europe has spent many years building a single market based on four basic freedoms: the free movement of people, goods, services, and capital. These freedoms allow European people and businesses to travel, trade, and operate across all EU countries. They allow innovative ideas to grow and spread to the greatest possible extent. They allow people to get the widest choice and opportunities that they deserve. Today, more and more products and services are going digital. But our single market has not yet gone digital. We are missing out on a wealth of opportunity."
>
> "A Digital Single Market will bring more opportunities and fewer barriers. It will bring a great deal of growth for the wider economy, and hundreds of thousands of new jobs as well. It will make a real difference to online consumers and everyday internet users."
>
> "Businesses will also gain – especially SMEs, startups, and web entrepreneurs. Small tech companies are our digital future. They are the ones who will create the ideas and jobs that Europe needs for its economic growth. Clearer EU-wide rules will make it easier – and cheaper – for them to sell across borders,

to expand their commercial operations and scale-up in Europe. They will no longer have to adapt to each country's consumer laws, which is a costly exercise in itself."

"They will get improved access to finance and a VAT system better adapted to small e-commerce businesses. Differences in national tax rules are among the most frequently quoted obstacles to the development of cross-border business. That burden has to be reduced. We will – again – propose a tax threshold that will help start-up e-commerce businesses. Conditions for competition will be made fairer, with every company – large or small – playing by the same rules. No discrimination. No favoritism."

The obstacles that would be removed for digital firms, and the cost savings for consumers from the proposed Digital Single Market, are substantial.[4] According to the Commission, only 7 percent of small and medium-sized enterprises (SMEs) in the EU sell across borders, as it is seen as simply too complicated and too expensive for them to adapt to 28 different sets of rules. While 61 percent of consumers feel confident about making online purchases from their domestic market, only 38 percent of consumers feel confident buying online from another EU country. Currently, only 15 percent of consumers shop online from another EU country.

The Commission has estimated that EU consumers could save EUR11.7bn (USD13.1bn) each year if they could choose from a full range of EU goods and services when shopping online.

The Commission has said that it sees its Digital Single Market agenda "as a timely opportunity to take stock of the issues which both tax administrations and business[es] face, and address these in the context of the 2016 proposal."

***Low-Value Consignment Relief***

The VAT Directive obliges member states to exempt all B2C commercial importations of consignments with a value not exceeding EUR10 from import VAT, commonly known as low-value consignment relief (LVCR). Member states are free to increase this threshold up to EUR22.

In addition to that exemption, non-commercial consignments sent from a third country by a private person to another private person in the EU with a value not exceeding EUR45 are also exempt from import VAT.

Unsurprisingly these rules have encouraged companies to establish consignment operations outside but in close proximity to the EU, and the Commission disclosed that several complaints and submissions have been received from EU industry stakeholders aggrieved that they are subject to unequal VAT treatment *vis-à-vis* non-EU competitors.

On tackling the avoidance of VAT on cross-border supplies of physical goods, the Commission said that the LVCR provisions, originally introduced as

a trade facilitation measure, have turned into "an expensive tax subsidy in favor of imports to the disadvantage of domestic and intra-EU sales."

***Taxing Small Consignments***

In its 2011 Communication on the future of VAT,[5] the Commission earlier committed to reform in this area, stating that "a number of provisions in the VAT Directive are outdated and do not take the single market aspect sufficiently into account."

Within this context, the Communication stated that "the treatment of small consignments and other internet sales is to be tackled" to ensure a "level playing field for non-EU and EU suppliers."

Thereafter, the Commission Expert Group made the specific recommendation in 2014 to "abolish the small consignments exemption" and said this should be pursued as "a priority in tandem with the development of the broader One Stop Shop also applying to other small consignments for which no customs duties are due" – that is, for goods valued at less than EUR150.[6]

"With the introduction of a single electronic registration and payment mechanism, this exemption will also no longer be needed," the Commission said, "as VAT could be accounted for at an earlier stage than customs clearance, by exporters or carriers."

The removal of the concession could boost EU businesses' turnover by up to EUR4.5bn annually, the Commission has calculated, with the concession said to have cost EU member states revenue worth EUR640m in 2011.

According to its estimates, VAT foregone in the EU grew from EUR118m in 1999 to just under EUR640m in 2011. Despite the economic crisis and interventions by certain member states (such as the UK and Denmark) to change the law relating to LVCR, the estimates still show that revenue worth about EUR535m was allowed to slip through the net in 2013. At its maximum, the VAT foregone within the EU could have reached just under EUR900m in 2011.

The UK, which removed its LVCR for consignments from the Channel Islands (Jersey and Guernsey) from April 1, 2012, said that the concession had cost the nation VAT revenues worth EUR170m in 2009. LVCR had been blamed for the downfall of many high street retailers selling CDs and DVDs in the UK.

Meanwhile, in Denmark, it was estimated by the Danish Government that the concession had cost revenues worth EUR8m in lost VAT from the magazine industry alone in 2004. Denmark confirmed in June 2015[7] that it will restrict the availability of its LVCR, applicable to imports from outside the EU worth less than DKK80 (USD12), from July 1, 2015. Denmark will no longer apply it to magazines, journals, and similar publications, including those published in an EU country and shipped from outside the EU.

The Commission's recent report – *Assessment of the application and the impact of the VAT exemption for importation of small consignments* [8] – notes that some product categories appear to be more affected than others. Authorities in a number of other member states have therefore also looked into the exemption, leading to a variety of interpretations and exclusions from the VAT exemption, such as for mail order. The Commission has confirmed that member states are already allowed to exclude mail order shipments from this arrangement, legally removing the exemption for most consignments.

According to the Commission, as well as costing member states considerable revenue, the current digital tax framework in the EU means that an EU business wishing to make cross-border sales faces a VAT compliance cost of at least EUR5,000 annually for each targeted member state. Introducing harmonized VAT rates, administration by a single EU authority, and introducing more consistent rules on online sales could substantially slash this cost.

## European Parliament Debate

Members of the European Parliament appear to be on side with all the proposals. However, many have questioned the delay in acting on the taxation of electronic books in particular.

The long-standing uncertainty surrounding the taxation of e-books and similar publications was settled by the European Court of Justice's (ECJ's) rulings in two cases concerning the legitimacy of reduced rates of VAT offered by France and Luxembourg on e-books (Cases C-479/139 [9] and C-502/1310 [10]).

The ECJ said on March 5, 2015, that a reduced VAT rate can apply only to supplies of goods and services covered by Annex III to the VAT Directive, which refers to the "supply of books … on all physical means of support."

The ECJ concluded that a reduced VAT rate may apply to a transaction consisting of the supply of a book found on a physical medium. While it agreed that in order to be able to read an electronic book, physical support (such as a computer) is required, that support is not included in the supply of electronic books; therefore, the supply of such books is not included within the scope of Annex III.

Additionally, the ECJ observed that, under the VAT Directive, the possibility of a reduced VAT rate being applied to "electronically supplied services is excluded." It confirmed that an e-book is such a service. The Court rejected the argument that the supply of electronic books constitutes a supply of goods (and not a supply of services).

Ahead of the release of the Digital Single Market plans, European Commission President Jean-Claude Juncker said that the Commission is aiming to implement reform to achieve "technology neutral" taxation for digital economy supplies.[11]

The tax treatment of e-books and proposals to harmonize VAT rates on physical goods sold online

were discussed at length at an EU parliamentary debate on May 18, also opened by Ansip, who said:

> "I would like first of all to state that the Commission has already started to explore ways to implement the definitive VAT regime. This regime should be based on the principle of taxation at the place of destination. Reviewing the scope of the application of reduced rates is part of this exercise."
>
> "In general, it is important that the VAT system be applied fairly and efficiently, without giving any sector or any business an advantage, nor inviting the relocation of activities within the EU based on VAT rules. The Commission intends to communicate its vision of the main features of a future definitive VAT regime next year. The current tax treatment of e-services, such as digital books and the digital press, will be reviewed in this framework. I would personally support an initiative for reduced rates on e-books and the digital press."
>
> "On the taxation of the digital economy, I am also fully aware of the complaints which we have received, mainly from the United Kingdom, on the impact of the new 2015 VAT rules on micro businesses. In the digital single market strategy, the Commission will come up with proposals in 2016 to reduce the administrative burden on businesses relating to VAT …"

During the debate, many MEPs stressed the need for reform before 2016, noting the pace at which the digital economy is evolving and the competition EU firms face, in particular from Asia. MEPs noted that numerous businesses have already ceased selling online as a result of the changes introduced from January 1, 2015, and urged that supplementary VAT reforms should be implemented as a priority.[12]

UK MEPs have been the most vocal about the impact on small businesses of the changes that took place from January 1, 2015. During the debate, UK MEPs Neena Gill and Vicky Ford welcomed the Commission's proposals for a long-sought-after exemption threshold, but they urged the Commission to fast-track the proposals. Gill, of the UK's Labour Party, observed that:

> "Commissioner Ansip acknowledges that by creating a connected digital single market, we can generate up to EUR250bn of additional growth in Europe, thereby creating hundreds and thousands of new jobs and a vibrant knowledge-based society. But Commissioner, to achieve this we do need several regulatory reforms and one of these is the tax treatment of digital products. I do support the need for alignment of VAT rates to ensure we have a level playing field and to eliminate distortion of competition, and tackling VAT fraud should remain a priority, but it is important not to forget the proportionality principle."

"So when on January 1, 2015, the new VAT rules on digital products sold in the EU came into force … this resulted in many EU businesses having to register an account for VAT in every single member state. I have been contacted by many new-tech SMEs which have been adversely affected and are on the point of closing down. So we do need to address this issue."

"For example, in the UK, there are about 240,000 designers of knitting and sewing patterns which are sold as PDF downloads. They are struggling in terms of the cost of compliance, especially if they trade across borders. They face something like EUR5,000 annually for each member state. So I am not sure how we are going to achieve the digital single market if we have regulations like this. European SMEs also face distortions from VAT-free goods supplied by non-EU businesses."

UK Conservative MEP Ford stated that:

"A recent survey of 2,000 small companies suggested that a quarter of firms are now blocking overseas sales, and one in five has stopped selling altogether. That means they are not earning any money, and the authorities are not collecting any tax at all. We have promised to change the way the EU makes laws. We need to sort this out, and it needs to be done quickly. I think the easiest solution is an exemption, through a threshold, for micro entities, but that needs unanimous support from finance ministers. So ministers, do not wait; next year is too late. Our entrepreneurs need us now."

Meanwhile, in comments on the disparity between VAT rates in the EU and its impact on competition, German MEP Andreas Schwab discussed the taxation of e-books, stating:

"It is obvious that the reader of a book [should] have to pay the same rate of VAT for this service, regardless of whether he takes this book in hard copy or digital service. It is easy not to explain why the two different rates of VAT are to be payable. So I would very explicitly ask … that we, as quickly as possible, begin [re-examining] the verdict, which came against France and against Luxembourg, to examine, in light of equal treatment of comparable services in the single market, a change as soon as possible to the VAT Directive in terms of uniformity of taxation in the digital single market to move it forward."

Hungarian MEP Tibor Szanyi talked about the potential impact of the proposed reforms on higher tax member states, with Hungary levying the EU's highest VAT rate of 27 percent. He suggested that states with the highest VAT rates, such as Hungary, run the highest risk of firms not reporting sales. In addition, he said some companies may decide to target only those markets with the lowest VAT rates and avoid higher tax states, where their products

would be more expensive. He therefore endorsed the idea of common VAT rates in the EU for digital goods and services.

Dutch MEP Sophia in 't Veld announced that:

> "I have been doing a bit of digging, and sometimes that gives you funny results. For example, … one of the first questions relating to the application of the higher VAT rate to e-books was introduced by [former MEP Marianne] Thyssen … [who] was very worried about the higher VAT rates on, I quote, 'books published on CD-Rom or DVD.' Now that was in 2009 – the Commission has not even started to think about solutions, but CD-Roms are no longer used for e-books."

> "So the key words here are speed and urgency. Because I have also submitted a series of questions over the years, and in the answer to one of my questions in 2013 the Commission replied that it 'is currently examining this issue … and these elements will be taken on board in completing the impact …' In other words, already back in 2013 the Commission was looking into it."

> "So what are you waiting for? The digital market, as you well know Commissioner, is developing much more rapidly than this. We are legislating at Flintstone speed but the digital market is moving on. It is not waiting for us, and if you say 2016, well by then so many small businesses will have gone down already because they cannot survive."

> "Why does the Commission have to wait until 2016? Why can't you just start tomorrow? If, Commissioner, you go back to the Commission and to the member states and tell them that we need action now, I think that the whole Parliament will back you up because everybody here is echoing the same message. So I would say, Commissioner, let us get to work tomorrow."

In her concluding remarks, Spanish MEP Maite Pagazaurtundúa Ruiz summed up most MEPs' frustration with the lack of progress in more emphatic fashion, stating that:

> "This debate is not a debate; it is a cry to the Commission. The old tax regulations on electronic commerce benefited large companies, the giants, who made their headquarters in countries with a very low VAT rate."

> "This new taxation must be seen as a whole and without hurting smaller companies … it cannot wait until 2016."

Czech MEP Dita Charanzová added:

> "VAT on e-books, I think, is an excellent example where we can show that we are committed to this agenda and that we are able to deliver without delay to our citizens. I do

not see any reason why I should pay twice as much in taxes on e-books than on books in their physical form. The rise in the price of e-books was never intended. It was an unforeseen consequence, an error, and now is the time to fix it. We all speak about the urgency of this topic."

"I am looking forward to your VAT proposal in 2016, but meanwhile here is one suggestion: Why do you not propose an urgent single sentence amendment to the 2006 VAT Directive allowing digital books, newspapers and magazines the same reductions already allowed for their physical counterparts? It would only require three words to be added to the Annex to fix it. The words are: 'physical or digital.' Let us solve this in the simplest and quickest way possible. Let us make this an example where Europe sees an error and fixes it; where Europe embraces our digital future."

## Ansip's Closing Thoughts

Although the Commission still has six months left to act before 2016, it has yet to show any signs that it is planning to act early. In his concluding remarks, Ansip responded to MEPs' concerns stating, first, on reform of the 2015 place of supply measures, that "in 2004, our [SMEs] were complaining because there was no fair competition. For big companies – for global players – it was so easy to remove their headquarters to countries where tax rates were at a very low level, and in this way our [SMEs] were just out of the competition. That is why this reform was made. The decision was made in 2008 already. But, during those debates between 2004 and 2008, it was proposed by the Commission to set a threshold at quite a high level, under which our [SMEs] did not have to declare their VAT revenue, and it was rejected by member states."

Following complaints from micro enterprises, he recalled, the Commission proposed a high threshold of EUR100,000, he said. The Commission is currently undertaking a study on the impact of such a threshold, it has confirmed.

"Talking about e-books," Ansip continued, "the decision was made in 2001 already not to allow those reduced VAT rates to be applied on e-services like e-books. Why is this question an urgent issue right now? It is because of this decision we had from the European Court of Justice just last year and we had to act."

"As President Jean-Claude Juncker stated already, we would like to propose to allow those reduced rates also to be used on e-books. We will get a report about the VAT MOSS this summer already, and on the basis of this report we can say when we will be able to make our proposals that change our legislation. So the Commission is acting already and I promise that I will do my utmost to make those proposals as soon as possible."

## Conclusion

While MEPs have urged the Commission to act as fast as possible, in view of the amount of preparation

still needed to deliver a properly functioning definitive VAT regime in Europe from 2016, it is unlikely that the Commission will bring forward its plans.

The OECD has only recently released for consultation its International VAT/GST Guidelines on the taxation of the digital economy,[13] containing proposals that are entirely consistent with those announced by the EU, and it may be seen as premature for the EU to act far ahead of the pack.

What's certain, regardless of when these reforms are implemented, is that digital firms face a period of greater uncertainty and increased administrative burdens before they will begin to reap the benefits of the EU's new vision for a Digital Single Market for Europe.

## Endnotes

1 http://europa.eu/rapid/press-release_IP-15-4919_en.htm

2 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:044:0011:0022:EN:PDF

3 http://europa.eu/rapid/press-release_SPEECH-15-5089_en.htm

4 http://europa.eu/rapid/press-release_MEMO-15-4920_en.htm

5 http://europa.eu/rapid/press-release_IP-11-1508_en.htm?locale=en

6 http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/good_governance_matters/digital/report_digital_economy.pdf

7 http://www.skat.dk/SKAT.aspx?oId=2175433&vId=0 (in Danish).

