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a closer look

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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

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GLOBAL TAX WEEKLY
a closer look

Global Tax Weekly – A Closer Look

Combining expert industry thought leadership and the unrivalled worldwide multi-lingual research capabilities of leading law and tax publisher Wolters Kluwer, CCH publishes Global Tax Weekly — A Closer Look (GTW) as an indispensable up-to-the minute guide to today's shifting tax landscape for all tax practitioners and international finance executives.

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Passport Control: New Legislation In The US Provides The IRS With Another Tool For Collecting Delinquent Taxes

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Introduction

While seemingly unrelated on its face, the recently-passed Surface Transportation Reauthorization and Reform ("STRR") Act of 2015 [1] should be of significant interest to US taxpayers working outside the United States, or those who frequently travel internationally for business or pleasure. Additionally, all taxpayers with significant outstanding tax matters before the Internal Revenue Service (IRS) should take special note of recent developments that result from this legislation.

The STRR Act (hereinafter "the Act"), which went into effect on January 1, 2016, [2] marks a new era in combating significant tax delinquencies. Under the Act, the US Secretary of State now has authority to, and in some cases is required to, make passport decisions based upon information provided by the IRS. Under the defined circumstances, such action can include denying new passport applications or renewals or revoking currently-in-force passports.

Contained in the "Finance" section of the Act, [3] the apparent intent of the new passport rules is to encourage compliance with past and present tax matters. It would seem that Congress's hope is that these new rules will inspire an in-flow of funds from currently-outstanding tax liabilities. Importantly, this marks one of the first times that the US Internal Revenue Service and the US State Department will share information to combat significant tax deficiencies.

Transportation Funding Act Of 2015 – Consequences To Passport Holders And Applicants

Under the Act, the Secretary of State can make passport determinations related to tax matters for taxpayers with "seriously delinquent tax debt" of more than USD50,000. [4]

i. Seriously Delinquent Tax Debt

Taxpayers that have significant outstanding tax matters with the IRS may see their passport, or passport application, affected directly. For the purposes of the Act, a tax debt is considered "seriously delinquent" if a notice of lien has been filed in public records, or a notice of levy has been filed. [5] Under current practices, the IRS provides written notice to taxpayers receiving notices of lien or levy.

For new or renewal passport applications made by persons with seriously delinquent tax debt of more than USD50,000, the Secretary of State is *required* to deny any such application. [6] Additionally, for taxpayers with currently-in-force passports, the Secretary has the authority to revoke such passports. [7] In cases of revocation, a current passport may be limited to only allow US return travel, or a new temporary passport may be granted for this purpose. [8]

ii. Exceptions

Notwithstanding the potential for denying or revoking a taxpayer's passport, the Secretary retains the authority to issue a passport to otherwise-covered individuals for emergency circumstances or humanitarian reasons. [9]

Taxpayers with greater than USD50,000 of outstanding tax debt, but whom are currently making payments under an IRS-approved repayment plan, are exempt from these rules. [10] Also exempted are those debts from which collection is suspended pending a Due Process hearing. [11]

Incentive For US Taxpayers Living Abroad To Become Compliant

The new passport rules should incentivize taxpayers to become compliant and up-to-date with their tax matters. This is especially true for US taxpayers living abroad, and those taxpayers that travel internationally on a frequent basis under a US passport. While compliance may appear a daunting task, taxpayers need not panic at the idea of catching up on prior returns. Under US tax law, certain relief may be available for taxpayers living abroad to reduce their overall US tax liability.

First, US citizens and residents may be eligible to claim a foreign tax credit for taxes paid to another country. [12] This credit is available for taxes paid on income that is earned in a country abroad. Therefore, while US taxpayers may otherwise have a large US tax liability, a foreign tax credit may help to reduce or eliminate any such liability.

Second, US citizens and residents may also be eligible to exclude a portion of their taxable income under the Foreign Earned Income Exclusion. [13] For 2016, the maximum eligible exclusion amount is USD101,300. [14] This exclusion is a reduction to US gross income, [15] thereby directly reducing the amount of income that is subject to tax in the US. In order to qualify for this exclusion, a taxpayer must either have a "tax home" in a country located outside the United States for an entire calendar year, or must be physically present in a foreign country (or countries) for more than 330 days in any consecutive 12-month period. [16]

However, a taxpayer must ultimately file a US tax return to claim these benefits. Taxpayers looking to claim these benefits for either the current tax year or prior years should consult a tax professional who has familiarity with globally mobile taxpayers. Even if the deadline to file a tax return for a prior year has passed, a taxpayer still has an obligation to file a return for that year. By seeking assistance with filing a US tax return and claiming benefits such as the foreign tax credit or foreign earned income exclusion, a taxpayer should be able to reduce their US tax liability.

In sum, there are significant relief options available to globally mobile US taxpayers. As such, maintaining compliance need not result in significant US tax liabilities. However, claiming such benefits can pose certain challenges to US taxpayers. For example, US tax returns for individuals living abroad are more frequently selected for further review by the IRS. While often times these issues are easily resolved, a taxpayer must be able to maintain regular avenues for receiving IRS correspondence to do so.

Considerations For Revoking Permanent Citizenship

For some US taxpayers living abroad, these new passport rules could prove to be the tipping point to considerations of revoking their US citizenship. For these taxpayers, who are taxed on a worldwide basis regardless of where they are personally living and working or where other income sources are located, may now risk losing their passport privileges if major disagreements with the IRS arise. For this, and other reasons, citizens and permanent residents may occasionally seek to weigh citizenship benefits with ongoing compliance requirements. While there are numerous other considerations for this decision, certain US tax concepts should at least be analyzed.

In 2008, the United States passed the Heroes Earnings Assistance and Relief Tax ("HEART") Act, which defines the current "expatriation" rules in the US. [17] Under the HEART Act, US citizens or green card holders who relinquish their citizenship or green card may be subject to an "exit tax." Under the exit tax, a "covered expatriate" [18] is essentially treated as if all of the taxpayer's assets were sold on the day before expatriation. [19] Any resulting gain recognized upon this "sale" would then be reportable on the taxpayer's current-year tax return. [20] Depending on the total value of the taxpayer's investments at the time of expatriation, this deemed sale can have a significant impact on the overall cost of relinquishing citizenship or permanent residence.

The HEART Act sets out certain other definitions for whom the act applies to, which types of assets are included, and applicable exceptions and special rules. Such topics are beyond the scope of this writing, but are nonetheless important considerations for any individuals considering relinquishing citizenship or green card status.

Conclusion

In summary, the recently passed legislation creates additional considerations for US passport holders when maintaining their US tax compliance status. If a US taxpayer has a significant tax debt of greater than USD50,000, this taxpayer's passport status may become jeopardized.

Maintaining compliance with the US tax law need not result in overly burdensome requirements or expenses. By utilizing relief methods such as Foreign Tax Credits or the Foreign Earned Income Exclusion, many taxpayers may be able to significantly reduce, if not fully offset, their US tax liability. However, claiming these benefits nonetheless requires that a return be filed, and correspondence from the IRS addressed in a timely fashion. Furthermore, IRS system limitations may prevent taxpayers from including complete foreign addresses on their US tax returns. As a result, such important correspondence may be significantly delayed, or in some cases, lost completely. For this reason, the new passport rules create an even stronger incentive for taxpayers to carefully consider the address being used on a US tax return. Using a US address and forwarding service may allow a taxpayer a greater opportunity to respond to IRS notices and receive final notices of levy or lien before their passport becomes at risk.

It is also important to keep in mind that the IRS will determine the amount of tax debt based on the information it has available. If an individual has not filed a US tax return for a given year, the IRS will determine the outstanding liability without taking into account the potential benefits of the Foreign Tax Credit or Foreign Earned Income Exclusion. Thus, it is extremely easy for an individual who has not filed a return to have outstanding tax debt with the IRS in excess of USD50,000, even if the individual's actual liability is much lower.

Finally, for US citizens and long-term permanent residents considering revoking their current status, the HEART Act should be carefully reviewed to determine if any exit tax concepts apply to their situation.

Needless to say, these new rules give the IRS an effective tool to use to bring US taxpayers into compliance and to accelerate the collection of tax liabilities. For some US taxpayers, this may compel them to address whether to maintain their US citizenship. For others, this could be the motivation they need to get their tax affairs in order.

Endnotes

1 The "Surface Transportation Reauthorization and Reform Act of 2015" was signed into law by the President on December 4, 2015. *See* Fixing America's Surface Transportation Act, H.R. 22, 114th Cong. § 32101 (2015). The Act amends Subchapter D of chapter 75 of the Internal Revenue Code to add a new Section 7345. *Id.* § 32101(a). Further citations to the actual text of the amendment will refer to the code section contained in the Internal Revenue Code.

2 *Id.* § 32101(f).

3 *Id.* § 30001.

4 This USD50,000 threshold is adjusted annually for inflation. IRC § 7345(c).

5 IRC § 7345(b).

6 *See* IRC § 7345(d)(1)(A) ("[T]he Secretary of State *shall not issue* a passport to any individual who has a seriously delinquent tax debt …") (emphasis added).

7 IRC § 7345(d)(2)(A).

8 IRC § 7345(d)(2)(B)(i)–(ii).

9 IRC § 7345 (d)(1)(B) & (e)(1)(B).

10 IRC § 7345(b)(1) (referring to agreements under IRC § 6159 & § 7122).

[11] IRC § 7345(b)(2).

[12] IRC § 901(b) (allowing for a credit based on foreign taxes paid or accrued during the taxable year).

[13] IRC § 911(a).

[14] Rev. Proc. 2015-53, 2015-44 IRB 32.

[15] IRC § 911(a).

[16] IRC § 911 (d)(1)(A)–(B).

[17] *See* Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245 § 301; IRC § 877A.

[18] A "covered expatriate" includes all US citizens, as well as green card holders, who held their green card status for at least eight of the fifteen preceding tax years before expatriation. *See* IRC § 877A(g)(1)(A)–(B).

[19] IRC § 877A(a)(1).

[20] IRC § 877A(a)(2).

Topical News Briefing: The Best Laid Plans …

by the Global Tax Weekly Editorial Team

Thanks largely to the tax policies of the current Conservative Government, and the former Liberal/Tory coalition prior to that, the United Kingdom is now one of the most competitive tax jurisdictions among the major trading nations.

This was the conclusion of a recent survey by KPMG, which found that as a result of tax measures put in place between 2010 and 2015, including a substantial corporate tax cut, the UK now has a much more business-friendly tax regime than other European countries, with the exception of Ireland.

Robin Walduck, Tax Partner at KPMG in the UK, explained: "When we first published this survey a decade ago the attractiveness of the UK's tax regime was in question as a number of high-profile companies had announced plans to relocate business activities out of the UK. The dial has moved since then with the number of companies looking to relocate falling sharply. Now, the UK is generally seen as an attractive place to live, work, and do business and has shown a renewed ability to attract and retain some of the world's most valuable companies."

Certain measures announced in the 2016 Budget last week, reported in this week's issue of *Global Tax Weekly*, will likely further enhance the UK's growing reputation as Europe's premier business hub, especially the surprise move to accelerate the pre-announced corporate tax cut. This will mean that by 2020, the UK's rate of corporate tax will be just 17 percent, and all things being equal, this will be comfortably the lowest rate of tax in the G7 (Canada's headline corporate tax rate is 15 percent, but firms locating there must also factor in provincial corporate tax). Chancellor George Osborne also provided a considerable boost to around 600,000 small firms by taking them out of the burdensome local business tax net altogether.

Yet, despite these accomplishments, there are some nagging doubts about the UK's future. The most obvious cloud of uncertainty on the horizon is the referendum over Britain's EU membership, with the "in" campaign warning in stark terms that a "Brexit" would lower trade and investment, increase unemployment, and retard the UK economy for years to come.

It would also surely undermine Prime Minister David Cameron's credibility, given his support for remaining in the EU, albeit on slightly amended terms. Indeed, influential "euroskeptics" in the party are already positioning themselves for a leadership contest. Yet, even if the British vote to remain in the EU, there's no telling what this result could do to the ruling Conservatives, who may already be on the brink of civil war over the issue of Europe.

There is also a lack of conviction among economists and analysts about Osborne's fiscal plans, especially given that targets have slipped in the past. The strength of the UK's economic recovery continues to surprise, but the Institute for Fiscal Studies (IFS) for one suggests that the Chancellor's economic assumptions are overly optimistic given the uncertainty surrounding the global economy, and that any external shock could seriously hinder his ability to balance the books by 2019/20, as is his goal. Indeed, the IFS rates his chances of success at about 50/50. What's more, critics of the Chancellor are asking just where the money to pay for the latest round of tax cuts is coming from, and not much liking the answer.

All of which could have serious repercussions for tax policy in the years ahead. How will Osborne deal with a potentially destabilizing economic and/or political crisis? Where will the revenue come from if the economy slows and his fiscal plans go awry?

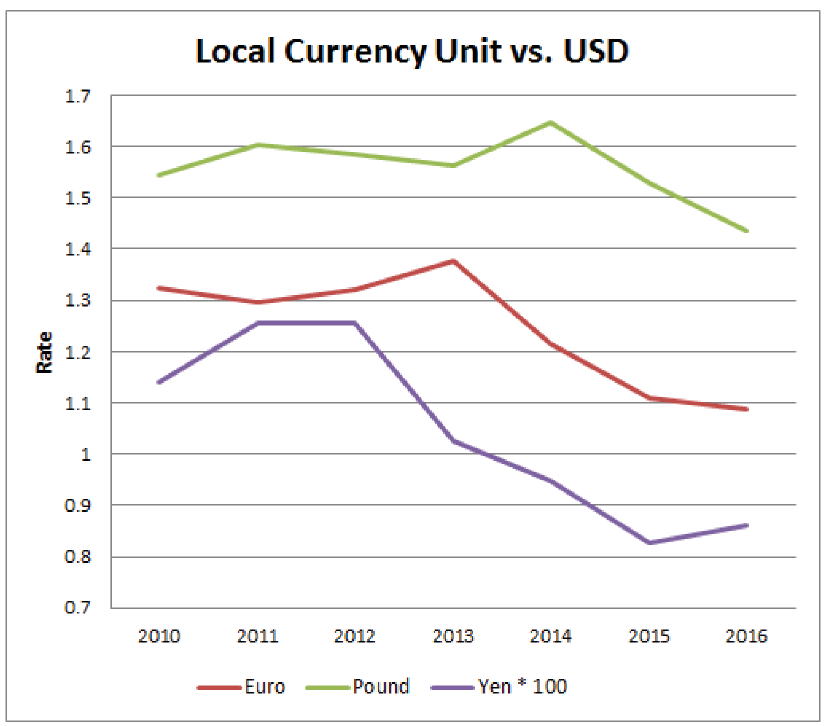
We cannot know the answers to these questions at present. But it is somewhat ironic that after spending the last six years attempting to rebuild confidence in the UK economy among multinational firms, the outlook should remain so uncertain, despite promising signs on the competitiveness front.

Repatriation Readiness: Now Is The Time

by Ian Boccaccio, Principal and International Tax Practice Leader, Michael Minihan, Principal, and Patrick Roach, Consultant, Ryan

Introduction

According to current estimates, US multinational businesses have more than USD2 trillion of unremitted foreign earnings, "permanently reinvested" in non-US jurisdictions. Because the Internal Revenue Code (IRC) does not impose taxation on most income earned by foreign subsidiaries until it is repatriated, businesses often delay domestic recognition of the income until economic conditions, market fluctuations, or tax law changes make doing so most advantageous. US generally accepted accounting principles (GAAP) further reward permanent reinvestment, by eliminating the need to accrue the US tax associated with future repatriations. Over the past three years, the dollar has strengthened dramatically against most foreign currencies, including the euro (EUR), British pound sterling (GBP), and the Japanese yen (JPY). The steady increase in the dollar's strength stands in sharp contrast to the previous decade, in which the dollar's spiraling value deterred many foreign investors from betting on the dollar.



A host of factors has contributed to the strengthening of the dollar, with economic upheaval within the Eurozone and uncertainty about the UK remaining in the European Union being the most commonly cited. The financial crises in Portugal, Ireland, Greece, and Spain (derisively referred to as "PIGS"), who have repeatedly failed to secure refinancing of their government debt, have contributed to considerable deflation of the euro. Meanwhile, the UK mulling a potential exit from the European Union, often referred to as the "Brexit," has significantly weakened the GBP. From December to March alone, the GBP to dollar exchange rate has dropped from 1.5 to 1.385.

The rise of the dollar presents a golden opportunity for many multinational businesses that can repatriate income with more favorable tax and economic consequences than at any time in most of the past five years. Because a stronger dollar produces a lower aggregate dollar repatriation amount relative to years with a weaker exchange rate, the benefit is twofold. First, the tax imposed on the repatriation itself is smaller. Second, the relative value of the associated foreign tax credits under Section 902 is higher. The following example is illustrative.

Repatriation Example

		Assumptions	2010	2016	Difference
a	Pre-tax Earnings (GBP)	1,000,000			
b	Tax (GBP, at 25%)	(250,000)			
c=a+b	E&P (GBP)	750,000	750,000	750,000	
d	FX Rates (GBP to USD)	2.0000	2.0000	1.5000	
e=b*d	Tax Pool (USD)	500,000	500,000	500,000	
f=c*d	Dividend (USD)		1,500,000	1,125,000	(375,000)
e	Section 78 Gross-up (USD)		500,000	500,000	0
g=f+e	US Taxable Income (USD)		2,000,000	1,625,000	(375,000)
h	US Tax (35%)		(700,000)	(568,750)	131,250
i=e	Less: Foreign Tax Credit		500,000	500,000	0
j=h+i	Net US Tax		(200,000)	(68,750)	131,250

Notes:

1 FX Rates are directionally appropriate, but rounded for convenience.
2 Earnings and Taxes are assumed to be accrued in 2010.
3 For purposes of the illustration, no further earnings or taxes are considered in the pools.
4 The entirety of the E&P pool is assumed repatriated.
5 For purposes of the illustration, the UK dividend is treated as the entity's entire net income.

This example is representative of the potential impact (nearly 20 percent reduction in the taxable dividend amount), but many taxpayers could see savings with relatively MORE significance! [1] For this reason, the continual strengthening of the dollar has made repatriation (assuming the timing of the repatriation is optional) extremely attractive at this time, but the decision always involves some element of foreign exchange risk, as delaying repatriation further is only financially advantageous if the exchange rate continues to improve.

There is reason to believe that the strengthening of the dollar will soon reach a crescendo; the Federal Reserve has made clear that, barring an unforeseen economic turn of events, it will not raise the policy rate further. Additionally, there is significant pressure on the European Central Bank to accelerate quantitative easing. Together, these decisions will likely create a degree of downward pressure on the dollar's value. Perhaps more significantly, however, is uncertainty surrounding the Chinese yuan (CNY). As Chinese gross domestic product (GDP) growth has slowed in recent years, the CNY's value has stagnated, with growing fears that it might be facing a precipitous devaluation. With so much American investment in China, and with a considerable portion of the economy tied to Chinese manufacturing, uncertainties related to the CNY are viewed as the biggest potential roadblock for sustained dollar strength. Consequently, for businesses considering repatriation, time may very well be of the essence.

Further, and perhaps more significantly complicating the repatriation decision, are the current rumblings from Washington, growing stronger and stronger, which indicate a resurgence of interest in a repatriation tax holiday. Most notably, the rumblings are coming from both political parties, lending credence to the idea that a holiday is coming. Given the tax savings that a holiday would provide, repatriating before there is clarity on the issue would be a premature decision.

Repatriation – Testing The Tax Director's Ability To Read Tea Leaves

The next test for strength of stomach and reliability of the crystal ball is the idea that proposed legislation on Capitol Hill will be worth the wait. The previous session of Congress is notable for three separate proposals for a repatriation tax holiday, through which foreign income could be repatriated at a temporarily lower tax rate. The idea gained traction on both sides of the political aisle, as shared budgetary concerns made a large influx of cash, and ergo, taxable income, attractive. Each proposal, if enacted, would have remitted all repatriation tax revenue to the Highway Trust Fund, a budgetary vortex in need of immediate attention, which strengthened the bipartisan appeal.

The first proposal was a bipartisan effort by Senators Rand Paul and Barbara Boxer to lower the corporate tax rate on repatriated income from 35 percent to 6.5 percent. The second was proposed by Senator John McCain and Representative Trent Franks, both Republicans, and suggested lowering the rate to 8.75 percent, unless a corporation were to use the repatriated income to create new domestic jobs, in which case the rate would be 5.25 percent. The final repatriation holiday proposal was contained in President Obama's 2016 budget proposal and suggested a reduced rate of 14 percent. Each of these proposals would have provided considerable tax savings over the headline 35 percent rate, illustrating well why no multinational corporation would want to miss such an opportunity.

These proposals echo a 2004 repatriation tax holiday enacted for similar reasons. A large injection of income into the economy was viewed as a short-term remedy for an increasing budget deficit and sluggish job growth. During the holiday, in which foreign-source income was subject to a tax rate of 5.25 percent, domestic corporations repatriated USD362bn. In hindsight, the Treasury viewed the holiday unfavorably, estimating that it had actually *cost* the government USD3.3bn, and noting that the companies that took advantage of it actually *cut* more than 20,000 jobs. The Treasury's report was frequently cited by opponents of a defeated 2009 proposal for another repatriation tax holiday.