8 http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/lvcr-study.pdf

9 http://curia.europa.eu/juris/document/document.jsf?text=&docid=162685&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=222698

10 http://curia.europa.eu/juris/document/document.jsf?text=&docid=162692&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=222785

11 http://www.tax-news.com/news/EU_VAT_Reforms_Planned_Under_New_Digital_Agenda____68012.html

12 http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-%2f%2fEP%2f%2fTEXT%2bCRE%2b20150518%2bITEM-019%2bDOC%2bXML%2bV0%2f%2fEN&language=EN

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## Topical News Briefing: Breaking Down The Barriers In Africa

by the Global Tax Weekly Editorial Team

In last week's issue, we observed how good progress has been made towards key bilateral and multilateral free trade agreements, encompassing mainly Asia, the US, and Europe. However, one continent that was conspicuous by its absence in the summary was Africa.

Although most of the African continent is already covered by networks of regional trade blocs, which also have preferential trade deals with developed economies like the US and the EU, it has to be concluded that these agreements haven't been nearly as effective at unlocking trade and economic growth as such deals have been elsewhere in the world. Although much headway has been made recently in the cutting of trade taxes, particularly on food, within Africa, non-tariff barriers remain a significant problem.

Traders encounter numerous issues when trading across borders, including outdated regulations that particularly inhibit seed trade; lack of competition in the transportation market and poor services; export bans; unnecessary permits and licenses; costly documentation requirements; and standards that rather than facilitating trade often instead create a barrier for small producers.

By way of an illustration of just how intensely bureaucratic the import/export business is in Africa, the World Bank has identified that a total of 17 documents are needed in the Central African Republic (CAR) to import goods, closely followed by 12 in Cameroon and Niger, and 11 in Chad. Importing goods takes on average 101 days in Chad, 73 in Zimbabwe, and 64 in Niger. Meanwhile, exporters in Congo are required to file 11 documents, while exporters in Cameroon are required to file ten. Exporting in Chad takes 75 days, 59 days in Niger, 54 days in the CAR, and 53 days in Zimbabwe, substantially pushing up the cost per container of exported goods to untenable levels.

It is hardly surprising, then, that intra-African trade has been slow to develop. Indeed, many African countries depend more on trade with countries half way across the world than with their neighbors. China for instance has become a particularly important buyer of raw materials from resource-rich countries in Sub-Saharan Africa, which then buy finished goods from China in return. However, according to the World Bank, African leaders could unlock an extra USD20bn annually for traders if the existing web of rules, fees, and expensive transportation costs and other barriers to trade within Africa can be dismantled.

Policymakers in Africa are not blind to the fact that the continent's unfit-for-purpose trading system is holding back the African economy. Indeed, judging by the statements coming out of the various regional political forums, there is an appetite for change,

to bring Africa's trading system into the 21st century. However, as the popular saying goes, talk is cheap. Action is proving much harder to come by.

Africa is perhaps on the cusp of achieving meaningful change, with the news, reported in this week's issue of *Global Tax Weekly*, that the proposed tripartite free trade area between the Southern African Development Community, the Common Market for Eastern and Southern Africa, and the East African Community, encompassing 26 nations and 625m people, is ready for signature by the participating countries. According to the African Union, this – if it happens – will represent a substantial stepping stone towards the creation of a pan-African free trade area including a population of 1bn and a total GDP of USD3 trillion. But until we do see some meaningful action towards these goals, it will remain a case of "if" Africa can step up to the free trade plate, rather than "when".

ISSUE 136 | JUNE 18, 2015

# Taxing Indirect Equity Transfers In China

by Shanshan Shi and Kenny Z. Lin



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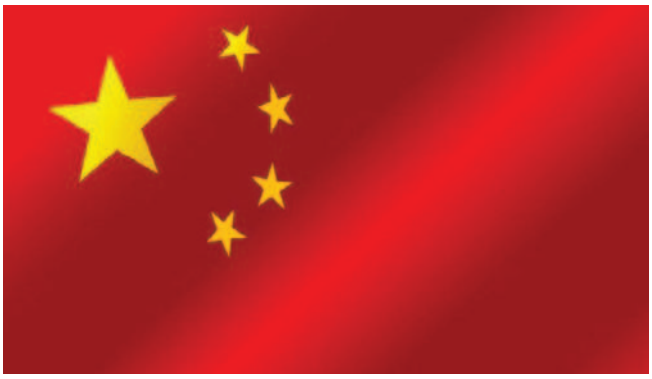
*This article was published in International Tax Journal, Volume 41, No. 2, March-April 2015*

In the past, China rarely taxed foreign investors on capital gains realized from selling their Chinese equity interests through offshore holding companies due to data and resource constraints. With the outset of a controversial policy adopted by the tax administration in late 2009, China began to tax such gains on the grounds that these offshore holding companies were vehicles to avoid China's income taxes. However, voluntary taxpayer compliance has been a problem due to the lack of a statutory basis for taxing indirect equity transfers, other than the general anti-avoidance rule (GAAR) of the income tax law. Moreover, the GAAR has been unpredictable and difficult to implement because uncertainty often arises as to how acceptable tax planning is distinguished from unacceptable tax avoidance and which transactions fall under the GAAR. Recently,



the Chinese tax authorities set a historical precedent by charging a capital gains tax on an indirect equity transfer made by a private US company based on an *ex-post* assessment that the transferor's *effective* management and control was in fact in China, and hence the company was a Chinese tax resident enterprise (TRE), liable to income tax. We expect that a sweeping application of the TRE concept by the tax authorities for taxing a broad range of indirect transfers will continue in the future. We suggest that the tax authorities design better rules for taxing indirect equity transfers to ensure adequate compliance with the withholding and reporting requirements by nonresident taxpayers. We offer foreign investors some practical advice on how to mitigate the potential risks in this area, which has come under increasing scrutiny by enforcing agencies.

## Introduction

China has been the largest recipient of foreign direct investments among developing countries since the early 1980s. Foreign investors typically structure their investments through one or multiple holding

companies domiciled in offshore jurisdictions to avoid onshore regulatory approvals, bypass foreign exchange control and provide ease of finance and investment disposal. Such holding companies are mostly established in low- or no-tax jurisdictions (*e.g.*, the British Virgin Islands, Singapore and Hong Kong). To reap the return of their years of investments, many foreign investors begin to sell, indirectly through an offshore holding company, their equity interests in China-domiciled subsidiaries to other foreign entities. The high rate and volume of indirect share sales by foreigners have recently come under increasing scrutiny by the Chinese tax authorities.

Traditionally, the taxation of indirect equity sales by foreigners applies only to foreign investments in domestic real estate assets. For example, Canada, Australia, Japan and the United States tax foreigners on the gains realized by transfers of interests in foreign entities that invest directly or indirectly in real estate in their country, as these countries explicitly regard any gain on such a transfer as arising from a domestic source.[1] However, the recent tax enforcement on capital gains realized by foreign investors from indirect transfers (through offshore holding companies) of their equity interests in China and India has drawn great attention from the international business community.[2] If countries for which an active offshore market for foreign investment exists soon adopt similar practices by expanding the scope of their home country taxation, a trend of taxing indirect equity sales by foreigners, which departs from the international norm of taxing asset sales only, will emerge.

In this article, we first give a brief account of the controversial policy of taxing indirect equity transfers in China and provide our analyses and comments on the way in which Chinese tax authorities handled various indirect transfer cases since the policy came into effect. We then use a landmark case to illustrate how China attempts to tax a *broad* range of indirect share sales by a sweeping application of the TRE concept.[3] Finally, we offer policy suggestions for the tax authorities to ensure compliance from nonresident taxpayers with tax withholding and reporting requirements. We also propose some tax planning strategies for potential foreign sellers and buyers of equity interests in Chinese-resident enterprises.

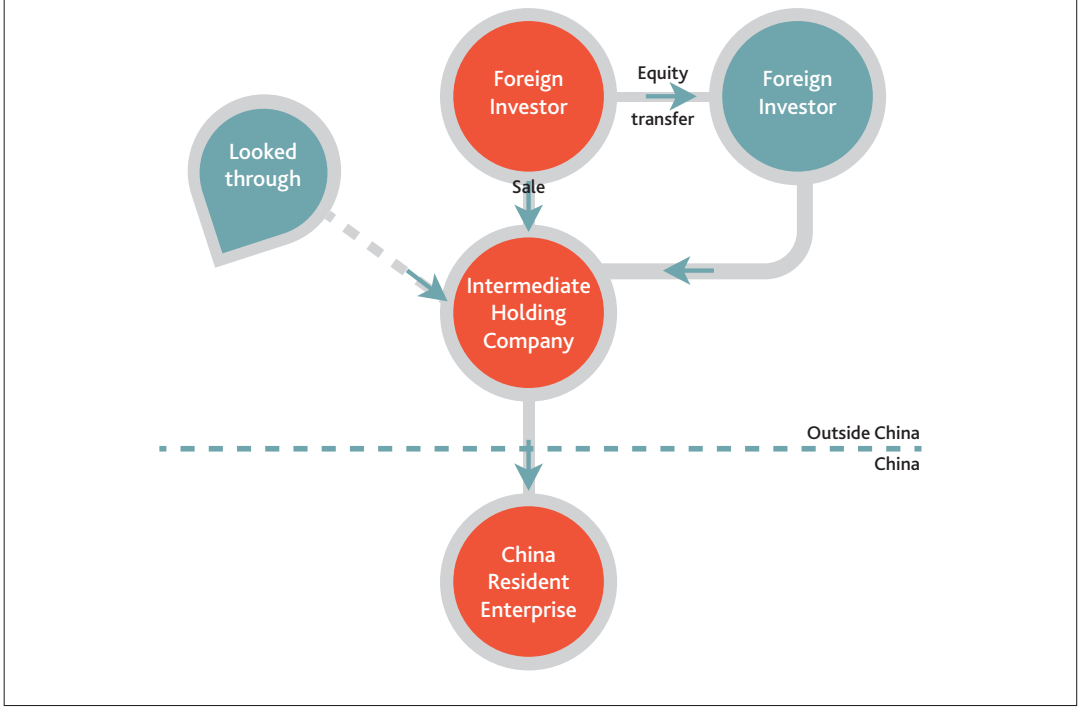
## Taxing Indirect Equity Transfers In China

Under current Chinese tax laws, a foreigner's *direct* transfer of equity interest in a Chinese resident enterprise is subject to a 10 percent income tax on the gains realized from the transfer (*i.e.*, the gain is from a Chinese source), whereas *indirect* equity transfers that are negotiated and effected completely offshore are not taxable unless they have been determined by tax authorities to be, in economic substance, direct transfers.[4] However, the high frequency and volume of indirect transfers in recent years by foreign investors with respect to their Chinese investments have caused the Chinese tax authorities to believe that many of these transfers are tax-avoiding. As a result, the Chinese Government

has significantly stepped up the regulations on the use of offshore holding companies to structure or dispose of Chinese investments.

In December 2009, the State Administration of Taxation (SAT) issued the *Notice on Strengthening the Administration of Enterprise Income Tax Collection on Proceeds from Equity Transfers by Nonresident Enterprises* (Circular 698) as an attempt to tax indirect equity transfers. Diagram 1 depicts a typical case of an indirect equity transfer. A foreign investor controls an intermediate holding company outside China, which in turn owns a Chinese resident subsidiary. Instead of making a direct sale of the Chinese subsidiary, the foreign seller disposes of the holding company to a foreign buyer outside China, thereby essentially disposing of the Chinese-resident enterprise. Due to information and resource constraints and the limited capacity of the tax administrations, in the past, China did not pay any attention to indirect equity sales that were conducted entirely outside the country.

DIAGRAM 1. A TYPICAL CIRCULAR 698 CASE




However, it is increasingly difficult to avoid China's income tax under Circular 698, which requires a foreign seller to disclose an indirect offshore transfer of a Chinese-resident enterprise to the local tax authority within 30 days after the execution of the transfer agreement if the actual tax burden in the jurisdiction of the intermediate foreign holding company is less than 12.5 percent

or if that jurisdiction exempts foreign-source income. Importantly, the Circular empowers tax inspectors to disregard the existence of an offshore holding company that is used as a tax planning vehicle and to recharacterize the indirect equity sale as a direct sale of the underlying Chinese-resident enterprise if the establishment of the offshore holding company represents an abusive use of organizational form or lacks economic substance (*e.g.*, few employees, no assets other than the shares of subsidiaries, and no operation of its own). In such cases, the gain from disposing of an offshore holding company is subject to a capital gains tax of 10 percent. So far, Chinese tax agencies have discovered over 30 "Circular 698 cases" that led to the collection of large sums of income taxes. A summary of the major cases is listed in Table 1 below.

TABLE 1. SUMMARY OF MAJOR CASES OF INDIRECT EQUITY TRANSFERS SINCE 2008 (AMOUNTS IN RMB MILLIONS)

| Case No. | Release Year | Location of Tax Bureau & PRC TRE | Tax and Interest Collected | How is the Case Disclosed? | Special Note |
|---|---|---|---|---|---|
| 1 | 2008 | Chongqing | 0.98 | Discovered when the PRC buyer submitted the cross-border transaction contracts to the local tax bureau for approval of foreign currency remittance. | First case of this kind, even before the promulgation of Circular 698. |
| 2 | 2009 | Yangzhou, Jiangsu | 71.63 | Discovered during routine information exchange with the Bureau of Commerce | Another case enforced before Circular 698. |
| 3 | 2010 | Jiangdu, Jiangsu | 173 | Discovered through routine tax administrative procedures, discussion with the subsidiary's management and public announcement by the U.S. buyer. | Largest amount of tax collection at the time. |
| 4 | 2011 | Shantou, Guangdong | 7.20 | The tax bureau noticed the disposal from information posted on the internet by a third-party. | Many layers of intermediate holdings with no economic substance. |
| 5 | 2011 | Guiyang, Guizhou | 31.50 | Not mentioned in the news how the case was discovered. | The first case in Guizhou province. |
| 6 | 2011 | Taiyuan, Shanxi | 43.89 | Discovered a suspicious equity transfer at cost during examination of inter-departmental information sharing. | Largest amount of collection in Shanxi province at the time. |
| 7 | 2011 | Xiamen, Fujian | 19.58 | Discovered during special examination because no tax has been filed and paid with respect to a sizable equity transfer. | Date of sale was before 2008 but date of agreement approval and change of registration took place in 2008, so Circular 698 still applied. |
| 8 | 2011 | Longgang, Guangdong | 24 | Not mentioned in the news how the case was discovered. | Obtained additional information from databank and website of the foreign seller during negotiation for settlement of the case. |
| 9 | 2011 | Kunshan, Jiangsu | 44 | The tax bureau was alerted to the indirect equity transfer when the finance manager of the Chinese subsidiary made enquiries on tax issues related to the transfer. | Obtained additional information from the website of the foreign seller, a Taiwanese company. |
| 10 | 2011 | Ningbo, Zhejiang | 4.23 | Discovered from local newspaper about an arbitration decision of a dispute between the German and local partners of an equity joint venture. | Adopted substance-over-form approach in the investigation. |
| 11 | 2011 | Dalian, Shandong | 62.25 | Discovered a pending equity transfer of a pharmaceutical company with high valuation premium during routine withholding tax investigation. | Though the transfer proceed was paid in three installments, the tax was collected in full at once. |

## TABLE 1. SUMMARY OF MAJOR CASES OF INDIRECT EQUITY TRANSFERS SINCE 2008 (AMOUNTS IN RMB MILLIONS)

| Case No. | Release Year | Location of Tax Bureau & PRC TRE | Tax and Interest Collected | How is the Case Disclosed? | Special Note |
|---|---|---|---|---|---|
| 12 | 2012 | Qidong, Jiangsu | 299 | The tax bureau learned of the disposal from the public announcements of both the buyer and the seller on internet. | The largest amount of tax collection in the country at the time. |
| 13 | 2012 | Jinchen, Shanxi | 403 | Not specifically mentioned but the information sharing on equity transfer with pertinent government units helps. | Largest tax collection in the country at the time of settlement. |
| 14 | 2012 | Hengshui, Hebei | 59.22 | The tax official learned of the pending indirect equity transfer from a casual conversation with his friend. | Largest amount of tax collection in Hebei province at the time. |
| 15 | 2012 | Kunshan, Jiangsu | 6.72 | Discovered through analysis of risk model of corporate income tax on equity transfers. | First successful case by Jiangsu local tax bureau. |
| 16 | 2012 | Suqian, Jiangsu | 9.77 | Discovered an equity transfer at cost through examination of equity transactions. | Enforced arm's length transaction in the settlement. |
| 17 | 2012 | Meihekou, Jilin | 307.67 | Discovered a sudden surge of tax payment by the Chinese subsidiary through routine tax revenue analysis. | First case of tax collection on indirect equity transfer in Jilin. |
| 18 | 2012 | Shengyang | 66.70 | Discovered the indirect equity transfer through tax examination of withholding tax on dividend paid to a non-tax resident enterprise.. | Tax bureau did not find sufficient grounds to "look through" the holding company so simply ordered the transfer to be taxable in China based on "substance over form." |
| 19 | 2012 | Shekou, Guanddong | 13 | Discovered through following up on equity changes of the companies. | Chinese subsidiary is the key contact point of the investigation. |
| 20 | 2012 | Nanjing, Jiangsu | 68.84 | Discovered through a tip-off letter of noncompliance from Shanghai. | Obtained information from the website of the parent company of the foreign seller. |
| 21 | 2012 | Xiamen, Fujian | 674 | Learned of the equity transfer through news release on mergers & acquisitions. | The buyer is Nestle. Largest tax collection on indirect transfer in the country at the time. |
| 22 | 2012 | Shanxi | 22.68 | Discovered during an analysis of the tax bureaus' withholding tax collection data.. | Sales proceed was not set at arm's length so adjustment was made. |
| 23 | 2012 | Xiamen Fujian | 20 | Discovered the case from local newspaper report. | Obtained information from various channels. |
| 24 | 2013 | Xi'an, Shanxi | 40 | Discovered through tax-exempt application under Double Tax Agreement filed by a non-tax resident enterprise in Barbados. | The first GAAR case approved by the State Administration of Taxation, obtained critical information from international anti-avoidance organizations. |
| 25 | 2013 | Shenzhen, Guangdong | 102.60 | Discovered from public information filed by listed companies on relevant stock exchanges. | Tax is collected within 1-½ months after the closing of the deal. |
| 26 | 2013 | Meishan, Sichuan | 33.20 | Discovered the indirect equity transfer at cost through routine check. | The case lasted two years and four months. |
| 27 | 2013 | Fenghua, Zhejiang | 5.91 | Not mentioned in the news how the case was discovered. | The case was settled based on special tax adjustment provision. |
| 28 | 2013 | Fuqing, Fujian | 5.64 | Not mentioned in the news how the case was discovered. | Tax is paid through wire transfer from overseas. |
| 29 | 2013 | Taizhou, Jiangsu | 98.25 | Discovered through routine review of sources of tax revenue. | First successful collection in Taizhou. |
| 30 | 2013 | Jiuquan, Gansu | 55.74 | Learned of the indirect equity transfer through tax assessment evaluation of a joined venture. | Largest collection in Gansu province at the time. |

TABLE 1. SUMMARY OF MAJOR CASES OF INDIRECT EQUITY TRANSFERS SINCE 2008 (AMOUNTS IN RMB MILLIONS)

| Case No. | Release Year | Location of Tax Bureau & PRC TRE | Tax and Interest Collected | How is the Case Disclosed? | Special Note |
|---|---|---|---|---|---|
| 31 | 2013 | Jiamusi, Helongjiang | 279 | Discovered from the seller's report of the equity transfer to the tax bureau claiming tax-free treatment. | First case ever to use the TRE concept to challenge the offshore equity transfer. |
| 32 | 2014 | Hangzhou, Zhejiang | 450 | Discovered through an enquiry letter from the legal counsel of the foreign seller. | The investigation lasted for more than two years. |
| 33 | 2014 | Qingdao, Shandong | 10.28 | Discovered the case from a local newspaper report. | A BVI company indirectly transferred a Chinese real estate company. |
| 34 | 2014 | Qidong, Jiangsu | 30 | Discovered while gathering public information for listed companies. | Solicited assistance from the foreign buyer to collect tax from the foreign seller. |
| 35 | 2014 | Ningbo, Zhejiang | 3.60 | Discovered during the process of investigating another equity transfer case. | The foreign seller was a German company. |
| 36 | 2014 | Shenzhen Guangdong | 28.78 | Discovered through public information of a listed HK company. | Involved a HK listed company. |

**Note:** Data compiled from public information are available on the SAT website at www.chinatax.gov.cn, China Tax News (the SAT's official newspaper), and other media sources.

From these cases, one can see that although China is a latecomer to the international anti-tax-avoidance scene, its tax officials are rapidly catching up and gaining the knowledge and technical skills required for such tax enforcements.[5] Tax agencies at various levels and in different cities are closely monitoring and scrutinizing all kinds of information channels (*e.g.*, public press, news releases on mergers and acquisition activities, regulatory reporting and filing databases, reports filed on stock exchanges, various social media, and information exchanges with other tax jurisdictions) to combat tax avoidance through abusive transfers of foreign investment in domestic assets. This partly explains why the tax and interest charges collected from anti-tax-avoidance enforcement increased by 100 times (from RMB0.46bn in 2005 to RMB46.9bn in 2013). Table 2 shows such dramatic increase of the tax collection. The sharp surge of 391 percent from 2009 to 2010 corresponds to the promulgation of Circular 698 in late 2009, as 2010 is the first full year in which Circular 698 was in effect. However, despite much enforcement efforts, the resultant revenues collected from enforcing the Circular 698 are still low relative to the high frequency and magnitude of indirect transfers with respect to Chinese investments.

TABLE 2. ANNUAL TAX RECOVERED FROM ANTI-TAX AVOIDANCE ENFORCEMENT, 2005 - 2013 (AMOUNTS IN RMB100 MILLION)

| Year | Tax Recovered from Anti-Tax Avoidance Enforcement | Percentage Increase from Last Year |
|---|---|---|
| 2005 | 4.60 | — |
| 2006 | 6.79 | 48% |
| 2007 | 10.00 | 47% |
| 2008 | 12.40 | 24% |
| 2009 | 20.91 | 69% |
| 2010 | 102.72 | 391% |
| 2011 | 239.00 | 133% |
| 2012 | 346.00 | 45% |
| 2013 | 469.00 | 36% |

Data compiled from public information available on the SAT website and China Taxation News.

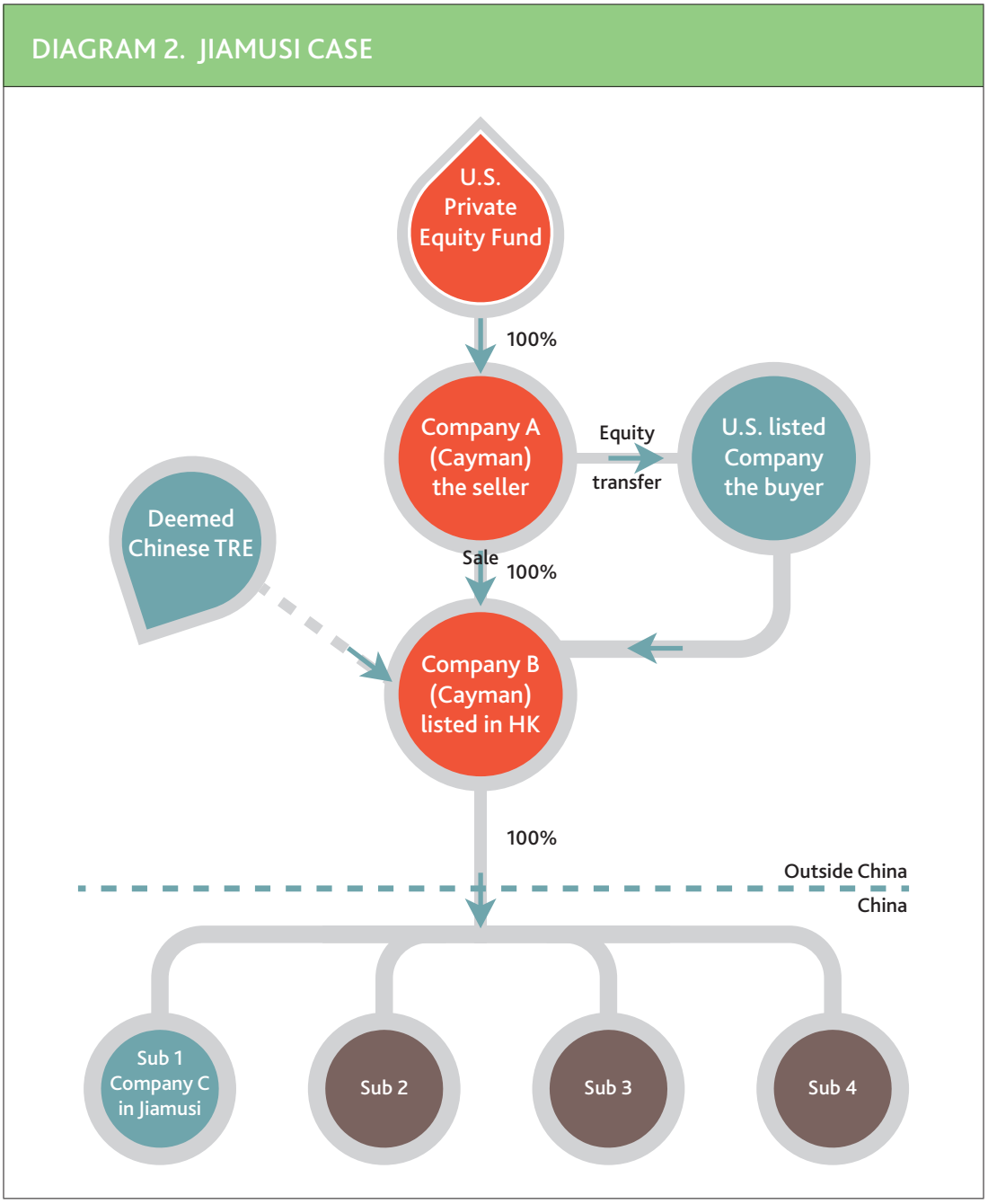
## Taxing Indirect Transfers: The *Jiamusi* Case And Its Implications

Circular 698 has proven to be a powerful weapon against abusive equity transfers. It is generally thought that the Circular would not apply to a non-China-controlled offshore holding company or to indirect share sale of a holding company that is listed on a major stock exchange, as it is implausible to characterize such a company as a tax shelter. However, a recent landmark case sets a historical precedent for the application of the concept of a TRE for taxing share transfers of a foreign, publicly traded company that is not China-controlled. The case shows how widely the local tax bureaus interpret the relevant tax rules in China.

As depicted in Diagram 2, Company A, a Cayman Islands company owned by a US private equity fund, sold shares of Company B, a Cayman holding company listed in Hong Kong, to a US publicly traded company. Company B has four Chinese subsidiaries, one of them being Company C, which is located in the city of Jiamusi in the Heilongjiang province. In accordance with Circular 698, Company A submitted a letter to the Jiamusi Tax Bureau, the in-charge tax bureau of Company C, claiming tax exemption on the capital gains from the transaction. The transaction drew the bureau's attention. The bureau realized that it was implausible to challenge the transaction under Circular 698 because the criterion for tax avoidance is whether an arrangement has a business purpose or represents an abusive use of organizational form, and Company B, which is listed on a major stock exchange, possessed a sufficient business purpose. However, the tax bureau probed further by studying a large amount of information on Company B, including its financial statements, shareholder information, overseas contracts, IPO prospectus, and documents relating to the company's purchase of Company C and other subsidiaries, in addition to information on related parties. The tax bureau found that the senior management personnel of Company B also belonged to Company C, and the place where they exercised the overall management and control over the production, operation, personnel and assets was located in Company C. Thus, the tax bureau concluded that Company B was "effectively managed" in China and that the transfer of equity interest in Company B generated

China-sourced capital gains subject to a 10 percent withholding tax. Company A eventually paid a settlement of RMB279m (USD45m) in income taxes (plus interest) in 2013.

DIAGRAM 2. JIAMUSI CASE




So what does it really mean to be "effectively managed?" The concept of effective management and control originates from a case law in 1906 in which the UK High Court of Justice ruled that a company in South Africa was in fact a UK tax resident because the company conducted its real business and located its central management and control in the United Kingdom.[6] Ever since, this

"effective management and control" test has been embraced by many countries for determining the tax status of companies conducting business in their tax jurisdictions. This test is largely based on factors such as where the majority of a company's directors reside, where the negotiation of a company's major contracts is undertaken, where a company's head office is located, how a company deals with matters of financing and capital structure, and where it invests surplus funds. Although modern business practices as a result of advanced telecommunication facilities make it difficult to determine the location of effective management and control, these factors still serve as a guideline in determining the taxability of foreign companies conducting business in a country.

Since the introduction of the TRE concept in China's income tax law, two SAT publications, Guoshuihan [2009] No. 82 (Circular 82) and Announcement [2011] No. 45 (Announcement 45), have provided detailed guidance of what constitutes effective management and control. Specifically, Circular 82 (effective as of January 1, 2008) defines the following four factors that determine whether an enterprise incorporated overseas is regarded as effectively managed in China (thus a Chinese TRE): (1) the senior executives responsible for its daily production or business operation and the place where such responsibilities are carried out are mainly located in China; (2) decisions about its finances (*e.g.*, borrowing, lending, financing, and managing financial risk) and human resources (*e.g.*, staff recruitment, termination and remuneration policies) are made or approved by organizations or individuals located in China; (3) its major properties, accounting books and records, company seal, board minutes and resolutions, shareholders' meeting minutes, *etc.* are kept in China; and (4) 50 percent or more of its voting directors or its senior executives habitually reside in China.

The effective management rule goes beyond merely holding board of directors' meetings in China; rather, it refers to more substantive operational management in China. The original, main purpose of Circular 82 is to address the situation of Chinese-capital-controlled foreign corporations, such as China Mobile Ltd, a company that is incorporated and listed in Hong Kong but is treated as a TRE because it is predominately controlled by its Chinese parent company and is effectively managed and controlled in China. Although this treatment subjects China Mobile to a 25 percent income tax on its worldwide income, it also exempts withholding tax on dividend incomes received by the company from its 31 subsidiaries in China, as such dividends are regarded as distributions between TREs.[7] It is clear that the Chinese tax authority has extended its position on the scope of the effective management rules to foreign-capital-controlled foreign corporations, as seen in the *Jiamusi* case, even without recourse to Circular 698.

The *Jiamusi* case is the first case in which a non-China-controlled foreign company is deemed as a Chinese TRE for the purpose of assessing tax on an offshore equity transfer. As local tax bureaus may

use this case as a guiding principle when dealing with similar cases in the absence of Circular 698 application, we expect to see more cases in which non-China-controlled foreign companies are deemed as Chinese TREs in the future. Given the number of offshore holding companies that are managed from China at some stage, such a sweeping application of the TRE concept would have significant tax implications. If the "deemed Chinese TRE" concept is widely applied, the tax consequences will be far reaching – the offshore holding company would have to pay: (1) China income taxes on its worldwide income; and (2) withholding taxes on the passive income paid (*e.g.*, dividend, interest and royalties) and capital gains received from the sale of equity interests in a Chinese resident enterprise.

### Suggestions For The Taxing Authority

Based on our observations and analyses of the aforementioned cases, we provide the following recommendations for the Chinese tax authorities to improve the policy of taxing a broad range of indirect transfers by foreign investors.

First, the cost of enforcing the policy of taxing indirect transfers whose cash flows take place outside China is likely to be very high due to the lack of voluntary transferor reporting. A vast majority of the cases reported in Table 2 show that tax authorities have to actually enforce the anti-avoidance rule, as opposed to relying on voluntary compliance. Therefore, if the Government wants to maintain the strength of its anti-avoidance policy without devoting unnecessary resources to enforcement, it should improve voluntary taxpayer compliance.