However, most of these analyses do not contemplate whether the cost to the Treasury and the net job losses would have actually been worse had the 2004 repatriation holiday not been enacted. Ultimately, consensus could not be reached before the most recent session of Congress concluded, and no proposal was enacted. However, chatter has resumed as 2017 budget discussions gather steam, and there remains a strong impetus for another holiday among Republicans and Democrats alike. Because the prospects remain favorable from a budgetary perspective, and because tax breaks are always attractive in an election year, there is a strong possibility that a repatriation holiday will become law during the next session of Congress.

Conventional wisdom suggests that a holiday with job creation incentives, such as the McCain-Franks proposal, is a highly possible final byproduct of negotiations. Accordingly, multinational businesses hoping to expand operations and hire new workers would greatly benefit from such a proposal if enacted. That said, although the characteristics of any impending repatriation holiday remain unclear, multinational corporations in the position to make an optional repatriation should likely table any immediate plans until the picture is clearer.

Regardless, however, of whether the repatriation plan is for tomorrow or next month or later this year, it seems near-term repatriation plans are important, be they driven by legislation or FX movements. Incumbent upon multinational businesses is that they make all necessary preparations for repatriation so that the opportunity does not escape them.

Repatriation Preparedness

Despite what seems to be a near inevitability of repatriation opportunity, most multinational companies remain dramatically unprepared. Regardless of the form that the legislation takes (or the benefit of the strong dollar), companies will need to have a strong handle on their earnings and profits (E&P) and tax pools. In addition, important ancillary attributes, such as an outside basis in the shares of non-US subsidiaries, could be immediately relevant. Finally, the attributes required for accurate IRC Section 904 foreign tax credit (FTC) limitation calculations will need to be polished and ready.

Many companies that asserted permanent reinvestment positions for their foreign operations diverted tax department resources away from calculations that lacked immediate relevance. In other words, why spend time, effort, and money on the computation of E&P pools and other attributes that will go no further than an unused line item on Form 5471 or Form 1118? With repatriation legislation, particularly if repatriation becomes mandatory, those attributes have to be correct, and the time to address the accuracy of those attributes is NOW.

Long-ignored pools could take weeks, if not months, to calculate. Documentation, particularly that which is needed to support claimed FTCs, should be gathered and organized immediately. Many taxpayers find this to be the most onerous attribute support exercise, as it requires the assistance of non-US operations to produce documents which are out of the immediate control of the US tax department.

Repatriation readiness can be distilled to four components.

1. Earnings and profits, including the proper computation of E&P by FTC limitation basket, the verification of any previously taxed income amounts, and the calculation of any applicable pre-87 E&P

E&P is rarely given any taxpayer's full attention, and this is particularly so for those entities for which permanent reinvestment assertions have been made. E&P calculations are often the red-headed stepchild of the tax department, something to be addressed "when we have time," or "when there is a need." There is a need, and that need is NOW, and unfortunately, the SWAG approach just will not work for this exercise. [2] Complexity has crept in, particularly if repatriation legislation requires the repatriation of an entity's full E&P balances. Sloppy analysis could easily result in over-taxation; even if overtaxation occurs at preferential tax rates, no taxpayer can afford to be overtaxed.

The full list of potential E&P items to address is beyond the scope of this article. However, some cornerstones that should be addressed in every E&P analysis include the following:

a. *The cumulative impact of timing items.* Full repatriation now will likely eliminate the opportunity to make future "pool adjustments" to account for errors in temporary E&P adjustments.
b. *The impact of Section 905(c) adjustments.*
c. *M&A transaction activity.* It will be important to trace and document the proper treatment of corporate activity that has impacted the E&P pools of the repatriating entity. Liquidations, hovering deficits, Section 304 transactions – these are but a few of the many, many adjustments that M&A activity requires in the computation of E&P.
d. *Flow-through adjustments.* Twenty years after the dawn of "Check-the-Box" introduction, many taxpayers still struggle with the accounting and compliance of tax flow-through entities. Now is the time to get it right.
e. *Basketing.* A popular shortcut for E&P calculations is to ignore the proper basketing of E&P balances. Frequently effective, it will probably not make the grade for a full repatriation exercise. It is not unreasonable to expect significant extra effort by Internal Revenue Service (IRS) examiners with respect to the repatriation holiday because of the sheer magnitude of earnings that will remit to the United States.
f. *Pre-87 E&P.* In many cases, it goes ignored, waiting for the day of relevance. It is highly likely that pre-87 E&P, and all E&P, will become immediately relevant. As such, it is time to gather the appropriate documentation to prepare the necessary calculations.
g. *Previously taxed income (PTI) balances.* Most taxpayers would not admit to losing track of PTI balances, but time and time again, they do. Even with a reduced tax rate on repatriations, even one dollar of tax paid on E&P that has already been subject to US tax is too much.

2. Tax Pools, including most of the same issues impacting E&P

The primary issue that will affect taxpayers in preparing their tax pools for a repatriation event is getting the documentation in order. With documentation so frequently out of the hands of the US tax department, this is very often the most difficult task that the E&P steward will tackle.

Additionally, many of the issues affecting the E&P pool calculations will also affect the tax pool calculations. Basketing, merger and acquisition (M&A) activity, flow-through calculations, Section 905(c) and pre-87 attributes affect taxes every bit as much as E&P. The updates will go hand-in-hand.

3. Outside basis

Pursuant to IRC Section 316, distributions are first made from E&P, and then treated as a return of basis, to the extent thereof. For this reason, and particularly if the attribute calculations are not fully updated at the point of repatriation, it will be important to have fully updated outside basis calculations. In addition, the potential impact of the outside basis amounts on the allocation and apportionment of interest expense will be relevant in the repatriation preparation process.

4. FTC limitation related calculations, including (but not limited to) Sec. 861 Expense Allocations, Overall Foreign Losses, Overall Domestic Losses, and Foreign Net Operating Losses

Perpetual hopelessness is the feeling experienced by many multinational companies that operate under the assumption that they will be unable to utilize foreign tax credits as a result of a difficult FTC limitation problem. These problems are often tied to the allocation and apportionment of interest expense. Proper planning for repatriation will involve getting this house in order. To that end, taxpayers should not only review the basis calculations described above but also look at a broader tune-up of these attributes. At a minimum, taxpayers should look at the following:

(a) Maximization of Gross Foreign Source Income: The harvest of low-hanging fruit in the area of gross foreign source income eludes many taxpayers. Simple changes in the terms associated with the transfer of title and risk of loss on intercompany sales, for example, can facilitate FTC utilization. Similarly, when there is a potentially large FTC event on the horizon, the opportunity is ripe to review transactions that could potentially trigger big hits of gross foreign source income. Finally, taxpayers should evaluate the net benefit to the FTC limitation calculation that will result from the repatriation event itself. For many taxpayers, the event will be a trigger of recognition of low-taxed foreign source income, but it is incumbent on the tax department to determine whether it will be enough to utilize the credits it brings, as well as any excess FTCs that may be part of the company's deferred tax asset profile.

(b) Review of Interest Expense Allocation and Apportionment Methodology: Because the interest expense allocation and apportionment is such a significant driver of the limitation calculations for many taxpayers, this calculation should receive a corresponding amount of attention. Taxpayers

should be analyzing the many nuances of this calculation, including its historic roots in old tax return workpapers, to the extent of overall foreign losses or excess FTCs that are carrying forward. Evaluations of the tax basis method versus the Fair Market Value (FMV) method for the asset based apportionment should be revisited as well.

(c) Review of Research Expense Allocation and Apportionment Methodology: Similar to the interest expense review, the methodology for calculating the allocation and apportionment of the research and developmental expense pool that is allocable for FTC limitation purposes should be reviewed. Beyond that, taxpayers should also evaluate the potential benefit of using one of the available alternative methods for computing the allocation and apportionment, as part of their preparation for repatriation.

(d) Review of the Allocation and Apportionment of Other Significant Expenses: With heightened scrutiny of FTC limitation calculations, a distinct probability in light of a repatriation holiday, there will almost certainly be a governmental spotlight on these calculations. Many taxpayers continue to struggle with the determination of the amount of allocable expenses and with subsequently finding an acceptable method to compute the allocation. This is an area that has already enjoyed enhanced scrutiny in recent years, and it is easy to predict that the heat will rise when the stakes are higher.

(e) Evaluation of Losses to Ensure Distinction and Proper Treatment of any Separate Limitation Losses, as well as Overall Foreign Losses (OFLs), Overall Domestic Losses (ODLs), and the Foreign Portion of any Net Operating Losses: There is interrelation between all of the calculations covered in this article. For that reason, taxpayers should build an outstanding documentation file that reviews and confirms appropriate treatment of income and expense items for FTC limitation purposes, and then ties that documentation into the tax return's overall results so that all categories and baskets of income and losses have been thoroughly documented. This is the finish line, yes, but it is also where sharp taxpayers stay focused to ensure that attributes, both favorable (ODLs) and unfavorable (OFLs), are properly calculated, tracked, and recaptured. It is not enough to rely on what has historically been reported on Schedule J of Form 1118. These are attributes that must be annually calculated, updated, tracked, and evaluated for correct utilization. This will be particularly critical as components of the numbers change as a result of further review of gross foreign source income and expense allocation and apportionment.

Conclusion

2016 appears to be an ideal time for multinational companies to repatriate foreign source income. The tax benefit afforded by a strong dollar will yield considerable tax savings on income earned over the previous decade. The strong possibility of the enactment of a repatriation tax holiday during the next session of Congress, however, makes adopting a brief wait-and-see approach most advisable. However, because there are strong indications of future downward pressure on the dollar, repatriation in the near term is advisable irrespective of any repatriation tax holiday. As such, it is incumbent upon multinational businesses to undertake all repatriation readiness measures to ensure that they are able to take full advantage of the favorable repatriation circumstances.

Endnotes

1 Some exchange rate fluctuations over this period are more than 20 percent. Note also that comparable benefits could be realized via the repatriation of previous taxed income, via the trigger of losses pursuant to IRC Section 986(c).

2 The acronym "SWAG" is colloquially understood to stand for "Super Wild-Ass Guess."

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An End To Tax Uncertainty In India?

by Stuart Gray, Senior Editor, Global Tax Weekly

The Bharatiya Janata Party (BJP) came to power in 2014 promising to create a more stable and predictable corporate tax regime, and to improve the environment for investors by not shifting the tax goalposts to the Government's advantage at any given moment. But, with two large taxpayers having recently resorted to international arbitration to resolve tax disputes, has anything really changed for the better?

Introduction

As Finance Minister Arun Jaitley observed at an event organized by the Board of Excise and Customs on January 27, 2015, there is "huge curiosity and interest in India especially among domestic and foreign investors." [1] And it is easy to see why: India is a member of the BRICS club of major emerging economies (along with Brazil, Russia, China, and South Africa), and stands on the cusp of becoming one of the world's foremost economies with its vast domestic market of over one billion people.

The fact that India isn't yet in the premier league of developed and emerging economies – in terms of raw GDP (it is only the world's ninth-largest economy, behind Italy, Brazil, France, and the United Kingdom) – is down to a number of political, cultural, and economic factors.

However, its tax regime, widely acknowledged to be one of the most complex and unstable in the world, is surely acting as a drag on investment and slowing growth. Indeed, if you were going to invest in a country based on the results of PwC's ease of paying taxes index, India wouldn't get a look in, ranked as it is in 157th place in the 2016 table. To put this ranking into context, it is only three places above Libya, which is hardly a paragon of political stability.

One of the major problems with India's tax regime, aside from its sheer complexity, is that many of its important provisions have been subject to widely differing interpretations by taxpayers and the tax authorities, and this has led to a seemingly unending series of tax disputes. In fact, when the BJP came to office, more than INR4 trillion (USD60bn) was disputed before various Courts and Appellate authorities. [2] Much of this was related to the previous Government's decision in 2012 to amend the Income Tax Act retrospectively in the wake of the Supreme Court's decision in favor of Vodafone, [3] which concluded – briefly as it transpired – a long-running tax dispute between the company and the tax authorities relating to its takeover of Hutchinson Essar's Indian assets in 2007. Indeed, the Vodafone affair is widely perceived as the nadir in relations between foreign investors and India. And the subsequent opening of separate transfer pricing inquiries against Vodafone and other multinationals seemed to add insult to injury.

Unclogging The Tax Courts – Measures To Reduce Tax Disputes

So, as far as the BJP is concerned, the only way is up, and Jaitley has certainly said all the right things about creating a more conducive framework for investors since becoming Finance Minister. But as the well-worn saying goes, talk is cheap. Action to improve the tax regime in a meaningful way is what taxpayers want to see.

And action they have seen, because in the last year or so the Government has made a number of changes designed to improve tax certainty and stability.

A key development occurred in January 2015, when India's Central Board of Direct Taxes (CBDT) instructed tax officials to follow the Bombay High Court ruling in favor of Vodafone in a transfer pricing dispute worth INR32bn.

In *Vodafone India Services Pvt. Ltd. v Union of India*, [4] the court said that the issuance of equity shares in FY2009/10 by Vodafone India's resident subsidiary, Vodafone India Services, to its UK parent as part of a rights issue did not give rise to income taxable under India's Income Tax Law and therefore the transaction could not be subject to India's transfer pricing rules.

In a letter addressed to senior officials, the CBDT on January 29, 2015, said: "It is hereby informed that the [CBDT] has accepted the decision of the High Court of Bombay … the judgment must be adhered to by the field officers in all cases where this issue is involved." [5]

The decision came shortly after Ravi Shankar Prasad, the nation's Minister of Communications and Information Technology, announced on January 28, 2015, that the Government will not appeal the Vodafone ruling. Prasad explained that: "A conscious decision has been taken not to file an appeal in the Supreme Court. The Government … wants to convey a clear message to investors [the] world over that this is a Government where the decisions will be fair, transparent, and within the four corners of the law." [6] It was said that this move would benefit at least 20 other companies embroiled in similar disputes.

In fact, the Government seems to have made great strides towards creating more certainty in its transfer pricing regime.

Also in January 2015, India signed a Framework Agreement with the United States under the mutual agreement procedure provision of the India–US tax treaty to resolve transfer pricing disputes. According to the CBDT, by January 2016, this had led to the resolution of more than 100 disputes. [7] In addition, on February 16, 2016, the US Advance Pricing and Mutual Agreement office began accepting requests for bilateral advance pricing agreements (APAs) between the US and India. The CBDT noted that the success of the Agreement in just one year led the US tax authorities to open up their bilateral APA program to India. "The US is expected to begin accepting bilateral APA applications shortly. Prior to resolution of disputes under the Framework Agreement, the US bilateral APA program was closed to India," it stated.

The CBDT has also begun to enter into bilateral APAs with other jurisdictions, including Japan and the United Kingdom, and has concluded several unilateral APAs in an attempt to provide taxpayers with more certainty. Indeed, by February 16, 2016, the CBDT had resolved a total of 180 mutual agreement procedure cases worth INR50bn since April 2014. [8]

The Government has also constituted a ten-member committee to identify provisions and phrases in the Income Tax Act that are leading to litigation due to differing interpretations. The committee, formed in October 2015, was asked to put forward recommendations without "substantially" impacting on the tax base or tax revenue, and its report, released on January 18, 2016, contains 27 suggestions for amendments under the Act and eight recommendations for reform through administrative instructions. [9] These recommendations are described as simple-to-address matters or issues that require immediate attention.

Further efforts to reduce tax disputes include revisions to the monetary limits for the filing of legal appeals by the tax authorities. Under existing rules, the CBDT could appeal to the Income Tax Appellate Tribunal in cases where the level of disputed tax is at least INR400,000, and to the High Courts in cases involving at least INR1m. But a circular issued by the Ministry of Finance on December 15, 2015, revised these thresholds to INR1m and INR2m, respectively. The new rules also apply retrospectively to pending cases. According to the Finance Ministry, these measures alone are expected to reduce pending appeals filed by the Department by 50 percent and "provide relief to taxpayers facing longstanding litigation."

In a similar vein, the Finance Ministry announced on December 17, 2015, that the monetary thresholds for appeals to the Customs, Excise and Service Tax Appellate Tribunal (CESTAT) have been raised to INR1m, and to the High Courts to INR1.5m. Additionally, all cases before the CESTAT and High Courts in which there is already a precedent set by the Supreme Court are to be withdrawn.

The tax authorities and taxpayers are being encouraged by the Government to talk to one another, so that further areas of improvement in the tax regime can be identified, and in September 2015, Revenue Secretary Hasmukh Aadhia started holding "detailed" meetings with business associations and representatives of industry on tax policy.

The Ministry of Finance said that it "is quite conscious of the fact that tax policy could be used as an important instrument of enhancing the speed of economic growth of the country and therefore, it is important to have proper stakeholder consultation out of box thinking. This is an attempt in that direction." [10]

The Court Of Last Resort? International Arbitration

However, while these measures suggest that India's tax environment is at last improving, every so often developments occur that sow the seeds of doubt in investors' minds.

For example, in November 2015, the CBDT confirmed that Vodafone is seeking conciliation to resolve the dispute stemming from its acquisition of Hutchison Essar. This followed the launch of international arbitration proceedings under the India–Netherlands bilateral investment treaty in 2014, shortly after talks with the Indian Government to settle the matter failed.

Specifically, the tax dispute related to the acquisition by Vodafone International Holdings BV, a company resident for tax purposes in the Netherlands, of the entire share capital of Cayman Islands-domiciled CGP Investment (Holdings) Ltd in order to take a 67 percent stake in Hutchinson Essar Limited (HEL), which was tax resident in India. According to the tax authorities, CGP held indirectly through other companies a 52 percent shareholding interest in HEL as well as options to acquire a further 15 percent shareholding interest in HEL. In short, the Revenue sought to tax the capital gains arising from the sale of the share capital of CGP on the basis that CGP, while not a tax resident in India, held the underlying Indian assets. Vodafone contended this reading of the situation from the start, stressing that as it was the purchaser, not the seller, it made no taxable gain from the transaction.

In January 2016, UK-based oil and gas exploration and extraction company Cairn Energy confirmed international arbitration proceedings in a USD1.6bn tax dispute with similarities to the ongoing Vodafone case. Worryingly, the imminent commencement of these proceedings hasn't deterred the Indian tax authorities from issuing Cairn with an updated tax assessment which, according to reports, has spiraled to USD4.4bn as a result of the addition of penalties and interest on the back tax they say is owed. [11]

These disputes are unlikely to be resolved quickly either. Cairn expects the international arbitration proceedings to take in excess of 12 months to conclude. [12] Significantly, if the Vodafone dispute drags on for a similar duration, then it would have taken almost a decade to come to a conclusion, if indeed the matter is resolved by then. And this is hardly a good sign for other multinationals operating in India, or with plans to.

Budget 2016 – The Direct Tax Dispute Resolution Scheme

A great deal of emphasis was placed on improving certainty and reducing litigation in the 2016 Union Budget, announced by Jaitley in February 2016, which included proposals for a new scheme to allow taxpayers to settle ongoing disputes arising from the retrospective amendment to the Income-tax Act.

"Litigation is a scourge for a tax friendly regime and creates an environment of distrust in addition to increasing the compliance cost of the taxpayers and administrative cost for the government," Jaitley explained, continuing: "In order to reduce this number, I propose a new Dispute Resolution Scheme (DRS)." [13]

Put simply, the DRS would allow the taxpayer to pay tax arrears (excluding interest and penalty), provided that they withdraw cases filed in any court or tribunal.

According to the explanatory memorandum to the Finance Bill 2016, [14] the salient features of the proposed DRS are as follows:

- The scheme will be applicable to "tax arrears" which are defined as the amount of tax, interest, or penalties determined under the Income-tax Act or the Wealth-tax Act, 1957, in respect of which an appeal is pending before the Commissioner of Income-tax (Appeals) or the Commissioner of Wealth-tax (Appeals) as of February 29, 2016;
- The pending appeal can be against an assessment order or a penalty order;
- The applicant under the scheme will be required to pay tax at the applicable rate plus interest up to the date of assessment. However, in cases of disputed tax exceeding INR1m, 25 percent of the minimum penalty leviable shall also be paid;
- If the pending appeal is against a penalty order, 25 percent of the minimum penalty leviable shall be payable along with the tax and interest payable on account of assessment or reassessment; and
- Consequent to such declaration, appeals in respect of the disputed income and disputed wealth pending before the Commissioner (Appeals) shall be deemed to be withdrawn.

The following cases are not eligible for the scheme:

- Cases initiated prior to February 29, 2016;
- "Search or survey" cases where the declaration is in respect of tax arrears (these are more serious cases of non-compliance);
- Cases involving undisclosed foreign income and assets;
- Cases based on information received under a Double Taxation Avoidance Agreement under section 90 or 90A of the Income-tax Act where the declaration is in respect of tax arrears;
- Where the person has been notified under the Special Courts Act, 1992; and
- Cases covered under the Narcotic Drugs and Psychotropic Substances Act, Indian Penal Code, Prevention of Corruption Act, or Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.