Second, the successful implementation of the policy of taxing indirect transfers can be challenging if such a policy lacks a statutory basis.[8] The lack of a jurisdictional basis for taxing an item encourages widespread corporate noncompliance and socially wasteful tax planning.[9] Chinese tax agencies currently rely on the anti-avoidance rules to substantiate their ground for taxing indirect transfers, presumably because Circular 698 takes the form of an administrative guidance issued by the tax authority.

Third, the anti-avoidance rules that lack easily determinable content are difficult to implement. The GAAR allows the Chinese tax authorities to disregard arrangements that would otherwise reduce tax liability.[10] However, as there is no "golden line" that can be drawn to separate acceptable tax planning from unacceptable tax avoidance, uncertainty often arises as to which transactions fall under the GAAR, making it difficult to apply the rule *ex-ante*.[11] Therefore, we suggest that to foster taxpayer compliance, the Chinese tax authorities should devise specific anti-avoidance rules to describe what transactions are most likely to be treated as lacking business substance.

Fourth, when the taxability of an indirect transfer is determined only *after* tax authorities have reviewed all relevant facts and circumstances (*i.e.*, the transfer lacks a reasonable business purpose), the imposition of reporting and, more importantly,

withholding requirements may not necessarily produce compliance. The "look-through" approach adopted by Circular 698 only allows tax authorities to determine the taxability of an indirect transfer on the basis of finding a tax-avoidance motive. In contrast, the conventional "source" approach allows taxpayers to self-assess the taxable indirect transfers of real estate based on simple, bright-line rules that are not subject to discretional interpretation. Voluntary compliance is likely to improve if equity transferors can self-assess the taxability of indirect transfers on the basis of *ex-ante* legislation.

Finally, there is the question of how standardized and consistent the practices of different state and local tax bureaus are in challenging the indirect transfer cases under their jurisdiction, as the open-ended criteria adopted by Circular 698 (*i.e.*, an abusive use of organizational forms, a lack of economic substance, and a motive to avoid tax) remain vague. When tax bureaus publicize a case of the recharacterization of an indirect equity transfer, they emphasize the amount of additional tax revenue collected, the magnitude of its implications, and whether it is the "first case of this kind" in the region (see the special note in Table 1). To the extent that the published cases create a sense of competition and urgency among tax bureaus of various provinces and cities to be the one to crack down the largest and first case of this kind in the region, their subjective interpretation of tax laws and regulations and the discretional exercise of GAAR rules for determining the taxability of indirect transfers become a real concern.

## Advice For Foreign Investors

Despite the global concerted effort to curb various forms of tax-avoidance schemes, legitimate tax planning strategies are perfectly justifiable business practices because a corporation has the right to arrange its financial affairs in a most tax-efficient manner.[12] As Chinese tax bureaus become more and more experienced with the investigation of indirect equity transfers, it is even more vital for foreign investors to be abreast of the most recent developments in China's taxes and to be alert on the possible negative implications of such an investigation. We therefore advise potential foreign investors holding equity interests in China to consider the following mitigating measures.

First, tax planning for future equity transfers must begin on day one, when foreign investors set up a holding structure for Chinese investments in order to sell them in the future on a tax-free basis. Extra care should be taken in the drafting stage of an offshore transaction to ensure all documents are prepared accurately and properly to avoid unexpected negative surprises.

Second, the function and substance of the intermediate holding company should be carefully thought through. Because the onus of proof lies with the foreign investors to show that the use of the overseas holding structure is driven by reasonable business purposes other than saving or avoiding taxes, the investors should carefully review the current group structure and establish sound commercial purposes for the intermediate holding company.

For example, the holding company can serve as the regional center of the group and carry out genuine business activities, such as R&D and fund raising. The holding company should hire formal staff for the office, hold genuine business assets, execute property leases, carry out business transactions with unrelated third parties, and file substantive reports with the respective authorities.

Third, documents and reports disclosed in the public domain and/or press should consistently depict the intermediate holding company as a substantive business entity carrying out normal operations on daily basis.

Fourth, to mitigate the possible negative impact of being a deemed Chinese TRE, the intermediate holding company should stay clear of the "effectively managed" trap in China. Specifically, (1) the major financial and operational decisions are not made or approved by Chinese subsidiaries; (2) the board meetings are held outside China; (3) the senior management personnel do not ordinarily reside in China; and (4) the major assets, books and records are located outside China.

Fifth, proactive and efficient communication with local-level tax authorities will help build candid relationships and enhance mutual trust and understanding. It helps to establish an effective communication channel, which in turn would enable tax certainty in China's unique and uncertain environment and help resolve any potential tax controversies and disputes relatively smoothly. In addition, from the buyer's perspective, cultivating and maintaining good working relationships with the Chinese tax authorities is helpful for post-acquisition operation purposes.

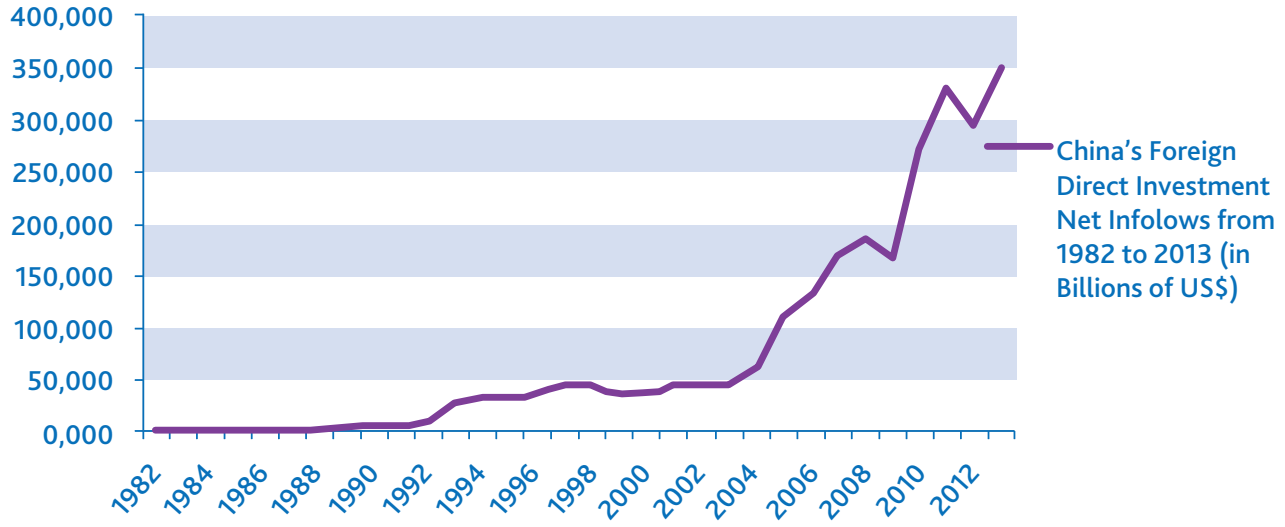
Finally, it is good practice to keep up-to-date on the most recent developments of the tax laws, regulations and practices in China relating to indirect equity transfers so as to act proactively in the case of any possible impact on the overall tax position of the group's companies. In addition, equity transferors should consider the cost and benefit guidelines when assessing the viability of establishing more substance in an intermediate holding structure. If the cost of establishing economic substance outweighs the possible 10 percent tax cost of being deemed a direct sale, they might consider absorbing the cost and negotiating with buyers by including such costs in the transaction considerations.

## Conclusion

China remains the largest recipient of foreign direct investments among developing countries. From 1982 to 2013, the net inflow of foreign direct investments into China rose from USD0.43bn to USD347.8bn, an annualized increase of more than 23 percent as illustrated in Chart 1. In recent years, however, there have been concerns that foreign investors are increasingly pulling out of China due to factors such as rising labor costs, steady RMB appreciation, and diminishing corporate tax advantages.[13] Similar to how they enter into the Chinese market, foreign investors exit mainly through offshore holding companies located in low- or no-tax

jurisdictions. We expect that the frequency and volume of sales of equity interests in the holding companies that hold Chinese investments will continue to accelerate in the future.

CHART 1: CHINA'S FOREIGN DIRECT INVESTMENT NET INFLOWS FROM 1982 TO 2013 (IN BILLIONS OF US$)




Data source: *www.data.worldbank.org/indicator/*.

China had no policy for taxing foreign investors on capital gains realized from sales of Chinese equity interests made through an offshore holding company until December 2009, when China's tax authority adopted an administrative guideline (*i.e.*, Circular 698). Under this guideline, the gain from the disposal of an offshore holding company that lacks economic substance or represents an abusive use of organizational form is subject to a 10 percent withholding tax. However, the guideline has low compliance with reporting and withholding requirements because it lacks legal authority for taxing offshore transfers. Although the Government has identified and investigated more than 30 tax-abusive indirect-transfer cases since 2009, these cases represent just the tip of the iceberg, as there are a large number of undetected cases. To substantiate the ground of taxing an even broader range of indirect transfers, China recently applied the rule of effective management and control to a case where a foreign, publicly traded company that is not China-controlled was recharacterized as a China-resident enterprise because it was "effectively managed" in China. A sweeping application of the effective management rules would have significant tax implications, as a large number of offshore holding companies are being managed in China to certain extent.

Looking forward, we expect China to (1) expand the reporting requirements for indirect transfers

to Chinese TREs, as these are the entities to which tax authorities have easy access; (2) embed more GAAR provisions in its *Individual Income Tax Law* so there are no loopholes in the anti-tax-avoidance relating to offshore transfers by a non-resident individual;[14] and (3) improve its tax administration infrastructure and capability to cope with the sophisticated business arrangements that aim to avoid China income taxes.[15] As securing compliance from foreign taxpayers is challenging when a taxable indirect transfer of shares and the related cash flow take place outside China, we offer policy recommendations for voluntary compliance improvement. Specifically, we suggest that Chinese tax authorities describe specific, bright-line rules that do not require extensive judgment on what constitutes a sufficient business purpose or effective management. This would lower the cost of subsequent determinations of the relevant laws and enforcement efforts and increase taxpayer-compliance incentives, as they can self-assess the taxability of indirect transfers on the basis of *ex-ante* legislations. As Chinese tax agencies are now more aggressive and assertive in combating corporate tax avoidance than before and could apply the effective management rules broadly to foreign transferors of shares in offshore companies that are not China-controlled, foreign investors should be on full alert. In summary, we recommend that investors carefully review the current group structure and establish sound commercial purposes for the intermediate holding company so as not to fall into the "effective management" trap in China.

## Endnotes

1 Wei Cui, "Taxing Indirect Transfers: Improving an Instrument for Stemming Tax and Legal Base Erosion," *Virginia Tax Rev.* 33 (4) (2014).

2 In 2007, when Hutchison BVI sold shares of Hutchison Cayman to Vodafone Netherlands, the Indian tax authorities attempted to tax the transaction on the ground that the transfer of Hutchison Cayman was in fact a transfer of the controlling interests in the India Company. In January 2012, the Indian Supreme Court ruled in favor of the taxpayer, judging that the existing provision of the Indian domestic tax law does not provide jurisdiction for "looking through" the share transfers of a foreign company and that the judicial application of anti-tax avoidance rules does not apply to genuine and strategic tax planning. The Indian tax authorities quickly reacted by proposing a new set of Direct Tax Codes, which establish not only the legal justification to tax the indirect transfers of a capital asset located in India, but also GAARs to grant the tax authorities the right to attack tax avoidance transactions in general.

3 Under the China Corporate Income Tax Law (CIT Law, effective January 1, 2008), a TRE is either an enterprise incorporated in China pursuant to Chinese laws and regulations, or an enterprise incorporated pursuant to foreign laws and regulations but with a "place of effective management and control" in China. A TRE is subject to taxation on its worldwide income, generally at the 25 percent tax rate.

4 However, gains from the trading of shares of Chinese companies on the Chinese and foreign stock exchanges are exempt from income tax, presumably because they are administratively costly to manage.

[5] "Shenzhen SAT Office Invites Leading International Tax Expert to Provide Trainings on GAAR Practices" (*previously available at www.chinatax.gov.cn/n2735/n565040/c572857/content.html*). China also sent tax experts to the London office of the Joint International Tax Shelter Information Centre to learn the advanced practices and procedures utilized in combating tax avoidance.

[6] The case is accessible at: *www.uniset.ca/other/cs5/19052KB612.html*

[7] Article 26 of the CIT Law and Article 83 of the Detailed Interpretation Regulations stipulates that dividends, bonuses and other equity investment proceeds distributed between qualified resident enterprises shall be tax-free.

[8] Wei Cui, *The legality of China's Attempt to Tax Indirect Equity Transfers* (accessible at: *www.taxindiainternational.com/columnDesc.php?qwer43fcxzt=MTg=*). *See Cui, supra* note 1. *See also* Lawrence Sussman *et al*, *China Adopts Controversial Vodafone-style Extraterritorial Tax and Disclosure Rule* (accessible at: *www.mondaq.com/x/91356/Capital+Gains+Tax/China+Adopts+Controversial+Vodafonestyle+Extraterritorial+Tax+And+Disclosure+Rule*).

[9] *See Cui, supra* note 1.

[10] Legislation of GAARs includes Article 47 of the CIT Law, which states: "if an enterprise carries out any other business arrangements without reasonable business purposes resulting in reduction of its taxable revenue or income, the tax authority shall be empowered to make adjustments using reasonable methods." Furthermore, Article 120 of the Detailed Implementation Regulations of the CIT Law (also effective January 1, 2008) states that "no reasonable commercial purposes … means that the main purpose is to reduce, exempt, or postpone tax payments."

[11] James Bailey, *The Thickness of a Prison Wall – the Difference between Tax Planning, Tax Avoidance, and Tax Evasion* (accessible at: *www.taxinsider.co.uk/166-The_Thickness_of_a_Prison_Wall_the_difference_between_tax_planning_tax_avoidance_and_tax_evasion.html*).

[12] At the beginning of 2013, the Organisation for Economic Co-operation and Development issued "Addressing Base Erosion and Profit Shifting" and later in the year issued a follow-up "Action Plan on Base Erosion and Profit Shifting" with a view to provide comprehensive, balanced and effective strategies for countries concerned with base erosion and profit shifting. Such a concerted international effort in combating harmful tax practices and aggressive tax planning is unprecedented (*see* details at: *www.oecd.org/ctp/beps.htm*).

[13] S. Cheng and S. Shi, "The Impact of New Income Tax Law on Foreign Invested Enterprises in China," *International Tax J.*, January–February 2012, at 17.

[14] A case has been reported on the collection of individual income tax of close to USD2.1m on the capital gain arising from an indirect transfer of an equity interest in a Chinese company through an offshore transfer of its Hong Kong parent by a Hong Kong resident individual (*see www.ey.com/CN/en/Services/Tax/APAC-Tax-Matters---October-2011---China*).

[15] For example, to improve tax administration, the State Tax Bureau of Anhui province establishes a cooperation mechanism with the Bureau of Commerce. Under such arrangement, when the indirect equity transfer is executed and filed with the Bureau of Commerce, the Bureau of Commerce will immediately

send the relevant approval documents to the State Tax Bureau so that the State Tax Bureau can launch the investigation without any delay. This practice is likely to be adopted by all the provinces. *See* KPMG Tax Alert, "Tax authority proactively enforces anti-tax avoidance on indirect disposal by non-resident enterprises" (accessible at: *www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Newsletters/China-alert-Transfer-Pricing-Focus/Documents/china-alert-TP-1203-02.pdf*).

## African Tripartite FTA Launched

On June 10 in Sharm El Sheikh, Egypt, the leaders of the Southern African Development Community, the Common Market for Eastern and Southern Africa, and the East African Community agreed to present the proposed tripartite free trade area (TFTA) for signature by their 26 member countries.

Following four years of negotiations, the completion of tariff negotiations for the TFTA, to establish a regional market with a total population of 632m people and a total gross domestic product of USD1.3 trillion (58 percent of Africa's total economy), will enable free market access for exporters of domestically produced goods.

The leaders also adopted a post-signature implementation plan detailing the initiatives to be implemented at national and regional levels under the first phase.

In addition, they directed negotiators to engage in the second phase, covering trade in services, cooperation in trade and development, competition policy, intellectual property rights, and cross-border investment.