To avail themselves of the scheme, applicants must withdraw "any writ petition or any appeal filed against such specified tax before the Commissioner (Appeals) or the Tribunal or High Court or Supreme Court, before making the declaration and shall also be required to furnish a proof of such withdrawal."

Significantly, if any proceeding for arbitration conciliation or mediation has been initiated by the taxpayer or they have given any notice under any law or agreement entered into by India, whether for protection of investment or otherwise, the rules stipulate that they "shall be required to withdraw such notice or claim for availing benefit under this Scheme."

In addition, it is proposed that "no appellate authority or Arbitrator or Conciliator or Mediator shall proceed to decide an issue relating to the specified tax in the declaration in respect of which an order is made by the designated authority or in respect of the payment of the sum determined to be payable."

It remains to be seen how effective the DRS is at reducing the backlog of pending tax cases. However, there are reasons to believe that investors will be less than impressed with the terms of the scheme, especially those already fighting what they consider to be unjust tax assessments.

For a start, the scheme will be no help to those engaged in long-running disputes, given the February 29, 2016 cut-off date. And taxpayers that are permitted to use the scheme may well feel aggrieved at having to pay up just to get out of a legal dispute, even though their legal position might be a strong one. Furthermore, there is no guarantee that the DRS will slow the rate at which new cases are brought by the tax authorities.

Conclusion

So, to go back to our original question: has the Government made any progress towards its goals of reducing litigation and stabilizing the tax framework? The answer, like so many things in life – and especially where India is concerned – probably isn't that clear cut. The Government is clearly trying, as the measures outlined above demonstrate. And it is probably fair to say that investor sentiment has improved considerably under the BJP Government.

However, Jaitley relayed a quite damning statistic during his 2016 Budget speech, betraying the fact that the Government is failing to get to grips with the situation. According to Jaitley, at the time of Budget 2016, 300,000 cases were pending with the 1st Appellate Authority alone, with INR5.5 trillion worth of tax in dispute. This is INR1.5 trillion higher than when the BJP came to power almost two years ago.

Perhaps the Government could have done itself – and taxpayers – a huge favor by simply repealing or amending the retrospective tax measure included in the 2012 Finance Act, which seems to be the source of so much of the litigation. However, despite condemning the actions of the previous administration, and speaking out against the ills of retrospective law-making on a regular basis, the current Government has been very reluctant to do so, promising only to resist taxing on a retrospective basis during its mandate. Nevertheless, the apparent failure to deal with one of the root causes of tax litigation must be a cause for frustration for domestic and foreign investors alike.

So things have yet to change appreciably on the ground for taxpayers, as Jaitley's revelations about the level of litigation shows. Perhaps it will take some time for the simplification measures to filter through India's byzantine tax system. However, the Government should hope that foreign investors in particular don't lose their patience once again before that happens.

Endnotes

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So You Want To Live Or Invest In The UK?

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Part 6: The Taxation Of Beneficiaries Of Non-UK Trusts

The taxation of non-UK trusts is, at present, in a state of flux. The Government has proposed reforms to the taxation of non-domiciled individuals. In particular, it is proposed that, with effect from April 6, 2017, non-domiciliaries who have been resident in the UK for more than 15 years will become deemed domiciled for all tax purposes. In other words, they will be taxed in the same way as a UK domiciled individual and will be liable on worldwide income, gains and estate. It is, however, proposed to protect trusts established by non-doms before they become deemed domiciled. While we still await clarity on how the new laws will apply, it seems that non-UK assets held in such trusts will continue to be outside the scope of inheritance tax.

The current rules will continue to apply to beneficiaries other than the settlor. The position of deemed domiciled settlors is more uncertain and we discuss this further below.

Special rules apply to UK residential property, as explained in a previous article in this series.

Inheritance tax

In general, the residence of the trustees does not make any difference for inheritance tax purposes. Liability is determined by the domicile of the settlor when he established the trust, and the location of the assets. Non-UK assets held in a trust established by a non-UK domiciled settlor are outside the scope of inheritance tax. They are said to be "excluded property."

This continues to be the case even if the settlor becomes deemed domiciled by long residence or actually domiciled in the UK.

Through a quirk of the legislation, UK authorized unit trusts and Open-ended Investment Companies are also regarded as excluded property in the hands of non-domiciled individuals and trusts established by them. As these are UK assets, any income arising from them will be taxable in the hands of the trustees, or in the hands of the settlor as set out below.

Any UK assets held in the trust remain in the inheritance tax net. Inheritance tax is charged at each tenth anniversary of the trust's creation and if assets actually leave the trust. The maximum rate on each occasion is 6 percent. Tax is charged **only** on the UK assets.

It is anticipated that these rules will continue after the proposed reforms become effective in April 2017. Any liability which does arise in relation to the trust is normally the responsibility of the trustees. Beneficiaries may have a secondary liability if the trustees have not paid the tax but only to the extent of assets they have actually received. The settlor of a non-UK trust also has a secondary liability for any inheritance tax.

Trustee Residence

Liability to income tax and capital gains tax is determined by the residence of the trustees *i.e.*, whether that is UK or non-UK.

The test for trustee residence is the same for both income tax and capital gains tax. The trustees are treated as a single body distinct from the individual trustees but the body of trustees is **not** a separate legal person. The residence of the separate members of the body of trustees is determined according to the usual individual or corporate tests.

Clearly, if all the trustees are UK resident then the trust will be regarded as UK resident. Similarly, where all the trustees are non-UK resident the trustees as a body will be non-UK resident.

Where there are "mixed trustees," *i.e.*, some UK resident and some non-resident trustees, residence status is determined by the status of the settlor.

If the settlor was not resident **and** not domiciled when the trust was set up **and** on any subsequent occasion when assets were added to the trust, then the trustees as a body will be treated as non-resident.

If the settlor was **either** resident **or** domiciled in the UK on **any** occasion when assets were put into a trust, the body of trustees will be treated as UK resident.

The residence test can be a particular trap for US trustees. It is common to have a sole trustee of US trusts. If a US person sets up a trust or is a trustee of someone else's trust and then becomes UK resident, he will cause the trust to become UK resident. This will mean that the individual, in his trustee capacity, is liable for tax on all the trust income and capital gains. If non-resident trustees are subsequently appointed, this could trigger a tax charge on unrealized gains.

Income Tax

At present, a different set of rules applies depending whether the beneficiary is the settlor or not.

In general, non-resident settlors and non-resident beneficiaries will not be subject to UK tax if they receive distributions from a non-UK trust. Indeed, payments to non-resident beneficiaries can be a useful form of tax planning.

Taxation Of Settlors

If a UK resident settlor of a trust (or his spouse) can benefit from the Trust, all the income arising in the Trust (including any income arising in an underlying company) is treated as if it were the settlor's income and he will be taxed according to his personal status, whether he receives the income or not.

A settlor who is a remittance basis user will only be taxable on the income if it is remitted to the UK. (Remember this could include remittance by the trustees who are relevant persons, *e.g.*, if they invested the income in the UK). He will in any event be taxable on UK income.

Other Beneficiaries

A beneficiary of a trust (other than the settlor) who is resident in the UK and who receives a "benefit" from the trust may have the value of that benefit matched with "relevant income." For this purpose, income is "relevant income" if it is held within the trust or an underlying company and can be used in that year, or a later year, for providing a benefit for the beneficiary. Broadly, all income in a structure will be relevant income if it has not actually been distributed to a beneficiary or used to meet trust expenses or already matched under these rules. The beneficiary is charged to income tax on the matched relevant income in accordance with his personal tax status.

"Benefit" has a very wide meaning. It, of course, includes transfers of cash or assets, but can also include any other benefits, such as an interest-free loan or the rent-free occupation of property. Any non-cash payments must be valued at their market value.

A beneficiary (other than the settlor) who is a remittance basis user, who is resident in the UK but not domiciled in the UK, and who receives a benefit outside the UK is effectively taxable on the remittance basis. If the benefit, or the income with which it has been matched, is remitted to the UK, within the wide definition, the beneficiary will be subject to income tax.

The income tax charges on the settlor and beneficiaries do not apply if there was no UK tax avoidance purpose in any of the arrangements relating to the trust and any associated structures. This is often called "the motive defense." (This defense does not apply to the capital gains tax rules below.) From December 2005 (when some changes to the rules were made), it is in practice very difficult to rely on this defense.

If the value of the benefit is greater than the amount of available relevant income, then the excess benefit may be matched with capital gains made by the trustees (see below). The income-matching rules do not apply to settlors, so the whole of a settlor's benefit can be matched with gains.

These rules, and the capital gains tax rules described below, also apply to foundations which are structured as trusts.

Planning

If a trust has both UK resident and non-UK resident beneficiaries, the income arising in the trust and any underlying companies could be paid out to the non-resident beneficiaries before any payments of capital are made to the UK beneficiaries. If the income has, in fact, been paid out it cannot be "relevant income" and so is not matchable. The capital distributions could then only be subject to capital gains tax, at worst, and further planning is available (see below). Once this strategy has been adopted, the trustees must continue to distribute income to non-residents, or it could be matched with previous capital distributions made to UK beneficiaries and would be taxable on them.

Capital Gains Tax

A UK resident and domiciled settlor will be immediately taxable on all gains made by the trustees (and possibly any underlying company) if the settlor and/or his children and/or grandchildren and/or spouses of any of the above and/or companies controlled by any of the above, are capable of benefiting under the settlement.

A UK resident but non-domiciled settlor is not taxable on such gains (whether or not a remittance basis user).

Any gains made by the trustees which are not immediately taxable on the settlor would be "Section 2(2) amounts." Gains made by any underlying company may be attributed to the trustees and would also be regarded as Section 2(2) amounts. Gains on UK residential property are taxed on the non-resident owner and are not Section 2(2) amounts.

No one is taxable on Section 2(2) amounts unless and until a beneficiary receives a "capital payment" from the trust. So capital gains tax on gains made within offshore trust structures can be deferred indefinitely. This applies even to gains made on UK assets, whereas a remittance basis user who personally holds UK assets would be immediately liable to capital gains tax on gains made on such assets.

A beneficiary (including a non-dom settlor) who receives a "capital payment" from the trustees may be taxable in respect of Section 2(2) amounts. The value of the capital payment is "matched" with Section 2(2) amounts which have previously arisen to the trustees and the beneficiary is taxed as if he had made gains of an equivalent amount.

In addition, the beneficiary must pay a surcharge in respect of any gains which arose, broadly, more than a year before the payment was received. The maximum tax rate (including the surcharge), which applies to gains which are six or more years old when matched, is 44.8 percent. The most recent gains are matched before older gains, so minimizing the surcharge.

Any unmatched capital payment can be carried forward and matched with the trustees' gains in future years.