It is expected that establishment of the TFTA "will bolster intra-regional trade by creating a wider market, increase investment flows, enhance competitiveness, and encourage regional infrastructure development, as well as pioneer the integration of the African continent," through the future establishment of a pan-African Economic Community.

Ratification of the agreement will now be taken forward in each member country. A simple majority of 14 countries will be required to ratify and then sign the agreement before the TFTA can come into effect, probably in 2017.

South Africa's Trade and Industry Minister Rob Davies said that, "in the context of markedly improved growth prospects for Africa alongside intensifying global competition for Africa's resources and markets, the need to enhance access to African markets is more urgent."

"The TFTA is an important initiative in accelerating regional integration efforts aimed at ensuring that African countries trade with each other on terms at least as favorable as other competitors," he added.

## Switzerland Rules Out FTA With EU

The Swiss Federal Council has concluded that a free trade agreement (FTA) with the EU would be a step backwards and cause uncertainty.

The Council was responding to the postulate of Council of States member Karin Keller-Sutter. The postulate mandated the Federal Council to analyze the pros and cons of an FTA between Switzerland and the EU and compare the proposal with current bilateral agreements.

In the resulting report, the Council considered a "comprehensive free trade agreement" scenario based on the concept that easier EU market access is feasible without the need for Switzerland to incorporate EU law or equivalent regulations through harmonizing legislation.

The Council said that Switzerland's bilateral agreements with the EU have created conditions for Swiss suppliers in a number of areas that are similar to those of an internal market. By contrast, an FTA without harmonizing legislation would rule out certain areas of market access, such as technical barriers to trade, customs security, the free movement of people, and the mutual facilitation of market access in certain service sectors. Negotiating the inclusion, in an FTA, of each element of the current bilateral agreements would depend on the willingness of both parties and would need to meet the interests of both sides.

The Council added that the goal of greater regulatory autonomy within the framework of a comprehensive FTA would only be formally guaranteed. It said that avoiding unnecessary divergences between Swiss and EU law is crucial for a small, export-dependent national economy such as Switzerland. Without the bilateral agreements, the disadvantages of having no contractual recognition of harmonized legislation would be significant.

The Council established that the bilateral agreements serve Switzerland's interests to a far greater extent than a comprehensive FTA could. They constitute a tailor-made legal framework that takes account of the close economic and political ties between Switzerland and the EU, as well as the country's geographical location in the heart of Europe, it said.

## WTO Welcomes New Commitments To TFA

The World Trade Organization (WTO) announced on June 11, 2015, that 66 developing and least-developed country members have now submitted notifications to the WTO outlining which provisions of the new Trade Facilitation Agreement (TFA) they intend to implement upon entry into force of the pact.

The TFA will create binding commitments across all WTO members to expedite the movement, release and clearance of goods and improve cooperation among WTO members in customs matters, forming part of international efforts under the Doha Round to cut tax barriers to trade on a global basis. In addition, the Agreement states that assistance and support should be provided to help least-developed countries (LDCs) implement the TFA.

To benefit from this, developing and LDC members must notify the WTO which provisions they will implement when the Agreement enters into force or, in the case of LDCs, within one year of entry into force (Category A commitments); which provisions they will implement after a transitional period following the entry into force of the Agreement (Category B); and which provisions they will implement on a date after a transitional period following the entry into force of the Agreement and

that require the acquisition of assistance and support for capacity building (Category C).

At the June 11 meeting of the WTO's Preparatory Committee on Trade Facilitation (PCTF), the chairman, Ambassador Esteban Conejos of the Philippines, said the number of "Category A" notifications received is an "encouraging sign of members' continued commitment" to the TFA.

"I am especially heartened to see the number of LDC notifications on the rise with three additional LDC submissions (Burundi, Rwanda, and Tanzania)," the chairman added.

In addition to the three LDCs, new Category A notifications have been received from Dominica, Kenya, the United Arab Emirates, Saint Kitts and Nevis, Saint Vincent and the Grenadines, Antigua and Barbuda, Grenada, and Trinidad and Tobago.

The TFA will only enter into force once two-thirds of the WTO membership (108 members) have formally accepted the Agreement. To date, Hong Kong, Singapore, the US, Mauritius, Malaysia, Japan, and Australia have ratified the TFA, representing 6 percent of the total needed to ensure entry into force.

## US Confirms Anti-Dumping Duties On Chinese Tires

On June 12, the US Department of Commerce confirmed final anti-dumping and countervailing duty rates on imports of Chinese passenger vehicle and light truck tires.

Commerce began investigations in July last year at the request of the United Steelworkers Union (USW) after duties on similar Chinese tires expired in 2012. The case involves imports worth an estimated USD2.1bn in 2013, up from only USD968m in 2011.

The anti-dumping margins announced by Commerce on imports from China range from 14.35 percent to 87.99 percent, and the countervailing duties range from 20.73 percent to 100.77 percent, depending on the Chinese tire manufacturer. The US International Trade Commission is also to rule on the case; its final determination is expected late next month.

Leo W. Gerard, USW International President, said that Commerce's announcement "further validates our allegations made more than one year ago about the unfair trade practices of tire producers in China. They have once again targeted the US market in an attempt to increase employment in China at the cost of job opportunities here in America."

However, China's Ministry of Commerce has previously expressed "serious concern" over the US action, stating that it is unjustified and is contrary to WTO rules. It had hoped that the US would "carefully handle the case," and learn from the damage caused by the duties introduced from 2009. Those measures had "seriously affected US–China trade relations and damaged industrial cooperation between companies in both countries," it noted.

## Isle Of Man Renegotiating UK VAT Split

The Isle of Man's Chief Minister, Allan Bell, has reportedly said that negotiations with the UK Government over the two territories' value-added tax revenue-sharing agreement are close to completion.

Alongside the Isle of Man's 2015 Budget, it was announced that the Isle of Man would be seeking a more certain flow of revenues from the UK Government, after the UK substantially reduced the island's share of pooled indirect tax levies from 2010.

The decision to revise the agreement announced in October 2009 led to a significant revenue gap for the Isle of Man, estimated to be worth GBP100m in 2010, before eventually rising to GBP140m each year thereafter.

Bell told *IOM Today* that the talks towards a more stable deal were restarted after a delay caused by the UK general election, and that a deal is likely to be signed off soon.

He told the paper: "We are very [close] to a conclusion of those discussions and I hope we will get the final sign off to this agreement fairly shortly. There is no indication what the final outcome might be. But I'm cautiously optimistic we will get a new agreement which will leave the island no worse off – and will give us stability for the next few years."

## DIFC To Triple In Size By 2024

The Dubai International Financial Centre (DIFC) announced on June 10, 2015, that it is looking to grow threefold over the next ten years, through a new strategy that includes enhancing infrastructure and increasing the availability of skilled staff.

Under the new strategy, the free zone aims to become one of the top-ten financial centers in the world. It plans to increase the number of active domiciled financial firms to 1,000 by 2024, up from 362 last year. Assets under the management of fund managers and financial institutions are expected to grow rapidly to an estimated USD250bn from USD10.4bn over the same period.

In addition, the DIFC expects the combined workforce of DIFC-registered companies to grow from 17,860 to 50,000 over the next decade.

The DIFC offers firms zero percent income tax guaranteed for 50 years, 100 percent foreign ownership, no exchange controls, and a legal system based on English common law.

## Bermuda Pushes For Solvency II Equivalence

The Bermuda Monetary Authority (BMA) has reported that Bermuda has been recommended for "provisional equivalence" with Europe's Solvency II Directive and will now be subject to a review by the European Parliament and Council.

Through the Solvency II regime, regulators hope to establish a harmonized, sound and robust prudential framework for insurance firms in the EU. It is based on the risk profile of each individual insurance company in order to promote comparability, transparency, and competitiveness.

The new regime is intended to tackle shortcomings under Solvency I, to establish a more accurate picture of an insurer's risk; ensure accurate and timely intervention by supervisors; and ensure an optimal allocation of capital (*i.e.*, an allocation which is efficient in terms of risk and return for shareholders).

The granting of equivalence is expected to greatly reduce the compliance burden on cross-border insurance business, significantly increasing Bermuda's competitiveness in the EU.

Following "provisional equivalence," Bermuda will seek to reach the status of "full equivalence."

Jeremy Cox, BMA CEO, said: "This is good for Bermuda, but it is not the complete and final result we seek. The Authority has an unreserved commitment to achieving full equivalence with Solvency II. It is essentially a timing issue. The European Commission included Bermuda on this new provisional list of countries before the deadline for Bermuda's submission on measures to be implemented for full equivalence."

"Our submission for full equivalence is being reviewed as we speak and we anticipate a decision sometime between Q3 2015 and Q1 2016. The bar is very high for non-European jurisdictions yet we firmly believe that a pathway to full equivalence exists for Bermuda. Executives of the Authority met with members of the European Commission in Brussels just last week, and discussions were favorable. By the end of this month, we will have all remaining measures in place. Full equivalence will help expand the global market for risk transfer products and in turn widen the choice of capacity for the buyers of these programs."

The insurance regimes of Australia, Brazil, Canada, Mexico, and the US have also been recommended for "provisional" equivalence with Europe's Solvency II Directive.

## Kenyan Budget Includes Major Tax Overhaul

The Kenyan Government has announced measures in its 2015/16 Budget to boost the tax take, in part to counteract an increase in government spending to record levels, and to "expand the revenue base and eliminate tax leakages."

The controversial and difficult-to-enforce 5 percent capital gains tax on the sale of shares, which was re-introduced on January 1 this year, is to be replaced by a 0.3 percent withholding tax on the transaction value of shares. The change is intended to boost compliance and ensure that the tax is enforceable.

In another move to increase compliance, Cabinet Secretary for the National Treasury Henry Rotich announced that there is to be a tax amnesty for landlords. As a further incentive, gross residential rent income below KES10m (USD100,000) a year is to be taxed at a lower income tax rate of 12 percent.

The Budget introduced a zero rate of value-added tax (VAT) for cross-border transportation services. Previously these supplies were exempt, meaning that Kenyan companies were unable to deduct VAT. Inputs for the local assembly of electronic devices used by schools will be newly VAT exempt, and the Budget newly places a 12-month time limit on all VAT refund claims.

Kenya will introduce a new gaming tax regime. A tax rate of 5 percent will apply to lottery turnover, and bookmakers will be subject to a 7.5 percent rate on gross betting revenues.

In addition, to support the film production industry, all payments by foreign film producers to local actors and crew will be exempt from withholding tax, and goods and services purchased for use in film-making will be VAT exempt. A fund will also be established to compensate production companies for certain expenses.

The Budget proposed the introduction of a new Excise Bill, which will impose excise duties only on goods with "harmful effects," based on volume or quantity. These goods will include cigarettes and tobacco, alcoholic or sugar-sweetened beverages, fossil fuels, motor vehicles, and plastic bags. Goods with no harmful effects will no longer be taxable under the new excise law. The Road Maintenance Levy will be increased by KES3 per liter of petrol or diesel, from its present level of KES9 per liter.

In addition, to simplify legislation and reduce cost of compliance, a Tax Procedure Bill is proposed to harmonize procedures across three parts of the tax code, covering VAT, excise duty, and income tax.

## France To Deduct Income Tax From Paychecks

France's President François Hollande has confirmed that the Government hopes to introduce income tax deduction at source from 2018.

In an interview with French newspaper *Sud Ouest*, Hollande confirmed that the plan is seen as a priority for the Government. He said that putting such a system in place will not be a simple undertaking, and committed to ensuring that the state and taxpayers are not adversely affected.

He said that the system will be introduced over a period of at least three years, to allow for careful and close management, with the first stage to be undertaken in 2016.

Hollande again confirmed that the Government is not considering proposals to amalgamate income tax and social security contributions.

## Indonesia Confirms Luxury Tax Cuts

The Indonesian Finance Minister, Bambang Brodjonegoro, has confirmed that the Government will shortly remove luxury goods tax from all goods, including electronic and high-end branded consumer items, except for cars and aircraft.

The new regulations are designed to encourage consumer spending and boost the Indonesian economy. Indonesian economic growth fell to 4.9 percent in the first quarter of 2015, the slowest rate of growth since 2009.

During a press briefing on June 11, the Minister said that the Government wants to maintain the purchasing power of people and encourage domestic industry. Furthermore, he hoped that removing the high luxury tax rates could improve tax compliance.

Brodjonegoro explained that the move was intended to deter people from buying luxury goods abroad. He gave the example of women buying handbags from Singapore, where they had been cheaper.

In addition, the changes are not expected have a significant effect on the Government's target to raise tax revenues by some 30 percent, as the tax loss from the luxury tax cut should only cost around IDR1 trillion (USD75m) in the current fiscal year.

In April 2010, the maximum rate of the luxury goods tax was increased from 75 percent to 200 percent. However, the rates were adjusted in 2014 so that the tax ranged from 10 percent to 125 percent.

## House Passes Permanent US Internet Tax Moratorium

On June 9, the US House of Representatives passed the Permanent Internet Tax Freedom Act (PITFA), which would permanently extend the Internet Tax Freedom Act (ITFA) and avert a possible tax increase on internet access later this year.

First enacted in 1998, ITFA placed a moratorium on the ability of state and local governments to impose new taxes on internet access, or to impose multiple or discriminatory taxes on e-commerce. ITFA has been extended multiple times and is currently scheduled to expire on October 1, 2015.

The original ITFA moratorium also included a grandfather clause to give states that were taxing internet access before October 1, 1998, a period of time to transition to other sources of revenue. Some have discontinued taxing internet access in support of a national broadband policy, but, for the remaining states, PITFA would eliminate the grandfather clause to make the moratorium effective nationwide, requiring states to repeal any remaining levies.

The Chairman of the House Judiciary Committee Chairman, Bob Goodlatte (R – Virginia), who introduced the bill, has previously noted that, "if the moratorium is not renewed, the potential tax burden on consumers will be substantial. The average tax rate on communications services in 2007 was 13.5 percent, more than twice the average rate on all other goods and services. To make matters worse, low income households pay ten times as much in communications taxes as high income households, as a share of income."

It has been estimated that internet access tax rates could be more than twice the average rate on all other goods and services. The bill's sponsors issued a statement adding: "the American people deserve affordable access to the internet and PITFA will help prevent unreasonable cost increases that hurt consumers and slow job creation."

A similar proposal in the Senate is reported to have 49 bipartisan co-sponsors. However, previous attempts to pass PITFA in the Senate have been complicated by attempts to tie a long-term ITFA extension to the more contentious Marketplace Fairness Act (MFA), which would allow US states to impose sales taxes on internet purchases made from online retailers outside their borders.

The MFA, a version of which has previously been approved by the (then Democrat-led) Senate and sent to the House for approval, was held up by the House Judiciary Committee. Republicans are wary of the MFA, mainly due to an aversion to what is considered to be an increase in taxation and in tax compliance burdens on smaller businesses.

## US EITC Effective But Inefficient, Says Research

The Congressional Research Service (CRS) has looked into the economic effects in the US of the refundable earned income tax credit (EITC), which is available to eligible workers earning relatively low wages.

The CRS pointed out that, since the EITC was enacted in the 1970s, it "has evolved from a relatively modest tax benefit to a significant antipoverty program." Initially, the credit was meant to encourage the unemployed with children to enter the workforce and to help reduce the tax burdens of working poor families with children.

In the 1990s, the CRS noted that the EITC's purpose was expanded to include poverty reduction, with a focus on encouraging welfare recipients – generally unmarried mothers – to work. At the time, the EITC "was seen as a way to ensure that a full-time worker with children would not be in poverty."

In the CRS's evaluation, it was found that the EITC has encouraged single mothers to enter the workforce, but it generally has had little to no impact on the number of hours they work. It was noted that it has had a significant impact on reducing poverty among recipients with children, but little impact among childless individuals.

The EITC has increased inequity in the tax code between those with and without children, the report found. For example, in 2015, a taxpayer with one child can receive a maximum credit of over USD3,350, while a taxpayer without a child receives a tax credit of only USD500. The report also said the credit's complex rules and formulas may make it difficult for taxpayers to comply with, and for the Internal Revenue Service (IRS) to administer.

Studies indicate that errors (whether intentional or unintentional) result in a relatively high proportion of EITC payments being issued incorrectly. The IRS has estimated that 27 percent of EITC payments were issued improperly in the 2014 fiscal year, with the value of these improper payments said to be USD17.7bn.

"The majority of the dollar amount of these errors is due to taxpayers incorrectly claiming children for the credit," the CRS stated. "In addition, the IRS may have difficulty ensuring that tax filers are in compliance with all the parameters of the EITC."

## IRS, Preparers, States Act On US Tax Refund Fraud

The US Internal Revenue Service (IRS) has joined with representatives from the software industry, tax preparation firms, payroll and tax financial product processors, and state tax administrators to announce a new collaborative effort to combat identity theft refund fraud.

They have agreed to identify new steps to validate taxpayer and tax return information at the time of filing. The public and private sector will share more information on potentially fraudulent information,

analytics that could be used to identify fraud schemes, and indications of fraud patterns.

"This agreement represents a new era of cooperation and collaboration among the IRS, states, and the electronic tax industry that will help combat identity theft and protect taxpayers against tax refund fraud," said IRS Commissioner John Koskinen. "Taxpayers filing their tax returns next filing season should have a safer and more secure experience."

Earlier, three working groups were set up at the Security Summit on March 19 to develop the agreement. It was recommended that the IRS, the industry and states should do more to inform taxpayers and raise awareness about the protection of sensitive personal, tax and financial data to help prevent refund fraud and identity theft. These efforts have already started and will increase through the year and expand in conjunction with the 2016 filing season, it was confirmed.

"Industry, states and the IRS all have a role to play in this effort," Koskinen said. "We share a common enemy in those stealing personal information and perpetrating refund fraud and we share a common goal of protecting taxpayers. We want to build these changes into the DNA of the entire tax system to make it safer."

## Most Individual US Taxpayers Receive Refunds

The Tax Policy Center (TPC) of the Urban Institute and Brookings Institution has found that, out of the 126m tax returns processed by the US Internal Revenue Service (IRS) by April 17 in the current 2015 filing season, almost three-quarters resulted in a tax refund.

While the federal Government requires employers to withhold taxes on wages, the TPC points out that taxpayers "routinely have too much income tax withheld. Getting a tax refund happens both by design and by choice."

For example, some taxpayers qualify for refundable credits, such as the earned income tax credit or the child tax credit, that exceed their tax liability but will only be received after people file their tax returns, while others claim fewer exemptions than they are likely to be eligible for when filling out the paperwork to calculate withholding.

The TPC adds that others may qualify for tax credits, such as those for college or childcare expenses, that are not accounted for in the standard withholding tables.

"All of these cases set taxpayers up to receive refunds," it continues. "Some people may opt to do this to avoid the risk of owing taxes, and others may choose this as a form of forced savings – a sort of Christmas club operated by the IRS."

In 2015, while almost 73 percent of tax returns processed by April 17 received refunds that averaged just over USD2,700, "early filers were more likely to get refunds than those filing later, and their average refund was larger. In total, the federal Government held USD249bn of excess withholding – interest free – for some part of 2014 and 2015."

The TPC concludes this was "not a bad deal for the Government – but may be something people who received those large refunds might want to think about when setting up their withholding for this year."

## NZ Investing In Simpler Tax Administration

The New Zealand Government has announced that it is on track with its plan to modernize and simplify the tax system after partnering with software company Fast Enterprises.

Revenue Minister Todd McClay said that a modernized tax administration system, enabled by the new software, would significantly boost the Government's ability to support flourishing businesses in New Zealand and make tax compliance less costly and time consuming for all New Zealanders.

He added that the time frame for completing the modernization program has been revised from ten years to under eight and the cost will be closer to the bottom end of the forecast – at around NZD1.3bn (USD935m). "I will be working with Inland Revenue to find further efficiencies and expect the cost could be as low as NZD1bn," he said.

The Minister said that New Zealand's tax system is well regarded internationally and plays an important role in supporting the kind of stability, certainty and predictability needed to maintain and attract good investment levels in the economy. He said that tax administration reform will improve the country's reputation in that area.

McClay said the Government will continue to consult with a wide range of stakeholders and organizations on the overall direction of the tax administration modernization program. "We recently launched the first two of a series of consultations with the documents *Making Tax Simpler – a Government green paper on tax administration* and *Better Digital Services*. More consultation papers are due later this year," he said.

"The changes are not just to IT systems, but to policy, processes, and the way people interact with Inland Revenue, and well positions New Zealand to continue to be a world leader in tax administration," McClay concluded.

## Ireland Issues Tax Amnesty Reminder

The deadline for those wishing to participate in Ireland's Tax Avoidance Settlement Opportunity is June 30, the Revenue has said.

The settlement opportunity was contained in the 2014 Finance Act. It applies to transactions that began on or before the publication of the Finance Bill on October 23, 2014.

Revenue said that taxpayers who entered into such a transaction to avoid tax that is being challenged, or is capable of being challenged under Ireland's general anti-avoidance rule, can settle with Revenue on advantageous terms. They must make a "Qualifying Avoidance Disclosure" before June 30, 2015. The settlement opportunity also applies to transactions that have not yet been challenged by Revenue, and covers tax disputes that do not involve tax evasion or fraud.

A taxpayer who makes a qualifying disclosure will receive a 20 percent reduction in the interest otherwise payable and will not face a surcharge. Penalties will not apply if Revenue accepts that the disclosure under the scheme is a qualifying avoidance disclosure and the taxpayer's name will not be published in the quarterly list of tax defaulters.

Transactions entered into after October 23, 2014, are covered by the 2014 Finance Act, which tightened the general anti-avoidance rule, introduced specific anti-avoidance rules, and increased the surcharge payable in failed tax avoidance schemes to 30 percent.

Revenue Chairman Niall Cody said: "If you're in dispute with Revenue over a tax avoidance scheme or if you're doubtful that a scheme you've entered into will stand up if probed by Revenue, you should act now to avail of this opportunity as time is fast running out. After the deadline, Revenue will rigorously pursue these cases and litigate through the Courts."

## New Demands Could Derail India GST Progress

The Select Committee of India's upper house of Parliament heard states' concerns about the introduction of the goods and services tax (GST) on June 16.

Although India has recently made considerable progress towards the introduction of the levy starting from April next year, many states are still seeking trade-offs in return for their support for implementing legislation.

The Select Committee discussed calls for an additional 1 percent tax to be levied by states that are home to significant manufacturing operations to cushion the impact of taxation in the location of consumption.

Talks continue also about compensation for states, which would be paid over a five-year period. Other states have called for the retention of certain minor indirect levies, which will be repealed when GST is introduced.

The Government and states have yet to agree on a revenue-neutral rate for the GST, with the Government earlier stating that a rate of 27 percent would be too high.

## Italian Split Payments Regime Endorsed

The Italian Government will reportedly receive approval from the European Commission to continue with its split payment value-added tax (VAT) mechanism, which is applicable to contracts with public sector entities.

Italian business newspaper *Il Sole 24 Ore* reported the development, citing Tax Commissioner Pierre Moscovici's spokesperson, Vanessa Mocka.

Since January 1, 2015, the 2015 "Stability Law" in Italy introduced so-called split payments, a new mechanism that requires government departments to pay a portion of the amount due under a contract – namely, the VAT of between 10 and 22 percent of the total amount of the invoice – no longer to their supplier but directly to the state.

The system was introduced in Article 1(629)(b) of the Law. It specifies that public bodies should make invoice payments minus VAT to suppliers, as any tax is paid directly to the state.

Italy had sought permission from the Commission to derogate from Article 395 of the VAT Directive on November 24, 2014, as a measure to tackle VAT fraud connected to public contracts.

## Luxembourg VAT Hike Had Limited Market Impact

The Luxembourg Government has said the value-added tax (VAT) increases introduced on January 1, 2015, have had a limited impact on the prices paid by consumers.

Luxembourg hiked each of its VAT rates by 2 percent on January 1, 2015, establishing a headline rate of 17 percent and reduced rates of 8 and 14 percent. The scope of the super reduced rate of 3 percent was also reduced.

Recent price comparisons of six brands sold in supermarkets before and after the VAT rise show an average price increase of just 0.43 percent between November 2014 and February 2015. If the VAT increases had been passed on in full, the overall price rise would have been in the region of 0.62 percent, the Government said.

Secretary of State for the Economy Francine Closener said that the study shows that less than half of the products directly affected by the VAT increase have actually increased in price.

## Maltese VAT Registration Deadline Approaching

Malta's VAT Department has reminded all taxpayers making taxable supplies that they are required to register for value-added tax (VAT) by no later than June 30.

The Maltese 2015 Budget included a measure to remove the value-added tax (VAT) registration threshold, which had been EUR7,000 (USD7,865). The change means that new businesses are required to register as soon as they issue their first invoice.

The VAT Department said: "All those conducting an economic activity must be registered with the VAT Department. Therefore, one may still opt to be exempted from collecting and paying VAT but has to register for VAT and issue fiscal receipts. This also applies to those who recently had been deregistered by the VAT Department. Those who have not yet registered should apply by June 30, 2015, by completing the registration form or reactivation form."

"Exempt registered persons with a turnover of under EUR7,000 per year will not receive a declaration from the VAT Department," it said.

The notice directs taxpayers to the relevant registration form, reactivation form, and to the webpage for registering online to receive a VAT number.

## ARMENIA - SLOVAKIA

### Signature

Armenia and Slovakia signed a DTA on May 15, 2015, Armenia's Ministry of Foreign Affairs has confirmed.

## BAHRAIN - PORTUGAL

### Signature

Bahrain and Portugal signed a DTA on May 26, 2015.

## CHINA - CHILE

### Signature

China signed a DTA with Chile on May 25, 2015.

## COLOMBIA - CZECH REPUBLIC

### Effective

The DTA between Colombia and the Czech Republic will become effective from January 1, 2016, the Czech Ministry of Finance confirmed on May 28, 2015.

## GUERNSEY - BULGARIA

### Signature

Guernsey and Bulgaria completed the signing of a TIEA on June 11, 2015.

## HONG KONG - JAPAN

### Ratified

Hong Kong gazetted an order on May 15, 2015, to ratify the TIEA signed with Japan.

## HONG KONG - SAUDI ARABIA

### Negotiations

Hong Kong and Saudi Arabia held a third round of DTA negotiations on May 12-14, 2015.

## HONG KONG - VARIOUS

### Ratified

Hong Kong gazetted two orders on May 15, 2015, to give force to the comprehensive DTAs signed with South Africa and the United Arab Emirates. They were tabled before the Legislative Council on May 20, 2015.

## INDIA - MONGOLIA

### Initialed

India and Mongolia initialed a DTA during Indian Prime Minister Narendra Modi's two-day visit to Mongolia, which began on May 17, 2015.

## LIECHTENSTEIN - ANDORRA

### Initialed

Liechtenstein and Andorra initialed a DTA on June 9, 2015.

## MOROCCO - GUINEA-BISSAU

### Signature

Morocco and Guinea-Bissau signed a DTA on May 28, 2015.

## QATAR - KENYA

### Ratified

Qatar has completed its domestic ratification procedures in respect of a DTA with Kenya.

## SINGAPORE - THAILAND

### Signature

Singapore and Thailand signed a DTA on June 11, 2015.

## SOUTH AFRICA - TURKS AND CAICOS ISLANDS

### Signature

According to a June 8 update from the South African Revenue Service, South Africa signed a TIEA with the Turks and Caicos Islands on May 27, 2015.

## SOUTH AFRICA - VARIOUS

### Into Force

According to a June 8 update from the South African Revenue Service, South Africa's TIEAs with Belize and Liechtenstein entered into force on May 23, 2015.

## SWITZERLAND - GRENADA

### Signature

Switzerland and Grenada signed a TIEA on May 19, 2015.

## TAIWAN - NIGERIA

### Negotiations

Taiwan and Nigeria have expressed interest in negotiations towards a DTA, Nigerian state media reported on June 3, 2015.

## UNITED ARAB EMIRATES - UGANDA

### Signature

The United Arab Emirates and Uganda signed a DTA on June 9, 2015.

## UNITED KINGDOM - KOSOVO

### Signature

The United Kingdom and Kosovo signed a DTA on June 4, 2015.

## UNITED KINGDOM - UNITED ARAB EMIRATES

### Negotiations

The United Kingdom and the United Arab Emirates committed to continuing DTA negotiations at a meeting on May 14, 2015.

A guide to the next few weeks of international tax gab-fests (we're just jealous - stuck in the office).

## THE AMERICAS

### BASICS OF INTERNATIONAL TAXATION 2015 – NEW YORK

PLI

Venue: PLI New York Center, 1177 Avenue of the Americas, New York 10036, USA

Chairs: Linda E. Carlisle (Miller & Chevalier Chartered), John L. Harrington (Dentons US LLP)

**7/21/2015 - 7/22/2015**

http://www.pli.edu/Content/Seminar/Basics_of_International_Taxation_2015/_/N-4kZ1z129zs?ID=223955

### INTERNATIONAL TAX ISSUES 2015 – CHICAGO, IL

Practicing Law Institute

Venue: University of Chicago Gleacher Center, 450 N. Cityfront Plaza Drive, Chicago, Il 60611, USA

Chair: Lowell D. Yoder (McDermott Will & Emery LLP)

**9/9/2015 - 9/9/2015**

http://www.pli.edu/Content/Seminar/International_Tax_Issues_2015/_/N-4kZ1z12a24?ID=223915

### BASICS OF INTERNATIONAL TAXATION 2015 – SAN FRANCISCO, CA

PLI

Venue: PLI California Center, 685 Market Street, San Francisco, California 94105, USA

Chairs: Linda E. Carlisle (Miller & Chevalier Chartered), John L. Harrington (Dentons US LLP)

**9/28/2015 - 9/29/2015**

http://www.pli.edu/Content/Seminar/Basics_of_International_Taxation_2015/_/N-4kZ1z129zs?ID=223955

### INTRODUCTION TO US INTERNATIONAL TAX – LAS VEGAS, NV

Bloomberg BNA

Venue: Trump International Hotel, 2000 Fashion Show Drive, Las Vegas, NV 89109, USA

Chairs: Bart Bassett (Morgan Lewis LLP), Doug Stransky (Sullivan & Worcester LLP)

**9/28/2015 - 9/29/2015**

http://www.bna.com/uploadedFiles/BNA_V2/Professional_Education/Tax/Live_Conferences/IntroIntermediateJuneAugSept2015.pdf

## INTERMEDIATE US INTERNATIONAL TAX UPDATE – LAS VEGAS, NV

Bloomberg BNA

Venue: Trump International Hotel, 2000 Fashion Show Drive, Las Vegas, NV 89109, USA

Chairs: Bart Bassett (Morgan Lewis LLP), Doug Stransky (Sullivan & Worcester LLP)

**9/30/2015 - 10/2/2015**

http://www.bna.com/uploadedFiles/BNA_V2/Professional_Education/Tax/Live_Conferences/IntroIntermediateJuneAugSept2015.pdf

## CAPTIVE INSURANCE TAX SUMMIT – WASHINGTON, DC

BNA

Venue: McDermott Will & Emery, 500 North Capital Street, NW, Washington, DC 20001, USA

Key Speaker: TBC

**10/26/2015 - 10/27/2015**

http://www.bna.com/captive_dc2015/

## INTERMEDIATE US INTERNATIONAL TAX UPDATE – CHICAGO, IL

BNA

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

Key Speaker: TBC

**10/28/2015 - 10/30/2015**

http://www.bna.com/inter_chicago2015/

## PRINCIPLES OF INTERNATIONAL TAXATION

Bloomberg BNA

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

Key Speakers: TBC

**11/16/2015 - 11/18/2015**

http://www.bna.com/principlesintltax_NYC/

## INTERNATIONAL TAX PLANNING

IBFD

Venue: Av. das Nacoes Unidas, 12901, Sao Paulo, SP 04578-000, Brazil

Key Speakers: Shee Boon Law (IBFD), Boyke Baldewsing (IBFD)