The definition of "capital payment" is very wide and is similar to a "benefit" for income tax purposes.

A capital payment made to a beneficiary who is a remittance basis user will be taxed on the remittance basis. The capital payment is treated as if it were derived from the trustees' gains, so it is a remittance of the capital payment which triggers the charge on the matched gains. There is no charge just because the gain on UK assets is matched. Nor is there a charge if the proceeds of sale of an asset which gave rise to the matched gains are remitted by the trustees.

A capital payment received by a UK domiciliary or a non-dom who is not a remittance basis user will be immediately taxable to the extent matched with Section 2(2) amounts.

A capital payment received by a beneficiary who is not UK resident will be matched with Section 2(2) amounts (so reducing the total), but the beneficiary will not be taxable on them in the UK.

Planning

As noted above, a capital payment made to a non-resident beneficiary will absorb Section 2(2) amounts but will not be taxable.

It would therefore be possible to make a capital distribution towards the end of a tax year to a non-resident beneficiary which would absorb all the existing Section 2(2) amounts. A capital distribution could then be made to a UK resident beneficiary in the following tax year. Assuming there is no relevant income in the trust, the payment would be tax free.

As with income tax, if this strategy is used, it will be necessary to continue to make distributions to the non-resident beneficiaries to absorb gains in future years. Otherwise, future gains can be matched with the previous distributions to UK beneficiaries.

Interaction Of Income Tax And Capital Gains Tax Rules

Where a beneficiary (other than a settlor) receives a benefit and there is both relevant income and Section 2(2) amounts, the benefit is matched first with relevant income. Any excess is matched with the realized gains. Any excess benefit remaining is carried forward to future years and is matched first with the relevant income of a particular year and only then with the trustees' gains.

Note also that both sets of matching rules are purely arithmetical and, in general, it does not matter whether income or gains arose in respect of a particular beneficiary's actual or notional share of the Trust Fund or not. This can result in unfairness. If capital is distributed to one beneficiary, that beneficiary's payment may suffer tax on more than his or her "fair share" of the income and/or gains in the structure.

2017 Changes

Note that the new rules are still the subject of consultation and whilst the comments below set out our current understanding, the proposals may change. In addition, they do **not** apply to non-domiciled individuals who were born in the UK and UK domiciled when they were born. These individuals will always be treated in the same way as someone who is actually UK domiciled If they become resident in the UK and their trusts are not protected.

It seems that the proposed changes will not affect the inheritance tax treatment of non UK trusts.

It is not yet clear how deemed domiciled settlors will be taxed in relation to income after April 5, 2017.

Other beneficiaries who become deemed domiciled will continue to be taxed under the current rules but, as they will no longer be able to use the remittance basis, they will be taxable on any benefit from the trust wherever it is received and whether or not it is brought to the UK.

It seems that it is not intended to change the above treatment for capital gains tax so that beneficiaries (including the settlor) will continue to be taxed only on gains matched to capital payments received from the trust. However, deemed domiciled beneficiaries will no longer have access to the remittance basis so all capital payments, whether in the UK or off-shore, will be taxable to the extent they are matched with Section 2(2) amounts.

UK Trusts

For completeness we compare the tax position of a UK resident trust.

A "UK trust" is one which has UK resident trustees or which has "mixed trustees" but a settlor who was UK domiciled or resident at the relevant time.

As noted, the residence of the trustees is not relevant to the inheritance tax position.

Broadly, if the trustees are UK resident, they will be subject to tax on the trust income and gains irrespective of the location of the assets and/or the residence or domicile of the settlor and beneficiaries.

UK resident trustees pay income tax at the highest rate of tax (45 percent or 37.5 percent for dividends).

If the trustees subsequently distribute income to a beneficiary, the beneficiary receives a credit for the tax paid by the trustees and, broadly, if the beneficiary is not liable to pay tax at such a high rate, they can reclaim the difference.

UK resident trustees are subject to capital gains tax at 28 percent (reducing to 20 percent with effect from April 6, 2016, under the 2016 Budget announced on March 16).

If UK resident trustees become non-resident, they are treated as if they had sold all the trust assets at market value and this triggers a potential capital gains tax charge on all the latent gains in the trust.

Penny Wise And Pound Foolish

by Mike DeBlis, DeBlis Law

As discussed in the previous article on the topic of disclosure of previously undeclared overseas assets for tax purposes, [1] it does not pay to be penny wise and pound foolish, as the old saying goes.

We all make purchasing decisions every day. In the previous article we looked at this dilemma as it pertains to those with unpaid US taxes on overseas assets. Many such people are attracted to the new Streamlined Filing Compliance Procedures (SFCP), due to the siren's song of low financial penalties and conducting business on the down-low. But these things come with strings attached.

Audit Risk

One risk of the SFCP is that, if you wish to deal with the matter quietly, the IRS might assume that you have something to hide. This supposition is backed up by a General Accounting Office Report from 2013, which records that the IRS audited over 10,000 [2] quiet disclosure returns between 2003 and 2008, a proportion that is much higher than that found in ordinary returns.

It gets worse. Once the agents get to work, they sometimes take a slash-and-burn approach to disallowing deductions. That is because the auditors see SFCP returns as amended returns, and they smell blood.

The heightened audit risk may not apply in the Offshore Voluntary Disclosure Program. In fact, most OVDP matters are concluded without audits, because of the cooperation agreement. Whereas the IRS may think you have something to hide if you do not want to be forthcoming, the agency may assume the opposite in those cases where the taxpayers are willing to bare their souls.

Lost Tax Credits

As a general rule, late-filed returns may not claim the Foreign Earned Income Exclusion (FEIE). Treasury regulations set forth very specific limitations when claiming the FEIE, and agents enforce these provisions without mercy. This loss can be financially debilitating in many cases, and certainly gives reason for pause before filing streamlined returns.

The same thing applies regarding the Foreign Tax Credit for Resident Aliens and US Citizens, because a late-filed return means a late foreign corporation and partnership report with Forms 5471 or 8865. That raises the possibility of eye-popping penalties: up to USD10,000 per incident, along with a 10 percent reduction in the credit for foreign tax paid. And if you think dual citizenship gives you immunity, think again. Although the Model Tax Treaty extends eligibility to these individuals, that eligibility is still subject to provisions in the Tax Code.

A 1996 tax court case highlights some of these issues. *Espinosa v. Commissioner* [3] involved a non-resident alien with rental property in Texas and New Mexico that produced a net loss. Mr. Espinosa, who had a number of years of unfiled returns, tried to claim the loss as a credit. Although there are no time deadlines in that section of the Tax Code, the court applied the above-referenced tax credit regulations, and disallowed the USD10,000 per year credit.

Criminal Liability

This is the big one. Participants in the OVDP get immunity from tax evasion and fraud charges, which could carry significant prison time and fines of up to USD100,000; SFCP filers get zero. As a matter of fact, they get less than zero. First, by filing a streamlined disclosure, the IRS is on your trail, as discussed above. Second, offshore tax disclosure is kind of like The Force: once you start down the dark path, forever will it dominate your destiny. Once you file an SFCP, you lose eligibility for the OVDP, so if the heat gets too intense, you simply have to suffer through it.

The bottom line is never be penny wise and pound foolish with your foreign asset tax returns.

Endnotes

1 "Cheap Shelf Or Top Shelf? The OVDP v. The SFCP," *Global Tax Weekly*, Issue 175, March 17, 2016.

2 *See* http://www.gao.gov/products/GAO-13-318

3 *See* http://www.leagle.com/decision/1996253107itc146_1245/ESPINOSA%20v.%20COMMISSIONER

Recent Tax Developments For Foreign Companies In Russia

by Anna Strelnichenko, Partner, Tax & Legal, Dmitry Nikolaev, Senior Manager, Tax & Legal, Yulia Timonina, Partner, Tax & Legal, and Larissa Gorbunova, Tax & Legal, EY Moscow office

Developments In The Recognition Of Foreign Companies As Russian Tax Residents

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In Letter No. ZN-4-17/18542@ of October 23, 2015, the Federal Tax Service presented clarifications regarding the recognition of a foreign company as a tax resident of Russia in accordance with Article 246.2 of the Russian Tax Code.

In particular, it explained that the Tax Code does not contain any provisions requiring the tax authority with which an economically autonomous subdivision of a foreign company is registered to issue any special confirmations of the receipt of a notice/statement of self-declaration by that company as a tax resident of Russia.

The application of international double taxation treaties requires confirmation of a taxpayer's tax status (residency) in the tax period (calendar year) in which the person in question (a resident of one state) received income from sources in a foreign (the other) state.

A notice/certificate confirming the status of Russian tax resident may be issued for Russian companies for any past tax period or for the current tax period if the required documents, including an application stating the company's Tax Identification Number (TIN), Code for Reason Registration (CRR) and Main State Registration Number (MSRN) (which are assigned when a company is registered with the Russian tax authorities), are submitted to the Interregional Inspectorate of the Federal Tax Service for Centralized Data Processing. The list of documents needed to obtain such a certificate is provided on the website of the Federal Tax Service under the section heading "Legal entities – Residence and International Transactions". [1]

Clause 12 of Article 84 of the Code provides that the tax registration of a foreign company which has independently declared itself a Russian tax resident is to be carried out by a tax authority on the basis of an application from the foreign company, after checking compliance with the requirements established by the Code in accordance with the procedure and within the time limits established by the Ministry of Finance.

It is in relation to this that on February 2, 2016, the Ministry of Justice registered Order No. MMV-7-17/595@ of the Federal Tax Service of February 23, 2015 "Concerning Approval of the Standard Form of a Notice of a Foreign Organization of Self-Declaration as a Tax Resident of the Russian Federation (Renunciation of the Status of Tax Resident of the Russian Federation)".

Now, foreign companies will be able to submit an appropriate official notice to the tax authority with which their subdivision in Russia is registered (according to the provisions of Clause 8 of Article 246.2 of the Tax Code).

However, as yet the Finance Ministry has not established any special procedures or time limits for the registration/deregistration of such foreign companies. According to the unofficial opinion of Finance Ministry officials, tax authorities may register and deregister the foreign companies concerned in accordance with the general procedure established by Order No. 117n of the Ministry of Finance of September 30, 2010 "Concerning Approval of Special Considerations Relating to the Registration with the Tax Authorities of Foreign Organizations Which Are Not Investors Under a Profit Sharing Agreement or Agreement Operators". The Finance Ministry has no immediate plans to make any amendments to that Order.

We should add that we are not aware as yet of any cases of foreign companies declaring themselves to be Russian tax residents.

2015 Annual Reporting Requirements For Foreign Companies Operating In Moscow

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Moscow Interdistrict Tax Inspectorate No. 47 has issued its traditional letter on the preparation and filing of reports for 2015 by foreign companies which operate in Moscow ("the Letter"). [2]

In terms of profits tax, annual reports to be filed by foreign companies include a profits tax declaration, an annual statement of activities prepared in the prescribed form, and an explanatory note to the annual statement of activities ("Explanatory Note"), which must be submitted no later than March 28, 2016.

Generally speaking, the matters and requirements contained in the Letter are the same as in previous years, [3] except for certain changes, which are detailed below.

Main Changes

The Letter contains new requirements for information to be disclosed in the Explanatory Note and additionally submitted documents, including the following:

- A requirement to provide information in the Explanatory Note on current borrowings of any kind which are undertaken in Russia, indicating the parties involved and the transaction amount;
- For foreign companies which have property which is subject to assets tax in accordance with Article 374 of the Tax Code – a requirement to present information on participants in that foreign company as at December 31 of the tax period together with an assets tax declaration (*i.e.*, not later than March 30, 2016 for 2015), including disclosure of the manner of indirect participation (if applicable) of an individual or a public company if their direct and (or) indirect participating interest in the foreign company exceeds 5 percent;
- A requirement to submit Form No. 6-NDFL reports.

Who Must Submit Profits Tax Declarations?

Foreign companies which are registered for the purpose of carrying on activities in Russia are obliged to submit a profits tax declaration and a statement of activities even if they did not have financial and economic activities in 2015 (the fifth and sixth digits of the CRR are "51").

Taxpayers which carry on activities in Russia via a permanent establishment must complete Sections 1 to 9 of the profits tax declaration. Foreign companies which have divisions but do not carry on business in Russia through them must complete Sections 1 to 3 of the declaration.

The Explanatory Note And Other Documents

As usual, the Letter includes a list of matters relating to a foreign company's activities in Russia (Moscow) which must be disclosed in the Explanatory Note. In particular, the taxpayer must, as before, disclose the name of the company, the type of activity, and details of contracts, personnel, income and expenses, immovable property, means of transport, and rented accommodation.

As for the previous year, a description of the method of calculation of income and expenses must be provided if there was involvement in the performance of head office contracts, or if the company's global income is allocated among divisions located in different countries or in different regions of Russia. The company must also disclose activities of a preparatory and auxiliary nature carried on in the interests of third parties.

It is stated in the Letter that supporting documents for expenses incurred abroad which are transferred to a division based in Moscow must be kept at the Moscow division and produced at the tax authority's request (Section II, paragraph 10 of the Letter).

The taxpayer is also required to provide the following additional documents:

- A copy of the order concerning approval of accounting policies for 2015–2016 (for permanent establishments);
- Copies of all licenses for licensable activities;
- The order concerning the appointment of the chief accountant;
- A statement from a tax agent confirming the withholding and payment of tax at source;
- A bank letter confirming that no movements on bank accounts or salary payments occurred (if the company does not carry on financial and economic activities);
- Copies of Form No. 2-NDFL statements if payments are made to individuals in connection with the rent of accommodation;
- Documents confirming entitlement to tax reliefs;
- Form No. 6-NDFL statements;
- Information on the structure of ownership where a foreign company has property in Russia which is subject to assets tax.

Companies With Multiple Subdivisions In Russia

Taxpayers must also provide information on other subdivisions in Russia and their activities, income and taxes paid.

Taxpayers which have multiple subdivisions in Russia which submit a consolidated VAT declaration and pay all VAT to the tax authority for one subdivision (other than Moscow) must, after the end of each quarter, submit a copy of that VAT declaration to Moscow Tax Inspectorate No. 47 (stamped by the tax inspectorate to which the consolidated VAT declaration was submitted).

Payment Details

The budget classification codes to be entered in payment documents when paying tax, fines and late payment penalties in 2016 have not changed from the previous year.

Foreign Companies Owning Immovable Property

Beginning in 2015, foreign companies which own immovable property in Moscow must submit tax declarations and pay assets tax at the location of the immovable property. It follows that information on company participants as at December 31, 2015 must be submitted by foreign companies to the tax inspectorate where the property is located. If a company has a number of immovable properties, that information must be submitted to the tax authority for the location of one of the properties, to be chosen by the company. [4]

Endnotes

1 http://www.nalog.ru/rn77/yul/interest/international_transactions/status_tax_resident/

2 Letter No. 07-12/01590 of Moscow Interdistrict Inspectorate No. 47 of the Federal Tax Service of January 27, 2016.

3 Last year it was Letter No. 07-12/02301 of Moscow Interdistrict Inspectorate No. 47 of the Federal Tax Service of February 3, 2015.

4 Clause 3.2 of Article 23 of the Tax Code.

Topical News Briefing: When The Gusher Runs Dry

by the Global Tax Weekly Editorial Team

It seems widely accepted that it's a question of when, rather than if, the oil rich states of the Persian Gulf will introduce taxes on corporate and personal income. However, governments in the area continue to leave taxpayers and investors on tenterhooks about when this shift will take place.

In recent history, taxpayers in the Gulf states have enjoyed some of the lowest taxes around. This is largely because revenues from the region's huge reserves of oil and natural gas precluded the need for the taxes on incomes and other sources we are so used to seeing elsewhere in the world. However, these governments have come to realize that dependence on a finite natural resource is not a recipe for economic stability, and while there are a good many years of reserves left under the sands of Arabia and the Gulf region, the sharp fall in oil prices has brought the issue into sharp focus.

As reported in this week's issue of *Global Tax Weekly*, Kuwait is facing up to its future financing needs with the introduction of a new corporate tax, which, at 10 percent, is still very low by international standards.

The United Arab Emirates has also revealed on numerous occasions that it is studying future taxation options, and has indicated that a new corporate tax regime will be introduced in 2018, although details about the proposed tax are lacking at this stage.

As to the other members of the Gulf Cooperation Council, their intentions with regard to tax reform are unclear, which is of little help to those businesses and individuals that might be hit by future changes.

This is an issue that the International Monetary Fund has regularly spoken out about, and last November IMF Managing Director Christine Lagarde noted:

> "Well-planned fiscal consolidation strategies need to be put in place as soon as possible and communicated so that people understand how the adjustment will take place.

> How best to carry out this fiscal adjustment will depend on each country's specific situation. But the main elements are common across countries: an expansion of non-oil tax revenues; raising energy prices which are still well below international norms; firm control of current spending, particularly on public sector wages; and a review of capital expenditures. Reforms to strengthen the fiscal frameworks would support these consolidation efforts."

Fortunately, the GCC states have been largely prudent over the past decade or so, enabling them to build up financial buffers and avoid the need for sudden or disruptive adjustments to fiscal policy. Nevertheless, with low oil prices expected to persist for a number of years, all GCC countries are expected to have to undertake some degree of fiscal adjustment in the future. It is probably safe to assume that at least some of this adjustment will come in the form of new revenue streams, probably on income and consumption. However, at the moment, precisely when this will happen is anyone's guess.

Surprise Tax Policies In UK's 2016 Budget

The UK's 2016 Budget includes plans to overhaul the business rates (property tax) regime, cut taxes for lower- and middle-income earners, and reduce capital gains tax (CGT) rates.

George Osborne delivered his eighth Budget as Chancellor on March 16. According to Osborne, his Budget is "one that reaches a surplus so that the next generation doesn't have to pay our debts. One that reforms our tax system so that the next generation inherits a strong economy … This is a Budget that gets investors investing, savers saving, businesses doing businesses – so that we build for working people a low-tax, enterprise Britain, secure at home, strong in the world."

Prominent among Osborne's announcements was the publication of the business tax roadmap he promised in his 2015 Autumn Statement. This plan, which builds on the Coalition Government's 2010–2015 corporate tax roadmap – is designed to "deliver a low-tax regime that will attract the multinational businesses we want to see in Britain, but ensure that they pay taxes here too. And it will level the playing field, which has been tilted against our small firms."

In delivering on the roadmap, Osborne will increase the small business rate relief threshold from GBP6,000 (USD8,582) to a maximum of GBP15,000. In addition, the threshold for the higher rate will increase from GBP18,000 to GBP51,000.

The administration of business rates will be simplified, and from 2020 the uprating mechanism will be switched from the Retail Price Index to the Consumer Price Index. The Greater London Authority will move towards full retention of its business rates from April 2017.

Osborne explained: "From April next year, 600,000 small businesses will pay no business rates at all. That's an annual saving for them of up to nearly GBP6,000 – forever. A further quarter of a million businesses will see their rates cut."

The other major reforms included in the roadmap are as follows:

- The corporation tax rate will be reduced to 17 percent by 2020, rather than the scheduled fall to 18 percent;
- From April 2017, the Government will restrict interest deductibility for the largest companies to 30 percent of UK earnings;
- The maximum amount of profits that can be offset using past losses will be restricted to 50 percent;
- The proportion of a banking company's

annual taxable profit that can be offset by brought forward losses will be restricted to 25 percent from April 1, 2016;

- New hybrid mismatch rules will "stop the complex structures that allow some multinationals to avoid paying any tax anywhere, or to deduct the same expenses in more than one country";
- New legislation will align the UK deduction of tax at source regime for royalties with UK taxing rights over such income;
- The definition of "transfer pricing guidelines" will be updated to incorporate recent revisions to the OECD's transfer pricing guidelines;
- The period in which businesses investing in new plant and machinery in enhanced capital allowance sites in Enterprise Zones can qualify for 100 percent capital allowances will be extended to eight years;
- Plans to more closely align payment dates for the largest firms to when profits are earned will be pushed back to April 2019;
- Overseas suppliers will be prevented from storing goods in Britain and selling them online without paying VAT; and
- New tax-free allowances will be introduced for trading and property income for start-ups.

On personal income tax, Osborne will implement a key Conservative manifesto pledge to increase the entry threshold for the "higher" (40 percent) tax rate. The threshold will rise from GBP42,385 to GBP45,000 from April 2016. "That's a tax cut of over GBP400 a year. It is going to lift over half a million people who should never have been paying the higher rate out of that higher tax band altogether," he said.

At last year's general election, the Conservatives also promised to increase the tax-free personal allowance to GBP12,000 over the life of the current Parliament. In line with this commitment, the allowance will increase to GBP11,500 from April 2017. It is already due to rise to GBP11,000 next month. According to Osborne, this measure "means a typical basic rate taxpayer will be paying over GBP1,000 less income tax than five years ago. And it means another 1.3m of the lowest paid taken out of tax altogether."

Somewhat more surprisingly, Osborne unveiled plans to slash the headline rate of CGT from 28 percent to 20 percent. In addition, the CGT paid by basic-rate taxpayers will be cut from 18 percent to 10 percent. These reductions will take effect next month. The current rates will however be retained for gains on residential property and carried interest. A new 10 percent rate will apply on long-term external investment in unlisted companies, up to a separate maximum of GBP10m of lifetime gains.