**11/25/2015 - 11/27/2015**

http://www.ibfd.org/Training/International-Tax-Planning-0

### INTRODUCTION TO US INTERNATIONAL TAX – ARLINGTON, VA

Bloomberg BNA

Venue: Bloomberg BNA, 1801 S. Bell Street, Arlington, VA 22202, USA

Chairs: TBC

**11/30/2015 - 12/1/2015**

http://www.bna.com/intro_va/

## ASIA PACIFIC

### 3RD GLOBAL CONFERENCE ON FINANCE & ACCOUNTING

Asia Pacific International Academy

Venue: Concorde Hotel, 100 Orchard Rd, 238840 Singapore

Chairs: Dr Raymond KH Wong (The Chinese University of Hong Kong), Prof. Dan Levin (Wharton Business School, University of Pennsylvania)

**7/29/2015 - 7/30/2015**

http://academy.edu.sg/gcfa2015/

### 4TH INTERNATIONAL TAX CONFERENCE

IBFD

Venue: JW Marriott, No. 83 Jian Guo Road, China Central Place, Chaoyang District, Beijing, China

Key speakers: TBC

**9/10/2015 - 9/11/2015**

http://www.ibfd.org/IBFD-Tax-Portal/Events/4th-International-Tax-Conference#tab_program

## MIDDLE EAST AND AFRICA

### TRENDS IN INTERNATIONAL TAXATION: AN AFRICAN PERSPECTIVE

IBFD

Venue: Zambezi Sun, Mosi-oa-Tunya Road, Livingstone 20100, Zambia

Key Speakers: Prof. Annet Wanyana Oguttu (University of South Africa), Antonio Russo (Baker & McKenzie), Belema Obuoforibo (IBFD), Eleni Klaver (Carrara Legal), Fredrick Omondi (Deloitte), among numerous others

**6/18/2015 - 6/19/2015**

http://www.ibfd.org/IBFD-Tax-Portal/Events/Trends-International-Taxation-African-Perspective-FULL-REGISTRATION-NOW

## WESTERN EUROPE

### TREASURY FOR TAX PEOPLE

IBC

Venue: etc Venues - Marble Arch, Garfield House, 86 Edgware Road, London, W2 2EA, UK

Chair: David Hill (Grant Thornton)

**6/18/2015 - 6/18/2015**

http://www.iiribcfinance.com/event/treasury-for-tax-people-event

### TAX PLANNING WORKSHOP

IBFD

Venue: IBFD head office, Rietlandpark 301, 1019 DW Amsterdam, The Netherlands

Key Speakers: Shee Boon Law (IBFD), Tamas Kulcsar (IBFD), Boyke Baldewsing (IBFD), Carlos Gutiérrez (IBFD)

**7/2/2015 - 7/3/2015**

http://www.ibfd.org/Training/Tax-Planning-Workshop

### SUMMER COURSE ON EU TAX LAW

ERA

Venue: ERA Conference Centre, Metzer Allee 4, 54295 Trier, Germany

Key speakers: Fatima Chaouche (Luxembourg University), Dr Charlène Herbain (Luxembourg University), Miriam Keusen (KPMG Luxembourg), Ine Lejeune (Advocaat/Avocat), Prof Jacques Malherbe (Liedekerke Wolters Waelbroeck Kirkpatrick), among numerous others

**7/6/2015 - 7/10/2015**

https://www.era.int/upload/dokumente/17230.pdf

### PRIVATE CLIENT INTERNATIONAL TAX UPDATES

IBC

Venue: TBC, London

Key speakers: Ian Maston, Suzanne Willis (Westleton Drake), Daniel Sopher (Sopher & Co), Patricia Garcia Mediero (Avantia Asesoramiento Fiscal y Legal), among numerous others

**7/7/2015 - 7/9/2015**

http://www.iiribcfinance.com/event/International-Private-Client-Tax-Seminars/speakers

## PRIVATE WEALTH AFRICA 2015

IIR & IBC

Venue: TBC, London

Key speakers: Richard Howarth (African Private Office LLP), Chris Moorcroft (Harbottle & Lewis LLP), Camilla Dell (Black Brick Property Solutions), Jonathan Burt (Harcus Sinclair), Liam Bailey (Knight Frank)

**7/8/2015 - 7/8/2015**

http://www.iiribcfinance.com/event/Private-Wealth-Africa-Conference

## UPDATE FOR THE ACCOUNTANT IN INDUSTRY AND COMMERCE – LONDON

CCH

Venue: Sofitel St James Hotel, 6 Waterloo Place, London SW1Y 4AN, UK

Key Speakers: Toni Trevett, Dr. Stephen Hill, Kevin Bounds, among others.

**7/8/2015 - 7/9/2015**

https://www.cch.co.uk/AIC

## OFFSHORE TAXATION – A BRAVE NEW WORLD

IIR & IBC

Venue: Grange City Hotel, London, 8-14 Cooper's Row, London, EC3N 2BQ, UK

Key Speakers: Emma Chamberlain (Pump Court Tax Chambers), Patrick Soares (Gray's Inn Tax Chambers), Simon McKie (McKie & Co LLP), Giles Clarke (Author - Offshore Tax Planning)

**7/14/2015 - 7/14/2015**

http://www.iiribcfinance.com/event/offshore-taxation-budget-special

## INTERNATIONAL TAX SUMMER SCHOOL 2015

IIR & IBC Financial Events

Venue: Gonville & Caius College, Trinity St, Cambridge, CB2 1TA, UK

Key Speakers: Timothy Lyons QC (39 Essex Street), Peter Adriaansen (Loyens & Loeff), Julie Hao (EY), Heather Self (Pinsent Masons), Jonathan Schwarz (Temple Tax Chambers), among numerous others

**8/18/2015 - 8/20/2015**

http://www.iiribcfinance.com/event/International-Tax-Summer-School-2015

## THE 25TH OXFORD OFFSHORE SYMPOSIUM 2015

Offshore Investment

Venue: Jesus College, Turl Street, Oxford OX1 3DW, UK

Chairs: Nigel Goodeve-Docker (Down End Office), Peter O'Dwyer (Hainault Capital), Richard Cassell (Withers LLP), Nick Jacob (Wragge Lawrence Graham & Co), Andrew De La Rosa (ICT Chambers)

**9/6/2015 - 9/12/2015**

http://www.offshoreinvestment.com/pages/index.asp?title=Programme_Ox_2015&catID=12148

## DUETS ON INTERNATIONAL TAXATION: GLOBAL TAX TREATY ANALYSIS

IBFD

Venue: IBFD Head Office Auditorium, Rietlandpark 301,1019 DW Amsterdam, The Netherlands

Key Speakers: Richard Vann, Pasquale Pistone, Marjaana Helminen, Peter Harris, Adolfo Martin Jimenez, Scott Wilkie

**9/7/2015 - 9/7/2015**

http://www.ibfd.org/IBFD-Tax-Portal/Events/Duets-International-Taxation-Global-Tax-Treaty-Analysis-1#tab_program

## DUETS ON INTERNATIONAL TAXATION: SUBSTANCE AND FORM IN CIVIL AND COMMON LAW JURISDICTIONS

IBFD

Venue: IBFD Head Office, Auditorium, Rietlandpark 301, 1019 DW Amsterdam, The Netherlands

Key Speakers: TBC

**9/8/2015 - 9/8/2015**

http://www.ibfd.org/IBFD-Tax-Portal/Events/Duets-International-Taxation-Substance-and-form-civil-and-common-law

## UPDATE FOR THE ACCOUNTANT IN INDUSTRY AND COMMERCE – BRISTOL

CCH

Venue: Aztec Hotel and Spa, Aztec West, Almondsbury, Bristol, South Gloucestershire BS32 4TS, UK

Key Speakers: Toni Trevett, Dr. Stephen Hill, Kevin Bounds, among others.

**9/9/2015 - 9/10/2015**

https://www.cch.co.uk/AIC

## UPDATE FOR THE ACCOUNTANT IN INDUSTRY AND COMMERCE – MILTON KEYNES

CCH

Venue: Mercure Abbey Hill Hotel, The Approach, Milton Keynes MK8 8LY, UK

Key Speakers: Toni Trevett, Dr. Stephen Hill, Kevin Bounds, among others.

**9/15/2015 - 9/16/2015**

https://www.cch.co.uk/AIC

## INTERNATIONAL TAXATION OF BANKS AND FINANCIAL INSTITUTIONS

IBFD

Venue: IBFD head office, Rietlandpark 301, 1019 DW Amsterdam, The Netherlands

Key Speakers: Ronald Aw-Yong (Beaulieu Capital), Peter Drijkoningen (French BNP Paribas bank), Francesco Mantegazza (Pirola Pennuto Zei & Associati), Omar Moerer (Baker & McKenzie), Pedro Paraguay (NautaDutilh), Nico Blom (NautaDutilh)

**9/16/2015 - 9/18/2015**

http://www.ibfd.org/Training/International-Taxation-Banks-and-Financial-Institutions

## UPDATE FOR THE ACCOUNTANT IN INDUSTRY AND COMMERCE – MANCHESTER

CCH

Venue: Radisson Blu Hotel Manchester, Chicago Avenue, Manchester, M90 3RA, UK

Key Speakers: Toni Trevett, Dr. Stephen Hill, Kevin Bounds, among numerous others

**9/22/2015 - 9/23/2015**

https://www.cch.co.uk/AIC

## CO-ORDINATED EUROPEAN PLANNING & TAXATION

IIR & IBC

Venue: TBC, London

Key speakers: Filippo Noseda (Withers), Timothy Lyons QC (39 Essex Street), Beatrice Puoti (Burges Salmon), Jonathan Burt (Harcus Sinclair), Line-Alexa Glotin (UGGC Avocats), among numerous others

**9/23/2015 - 9/24/2015**

http://www.iiribcfinance.com/event/Co-ordinated-European-Planning-and-Taxation

## UPDATE FOR THE ACCOUNTANT IN INDUSTRY AND COMMERCE – OXFORD

CCH

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

Key Speakers: Toni Trevett, Dr. Stephen Hill, Kevin Bounds, among numerous others

**10/6/2015 - 10/7/2015**

https://www.cch.co.uk/AIC

## INTERNATIONAL TAX PLANNING ASSOCIATION MONTE-CARLO MEETING

**10/11/2015 - 10/13/2015**

ITPA

Venue: Hôtel Hermitage Monte-Carlo, Square Beaumarchais, 98000 Monaco

Chair: Milton Grundy

https://www.itpa.org/?page_id=9909

## INTERNATIONAL TAX STRUCTURING FOR MULTINATIONAL ENTERPRISES

IBFD

Venue: IBFD head office, Rietlandpark 301, 1019 DW Amsterdam, The Netherlands

Key Speakers: Boyke Baldewsing (IBFD), Tamas Kulcsar (IBFD)

**10/21/2015 - 10/23/2015**

http://www.ibfd.org/Training/International-Tax-Structuring-Multinational-Enterprises#tab_program

## EU FINANCIAL ACCOUNTING IN INTERNATIONAL COOPERATION AND DEVELOPMENT PROJECTS

European Academy

Venue: Arcotel John F, Wederscher Markt 11, 10117, Berlin, Germany

Key Speakers: TBC

**11/26/2015 - 11/27/2015**

http://www.euroacad.eu/events/event/eu-financial-accounting-in-international-cooperation-and-development-projects.html

## THE AMERICAS

### United States

The US Supreme Court has ruled against Maryland's personal income tax, in a case concerning the taxation of the interstate commerce activities of a company.

Maryland's personal income on state residents consists of a "state" income tax and a "county" income tax. Residents who pay income tax to another jurisdiction for income earned in that other jurisdiction are permitted a credit against the "state" tax but not the "county" tax. Nonresidents who earn income from sources within Maryland are required to pay the "state" income tax; and nonresidents not subject to the county tax must pay a "special nonresident tax" in lieu of the "county" tax.

The respondents (Maryland residents) earned passthrough income from a Subchapter S corporation that earned income in several states. The respondents claimed an income tax credit on their 2006 Maryland income tax return for taxes paid to other states. The Maryland State Comptroller of the Treasury, the petitioner in the case, allowed the respondents a credit against their "state" income tax but not against their "county" income tax and assessed a tax deficiency.

That decision was affirmed by the Hearings and Appeals Section of the Comptroller's Office and

*A listing of key international tax cases in the last 30 days*

by the Maryland Tax Court, but the Circuit Court for Howard County reversed on the ground that Maryland's tax system violated the Commerce Clause of the Federal Constitution. The Court of Appeals of Maryland affirmed and held that the tax unconstitutionally discriminated against interstate commerce.

Before the Supreme Court, it was highlighted that the Commerce Clause, which grants Congress power to "regulate Commerce … among the several states," also has "a further, negative command, known as the dormant Commerce Clause," which precludes states from "discriminat[ing] between transactions on the

basis of some interstate element." Therefore, *inter alia*, a state "may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the state [or] impose a tax which discriminates against interstate commerce either by providing a direct commercial advantage to local business, or by subjecting interstate commerce to the burden of 'multiple taxation'."

The Supreme Court said this case was all but dictated by its dormant Commerce Clause cases, particularly *J. D. Adams Mfg. Co. v. Storen* (304 U.S. 307, 311), *Gwin, White & Prince, Inc. v. Henneford* (305 U.S. 434, 439), and *Central Greyhound Lines, Inc. v. Mealey* (334 U.S. 653, 662), which all invalidated state tax schemes that might lead to double taxation of out-of-state income and that discriminated in favor of intrastate over interstate economic activity.

Ruling against Maryland's personal income tax regime, the Supreme Court said this conclusion is not affected by the fact that these three cases involved a tax on gross receipts rather than net income, and a tax on corporations rather than individuals.

It observed that:

> "This Court's decisions have previously rejected the formal distinction between gross receipts and net income taxes. And there is no reason the dormant Commerce Clause should treat individuals less favorably than corporations; in addition, the taxes invalidated in *J. D. Adams* and *Gwin, White* applied to the income of both individuals and corporations. Nor does the right of the individual to vote in political elections justify disparate treatment of corporate and personal income. Thus the Court has previously entertained and even sustained dormant Commerce Clause challenges by individual residents of the state that imposed the alleged burden on interstate commerce."
>
> "Maryland's tax scheme is not immune from dormant Commerce Clause scrutiny simply because Maryland has the jurisdictional power under the Due Process Clause to impose the tax. While a state may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause."

The Supreme Court concluded that Maryland's income tax scheme discriminates against interstate commerce. The "internal consistency" test, which helps courts identify tax schemes that discriminate against interstate commerce, assumes that every state has the same tax structure. Maryland's income tax scheme fails the internal consistency test because if every state adopted Maryland's tax structure, interstate commerce would be taxed at a higher rate than intrastate commerce.

This judgment was released on May 18, 2015.

http://www.supremecourt.gov/opinions/14pdf/13-485_o7jp.pdf

US Supreme Court: *Comptroller of the Treasury of Maryland v. Wynne et ux.*

## Germany

The European Court of Justice (ECJ) has ruled that Germany's duty on nuclear fuel is compatible with EU law.

In 2010, Germany adopted a law on excise duty on nuclear fuel (*Kernbrennstoffsteuegesetz*). That law introduced, for the period from January 1, 2011, to December 31, 2016, a duty on the use of nuclear fuel for the commercial production of electricity. The duty in respect of 1 gramme of plutonium 239, plutonium 241, uranium 233, or uranium 235 is EUR145 and is payable by nuclear power station operators.

Kernkraftwerke Lippe-Ems, which operates the Emsland nuclear power station in Lingen (Germany), challenged the duty before the *Finanzgericht Hamburg* (Finance Court, Hamburg, Germany). It took the view that the German duty on nuclear fuel is incompatible with EU law. The Finanzgericht decided to submit questions to the ECJ concerning the compatibility of the duty with EU law.

The ECJ replied that EU law does not preclude a duty such as the German duty on nuclear fuel.

First, the ECJ rejected the argument that nuclear fuel must be exempt from taxation under the Directive on Taxation of Energy Products and Electricity (the Directive which lays down a mandatory exemption for, among other things, energy products subject to harmonized excise duty and used to produce electricity). With the fuel not appearing on the exhaustive list of energy products set out in the Directive, nuclear fuel cannot be covered by the exemption provided for some of those products, the ECJ said. According to the Court, nor can the exemption in question be applied by analogy. In essence, the ECJ rejected the idea that a duty cannot be levied at the same time on the consumption of electricity and on the sources from which that energy is produced, which are not energy products within the meaning of the Directive.

Next, the ECJ found that the Directive concerning the general arrangements for excise duty does not preclude the German duty on nuclear fuel. As it is not levied (directly or indirectly) on the consumption of electricity or that of any other product subject to excise duty, that duty does not constitute excise duty or "other indirect taxes" on that product within the meaning of the Directive. In that connection, the ECJ observed in particular that it is not apparent that a direct and inseverable link exists between the use of nuclear fuel and the consumption of electricity produced by the reactor of a nuclear power plant. Nor can the duty in question be regarded as being calculated directly or indirectly on the quantity of electricity at the time of release for consumption of that product.

Moreover, the German duty on nuclear fuel does not constitute state aid prohibited by EU law, the ECJ said, as methods of producing electricity, other than that based on nuclear fuel, are not affected by the rules introduced by the law on duty on nuclear fuel.

The ECJ considered next that the Treaty establishing the European Atomic Energy Community (Euratom Treaty, or EAEC), which covers nuclear fuel, does not preclude the German duty either. That duty does not constitute a charge having equivalent effect to a customs duty. It is levied not because nuclear fuel has crossed a frontier, but because it is used for the commercial production of electricity, irrespective of the source of that fuel. The ECJ also observed that the attainment of the Euratom Treaty's objectives does not require member states to maintain or increase their level of use of nuclear fuel or prevent them from taxing such use, which would make such use more costly and, therefore, less attractive. Furthermore, as it is levied not on the purchase of nuclear fuel but on the use of such fuel, the German duty does not jeopardize the fulfillment of the EAEC's duty to ensure that that community's users receive a regular and equitable supply of ores and nuclear fuels, the ECJ said.

This judgment was released on June 4, 2015.

http://curia.europa.eu/jcms/upload/docs/application/pdf/2015-06/cp150062en.pdf

European Court of Justice: *Kernkraftwerke Lippe-Ems GmbH v. Hauptzollamt Osnabrück (Case C-5/14)*

**Germany**

The European Court of Justice (ECJ) was asked to consider a dispute between Verder LabTec, a partnership established in Germany, and the Finanzamt (tax office) in Hilden concerning the taxation of the transfer of unrealized capital gains to its Dutch permanent establishment (PE).

From May 2005, Verder LabTec dealt exclusively with the administration of its own patent, trademark and model rights. The Finanzamt said the transfer of those rights to the Dutch PE had to take place with disclosure of the unrealized capital gains pertaining to those rights at their arm's length value at the time of the transfer.

The Finanzamt considered that the gains (the amount of which was agreed by all parties and not under dispute) should not immediately be subject to taxation in full, and instead the amount should be incorporated in profits on a straight-line basis over a period of ten years, for German tax purposes.

Verder LabTec brought an action against the authority's decision to bring forward the taxable event before the Finanzgericht (tax court) in Düsseldorf, arguing that the decision undermines the freedom of establishment guaranteed by Article 49 of the Treaty on the Functioning of the EU (TFEU). The recovery of that tax at the time of the realization of those capital gains would be a less restrictive option, it argued.

The Finanzamt said any infringement of the freedom of establishment is justified by overriding reasons in the public interest related to the preservation of the allocation of powers of taxation as between member states, and that its treatment of the unrealized gains was proportionate to achieve that objective.

Considering whether this was the case, the ECJ agreed that the taxation of the unrealized capital gains did constitute a restriction to freedom of establishment, as the taxation of unrealized gains – effectively an exit tax – would not take place in relation to a similar transfer within the national territory, with those capital gains not being subject to tax until they have actually been realized.

However, the ECJ then went on to consider the Finanzamt's justification of "overriding reasons in the public interest."

The ECJ said, first, that it should be borne in mind that the preservation of the balanced allocation of powers of taxation between member states is a legitimate objective recognized by the Court, and that, in the absence of any unifying or harmonizing measures of the EU, the member states retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, with a view to eliminating double taxation.

Second, a member state is entitled, in the case of a transfer of assets to a PE located within another member state, to impose tax, at the time of the transfer, on the capital gains generated on its territory prior to that transfer (according to the fiscal principle of territoriality) – a measure intended to ensure the member state of origin may exercise its powers of taxation in relation to activities carried on in its territory.

Recalling its decision in *DMC* (C-164/12), the ECJ said that member states are entitled to tax capital gains generated when the assets in question were on their territory and have the power, for the purposes of such taxation, to make provision for a chargeable event other than the actual realization of those gains, in order to ensure that those assets are taxed.

Accordingly, it observed:

> "It is proportionate for a member state, for the purpose of safeguarding the exercise of its powers of taxation, to determine the amount of the tax due on the unrealized capital gains that have been generated in its territory pertaining to the assets transferred outside its territory, at the time when its powers of taxation in respect of the assets concerned cease to exist, namely, in the present case, at the time of the transfer of the assets at issue outside the territory of that member state."

It also said it was appropriate to give the taxable person the choice between, on the one hand, immediate payment of that tax, and, on the other hand, deferred payment of that tax, together with, if appropriate, interest in accordance with the applicable national legislation. It cautioned, however, that account should also be taken of the risk of non-recovery of the tax.

It noted that in its ruling in *DMC*, the ECJ had held that requiring the payment of tax on unrealized capital gains within a period of five years had been found to be a proportionate measure. A staggered recovery of tax on unrealized capital gains

over ten annual installments, such as that at issue in the main proceedings, can only therefore be considered to be a proportionate measure to attain that objective, the ECJ concluded.

This judgment was released on May 21, 2015.

http://curia.europa.eu/juris/document/document.jsf?text=&docid=164355&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=104339

European Court of Justice: *Verder LabTec v. Finanzamt Hilden (C-657/13)*

## Hungary

The European Court of Justice (ECJ) has provided a preliminary ruling concerning Hungary's decision to substantially increase tax on amusement arcades in 2011. It said Hungarian legislation which prohibits the operation of slot machines outside casinos may be contrary to the principle of freedom to provide services.

Up until October 9, 2012, slot machines could be operated in Hungary either in casinos or in amusement arcades. Until October 31, 2011, the flat-rate tax on the operation of slot machines amounted to HUF100,000 (USD361) per playing position per month. As from November 1, 2011, that amount was increased to HUF500,000. From that date, the operation of slot machines in amusement arcades was also subject to a proportional tax which, for each playing position, amounted to 20 percent of the net quarterly revenue from the machine in excess of HUF900,000. The operation of slot machines in casinos was subject to a separate system of taxation, which was not changed in the fall of 2011.

Under a law adopted on October 2, 2012, the operation of slot machines was restricted to casinos, with effect from October 10, 2012. Since that date, such activity can no longer be carried out in amusement arcades.

Several companies that operated slot machines in amusement arcades brought an action before the Hungarian courts, claiming that EU law precludes measures which initially drastically increased their tax burdens and then, at a later stage, prohibited, with almost immediate effect, the operation of the machines concerned. Those companies are seeking compensation for the damages they claim to have suffered as a result of those measures.

The ECJ found that, first of all, national legislation which authorizes the operation and playing of certain games of chance only in casinos constitutes a restriction on the freedom to provide services. Likewise, a measure that drastically increases the amount of taxes levied on the operation of slot machines in amusement arcades can also be considered restrictive if it is liable to prohibit, impede, or render less attractive the exercise of the freedom to provide the services of operating slot machines in amusement arcades. In that regard, the ECJ observed that that would be the case if the national court found that the tax increase prevented profitable operation of slot machines in amusement arcades, thereby effectively restricting it to casinos.

The ECJ referred a number of other matters to the national court for it to decide upon. It said the national court must decide whether the objectives pursued by the contested measures, namely the protection of consumers against gambling addiction and the prevention of crime and fraud linked to gambling, are, in principle, capable of justifying restrictions on gambling. Those restrictions must, however, pursue those objectives in a consistent and systematic manner, it argued.

The ECJ did note, however, that Hungary seems – subject to verification by the referring court – to be pursuing a policy of controlled expansion of gambling activities, which included the issuing of new casino operating licenses in 2014.

It observed that such a policy can only be regarded as pursuing the abovementioned objectives if, first, it is capable of remedying in Hungary a real problem linked to criminal and fraudulent activities concerning gambling and addiction to gambling, and, secondly, it is not on such a scale as to make it impossible to reconcile with the objective of curbing addiction to gambling, which it stated is for the national court to determine.

The ECJ also announced that it is for the national court to determine whether the measures at issue comply with the principles of legal certainty and the protection of legitimate expectations and the right to property of amusement arcade operators. In that context, the ECJ noted that, when the national legislature revokes licenses that allow their holders to exercise an economic activity, it must provide a reasonable compensation system or a transitional period of sufficient length to enable that holder to adapt.

Finally, the ECJ pointed out that, if it is found that there is an unjustified restriction of the freedom to provide services, the operators of amusement arcades could obtain from the Hungarian state compensation for the damage suffered as a result of the infringement of EU law, provided that that infringement is sufficiently serious and there is a direct causal link between that infringement and the damage suffered. This latter point was also left for the national court to determine.

This judgment was released on June 11, 2015.

http://curia.europa.eu/juris/document/document.jsf?text=&docid=164955&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=297553

European Court of Justice: *Berlington Hungary and Others v. Hungary (Case C-98/14)*

## United Kingdom

The UK cannot apply, with respect to all housing, a reduced rate of value-added tax (VAT) to the supply and installation of energy-saving materials, since that rate is reserved solely for transactions relating to social housing, the European Court of Justice (ECJ) ruled on June 4.

The UK applies a reduced rate of VAT to "energy-saving materials" that are installed in housing or

that are supplied for installation in housing. The European Commission had challenged the measure, arguing that it contravenes the EU VAT Directive.

According to the Commission, a reduced rate of VAT can be applied only to supplies of goods and services specified in Annex III to the Directive. That annex refers to the "provision, construction, renovation, and alteration of housing, as part of a social policy" and to the "renovation and repairing of private dwellings." The Commission considered that the supply and installation of "energy-saving materials" in the housing sector do not fall into either of those two categories.

The Commission said – and the ECJ agreed – that even if such a supply or installation were to be regarded as falling under the second category ("renovation and repairing of private dwellings"), under the actual provisions of the VAT Directive, a reduced rate of VAT cannot be applied to that category where the materials account for a significant part of the value of the service supplied. The Commission stated that the energy-saving materials covered by the UK legislation extend to materials that account for a significant part of the value of the service supplied.

In its judgment, the ECJ stated that, with regard to the first category ("provision, construction, renovation, and alteration of housing, as part of a social policy"), Annex III to the VAT Directive permits the application of a reduced rate of VAT solely to the provision, construction, renovation, and alteration of housing which relate to social housing or to services supplied as part of a social policy. It follows that the VAT Directive precludes national measures that have the effect of applying the reduced rate of VAT to the provision, construction, renovation, and alteration of any housing, irrespective of the social context in which such operations take place.

Further, the ECJ stated that, while it is true, as asserted by the UK, that a policy of housing improvement may produce social effects, the extension of the scope of the reduced rate of VAT to all residential property cannot be described as essentially social.

By providing for the application of a reduced rate of VAT to supplies of energy-saving materials and installation of such materials, irrespective of the housing concerned and with no differentiation among people living in that housing, the ECJ concluded that the UK measures cannot be regarded as having been adopted for reasons of exclusively social interest or even for reasons of principally social interest.

This judgment was released on June 4, 2015.

http://curia.europa.eu/juris/document/document.jsf?text=&docid=164731&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=41944

European Court of Justice: *Commission v. United Kingdom (C-161/14)*

## Dateline June 18, 2015

Legislation designed to bind governments to maintaining a budget surplus might initially sound like a good idea. But are such laws mere political gimmickry? I'm still trying to work out whether or not to take George Osborne's proposal for such a law in the United Kingdom seriously. In actual fact, the UK had a budget law for a brief time before the end of the last Labour administration, called the Fiscal Responsibility Act, which committed whichever party was in government to halve the deficit in four years. But the Conservative-dominated coalition repealed it in 2010 after Osborne disparaged the law as "vacuous" and an irrelevance. Which hardly helps him to make the case for a similar law now.

What's more, if the Tory Government's fiscal plans come to pass, it will have eliminated the deficit by the end of its current five-year term anyway, and presumably, if it wins another election, it's not going to go on a sudden irresponsible public spending surge. If it doesn't get voted in again, recent history shows that its replacement could simply repeal the law anyway.

I suspect what's really going on here is Osborne's determination to paint his party as fiscally virtuous, and tar Labour – searching for a new direction after the disastrous Ed Miliband years – as fiscally wanton, even before they've had a chance to reinvent themselves.

On the other hand, I'm growing a little weary of hearing economic commentators say that this will be a bad idea because deficits are a good thing. It would be impossible, so their argument goes, for governments to invest in such things as infrastructure and other growth-inducing projects without borrowing. After all, debt-financed investment is common in the corporate world, and most small businesses probably wouldn't get off the ground at all without at least some leverage. Yes, that's true, but governments aren't businesses. Not subject to the same commercial and competitive pressures, governments are very different animals altogether. In fact, they are the sort of creature that is very good at spending money, but not very good at generating it, apart from through excessive levels of taxation, of course.

With government after government around the world proving to us that they are largely incapable of restraining themselves, surely some kind of externally enforced discipline is no bad thing? Besides, how would Britain ever hope to reduce its debt, which currently stands at 80 percent of GDP, if deficits are the norm and surpluses are the exception? And this of course applies to any other country with dangerously high sovereign debt. Okay, the Osborne law probably is a gimmick, but the era of profligacy with public money has to come to end at some point, so I'm going to award an encomium.

Colombia's recent economic track record is quite remarkable given the internal strife that continues to blight the country. Large swathes of rural

Colombia remain no-go zones for those not affiliated with the FARC guerrilla movement, which the Government has been battling (literally) for 50 years. Yet the economy has been growing at a very respectable 4 percent a year for the past four years, stretching a trend of unbroken economic growth which has lasted a decade. Colombia also attracted record levels of foreign investment last year after all three international credit rating agencies upgraded the Government's debt to investment grade. Not bad for a country seemingly in a perpetual state of civil war!

It's also pretty impressive when you consider how bad the country's tax system is. As the OECD pointed out recently, the combined statutory corporate tax rate of 34 percent (consisting of the 25 percent headline corporate tax and a 9 percent "equity" tax on corporate income) is high even by OECD standards. But it gets worse. According to PwC, the total tax rate, made up of corporate taxes, labor taxes, and other taxes paid by businesses in the country, is a whopping 75 percent.

Out of the 189 economies in PwC's annual Paying Taxes survey, only six have a higher total tax rate (Palau, Tajikistan, Eritrea, Bolivia, Argentina, and, topping the list, Comoros, if you're curious). Coupled with the fact that it takes businesses 239 hours on average to comply with their taxes, Colombia gets a very bad score indeed from PwC, and an overall ranking of 146th. Presumably, investors must be finding ways around these taxes (legitimately of course!) otherwise you'd expect foreign investment levels to be a lot lower. But just imagine what an economic powerhouse Colombia could be if it had a more sensible tax system.

If the Paying Taxes index is a reliable guide to a country's corporate tax environment, then my next subject, the Philippines, doesn't fare much better (ranked 127th, with a total tax rate of 42.5 percent and a 193-hour average compliance time). Ironically, one of the problems with the Filipino tax system is the array of tax incentives on offer, which might actually be serving to deter investors rather than encourage them to establish operations in the country.

At present, the Philippines has 211 special laws that provide numerous tax incentives from some 14 investment promotion agencies (IPAs), with each IPA operating differing and competing tax regimes. The estimated cost of FIs in the country in 2012 was PHP157bn (USD3.5bn), after PHP144bn in 2011 – over 10 percent of government revenues in both years. It would appear that this clunky tax system has already damaged the country's reputation with foreign investors, with the President of the European Chamber of Commerce of the Philippines recently saying that companies relocating from China are overlooking the Philippines in favor of other ASEAN (Association of South East Asian Nations) hosts, with Vietnam seemingly becoming the location of choice.

However, the Government has at least responded to these concerns with the proposed Tax Incentives Management and Transparency Act, which was

passed by the Senate last week. Not that the legislation really gets to the root of the problem; it merely provides a framework for the Government to assess the effectiveness of the myriad tax incentives, rather than redesigning and simplifying them. However, it's a start at least, and a lot of governments probably wouldn't manage to go that far, so the Philippines does make the good books this week.

The Jester