Also unexpected was Osborne's announcement of a so-called "sugar tax." The tax will be levied on drinks companies, and will be assessed on the volume of the sugar-sweetened drinks they produce or import. There will be two bands: a lower band for total sugar content above five grams per 100 milliliters; and a higher band for drinks with more than eight grams per 100 milliliters. Pure fruit juices and milk-based drinks will be excluded, and the smallest producers will be kept out of the scope of the levy.

The remaining tax-related measures included in the Budget are as follows:

- Class 2 National Insurance contributions paid by the self-employed will be abolished from 2018;
- The annual Individual Savings Account (ISA) contribution limit will increase from GBP15,000 to GBP20,000 from April 2017;
- The rates of commercial stamp duty will be reformed, with the introduction of: a zero rate band on purchases up to GBP150,000; a 2 percent rate on the next GBP100,000; and a 5 percent rate above GBP250,000;
- The Carbon Reduction Commitment will be abolished and the Climate Change Levy will rise from 2019;
- The Supplementary Charge on oil and gas (payable in respect of adjusted ring fence profits) will be halved from 20 percent to 10 percent;
- The Petroleum Revenue Tax will be reduced from 35 percent to a zero rate;
- GBP12m raised by the VAT on sanitary products will be allocated to women's charities;
- Fuel duty will be frozen for a sixth year in a row;
- Tobacco duty was increased by 2 percent above inflation from March 16, and loose tobacco rose by an additional 3 percent; and
- The duties on beer, cider, and spirits will be frozen.

UK's Tax Roadmap Includes European Commission's Anti-Avoidance Proposals

The UK has published, alongside its 2016 Budget, a business tax roadmap setting out a slew of measures aimed at tackling tax avoidance and aggressive tax planning arrangements.

The roadmap includes at least two of the proposals contained in the European Commission's Anti Tax Avoidance Directive, which was presented in January 2016, namely, a framework to tackle hybrid mismatch arrangements and measures restricting the deductibility of corporate interest expenses. Additionally, the roadmap includes specific changes to strengthen the UK's withholding tax regime on royalty payments.

The roadmap states that the Government will introduce, from April 2017, a fixed ratio rule to restrict interest deductibility for the largest companies to 30 percent of UK earnings, targeting the measure by introducing a group ratio rule, an exemption for public benefit infrastructure, and a GBP2m *de minimis* threshold.

Next, the roadmap includes plans to eliminate the tax advantage arising from the use of hybrid mismatch arrangements involving permanent establishments (PEs). The measure is targeted at complex structures that allow some multinational corporations to avoid paying any tax anywhere, or to deduct the same expenses in more than one country.

Finally, the roadmap states that the Government would seek to extend the withholding tax rights so that payments for the use of intangible assets such as trademarks and brand names made to overseas persons will be subject to withholding tax. Alongside this, the Government would introduce a domestic law treaty abuse rule to ensure that payments cannot be diverted through conduit countries with which the UK has a tax treaty; and apply withholding tax on royalty payments that are connected with the activities of UK PEs of overseas companies.

Delivering his Budget Statement on March 16, Chancellor George Osborne noted that the roadmap "will deliver a low tax regime that will attract the multinational businesses we want to see in Britain, but ensure that they pay taxes here too. And it will level the playing field, which has been tilted against our small firms. The approach we take is guided by the best practice set out by the OECD, work which Britain called for, Britain paid for, and Britain will be among the very first to implement."

UK Boosts Tax Take From 'Sin Tax' Evasion Investigations

HM Revenue & Customs' (HMRC's) investigations into underpayments of UK "sin taxes" on cigarettes and alcohol yielded GBP1.63bn (USD2.33bn) in extra tax in 2014/15, according to research by accountancy group UHY Hacker Young.

This figure is up on the GBP1.54bn collected in 2013/14, UHY Hacker Young said. It explained that HMRC estimates that as many as six billion cigarettes consumed in 2014/15 were purchased on the black market, meaning that no duty was levied on them. This represents 14 percent of the total UK market for cigarettes. Illicit purchases account for 40 percent of the UK hand rolling tobacco market.

UHY Hacker Young added that in 2014/15, HMRC seized more than 5m liters of beer, nearly 190,000 liters of spirits, and almost 1.5m liters of wine.

Roy Maugham, Tax Partner at UHY Hacker Young, said: "Duty on cigarettes and spirits is consistently increased well above inflation – but the production cost of the goods is low – this makes them a prime target for smuggling. A significant number of taxpayers are disinclined to pay the full duty on alcohol and, particularly, cigarettes – which has created a thriving black market. It's the inevitable result of heaping a heavy tax load onto any product."

"HMRC has been attempting to tackle the problem for some time and not without successes, but smuggling is very difficult to eliminate altogether. At points HMRC's efforts have gone too far – for example they have been criticized for seizing and destroying legal imports of alcohol and tobacco intended for personal consumption."

"At a time when HMRC is under significant political pressure to maximize the tax take, cracking down on those avoiding 'sin taxes' generates considerable additional revenue, and is broadly popular with the public."

IRS Says Foreign Income Tax Compliance Improving

The Internal Revenue Service (IRS) has recently noted a strong and sustained growth in US taxpayers complying with their foreign financial account reporting requirements.

"Taxpayers here and abroad need to take their offshore tax and filing obligations seriously," said IRS Commissioner John Koskinen. "Improving offshore compliance has been a top priority of the IRS for several years, and we are seeing very positive results."

For example, US persons are required to file Form 114, Report of Foreign Bank and Financial Accounts (FBAR), annually to the Treasury Department if they have a financial interest in or signature authority over certain financial accounts, including bank and securities accounts, in a foreign country, if the aggregate value of these financial accounts exceeds USD10,000 at any time during a calendar year.

In 2015, the US Financial Crimes Enforcement Network (FinCEN) received a record high 1,163,229 FBARs, up more than 8 percent from the prior year. In fact, FBAR filings have grown on average by 17 percent per year during the last five years, according to FinCEN data.

In addition, under the Foreign Account Tax Compliance Act (FATCA), certain US taxpayers holding financial assets outside the US must also report those assets to the IRS on Form 8938, Statement of Specified Foreign Financial Assets. Reporting thresholds are higher than for the FBAR, the lowest being USD50,000, and vary based on whether a taxpayer files a joint income tax return or lives abroad.

The IRS confirmed that more than 300,000 Forms 8938 were received with tax returns in the 2014 tax year, around the same as the previous year and up from about 200,000 for the 2011 tax year, the first year of the Form.

Panama Should Improve Tax Compliance, IMF Says

Panama needs to take steps to improve tax compliance, which is very low given the country's level of development and economic dynamism, a statement from the International Monetary Fund (IMF) said.

The statement, which was released following the IMF's 2016 Article IV mission to the country, welcomed the authorities' efforts to improve revenue administration, including through value-added tax retention measures, the development of an improved electronic tax platform, and enhancements to human resources.

The IMF said these measures should be complemented by developing a tax compliance strategy, broadening the tax base, improving the availability and quality of data, and developing the proper incentives for tax compliance.

The Fund also said that the authorities should refrain from tax amnesties as they erode tax discipline and undermine the credibility of the tax administration when used repeatedly.

Tax Enforcement Key For LATAM, Caribbean: Report

Governments in the Latin American and Caribbean region should improve the tax culture by robustly dealing with tax evasion, according to a new report.

The report, from the Economic Commission for Latin America and the Caribbean (ECLAC), said that tax revenues lost to evasion were worth USD320bn in 2014. Value-added tax (VAT) worth 2.2 percent of gross domestic product (GDP) was lost to evasion, along with 4.4 percent of GDP in income tax.

ECLAC acknowledged that bringing down rates of non-compliance is difficult during an economic downturn, but said that the potential revenue gain from tackling evasion is great. VAT evasion rates had fallen in the period 2007–2008 but this favorable trend reversed due to the financial crisis. The report urges countries to make structural changes to their VAT systems and improve administration.

The report also highlighted that there have been limited efforts from jurisdictions in the region to tackle income tax evasion.

Looking at the finances of territories in the region, ECLAC concluded in recommending that territories should look to pursue reforms to improve the competitiveness of their tax regimes to attract investment.

Kuwait To Levy 10 Percent Corporate Income Tax

Kuwait's Cabinet has approved a proposal to levy a 10 percent tax on corporate profits, Finance Minister Anas Al Saleh said at a press conference on March 14, 2016.

The proposed measure is intended to rein in a deficit that is expected to reach around KWD12bn (roughly USD40bn) in the coming fiscal year.

Kuwait and the other Gulf Cooperation Council (GCC) countries – Bahrain, Oman, Qatar, Saudi Arabia, and the United Arab Emirates – have been jointly considering introducing a pan-GCC value-added tax (VAT) to diversify their tax bases away from oil revenues. The United Arab Emirates has now confirmed that it will introduce its own VAT regime from 2018, and the other GCC states are expected to soon officially confirm similar plans, for a 5 percent rate, introduced in the same year.

At the end of last year, the International Monetary Fund welcomed Kuwait's plan to tax business profits. It also urged the country to redouble efforts to prepare for the introduction of the VAT.

ATO Publishes Companies' Tax Affairs

The Australian Taxation Office (ATO) has published information on the tax affairs of more than 300 Australian-owned resident private companies.

Releasing the data, Tax Commissioner Chris Jordan said: "This transparency measure gives the community the chance to see a small part of the corporate tax data that the ATO holds. It is also an opportunity for us to talk about how we engage with these companies and the confidence we have in our compliance approach."

The report covers entities with a total income of AUD200m (USD152m) or more in 2013/14. The data published includes: company name; Australian Business Number; total income; taxable income; tax payable; and, where applicable, Petroleum Resource Rent Tax and Minerals Resource Rent Tax payable. The figures are taken directly from tax return labels, or amendments advised by the taxpayers concerned (prior to September 1, 2015).

According to Jordan, the 321 companies concerned "reported income tax payable of around AUD2bn in 2013/14, with an additional AUD1.6bn reported by their associated entities."

The ATO said that there are some taxpayers in this report with nil tax payable for the reporting period. It stressed that no tax paid is not necessarily an indicator of tax avoidance.

The Office explained that private companies are often connected with privately owned wealthy groups. It said that it conducts risk assessments to ensure that these companies, and the entities or groups they are linked to, comply with their tax obligations.

Jordan elaborated: "Since 2013 more than half of the private companies in the report and/or their associated groups have been subject to some form of ATO engagement to seek further explanation and understanding of their tax position. Of these engagements about 25 percent resulted in additional assessments of over AUD531m in liabilities."

Similar data was published in December 2015 on the tax affairs of large companies with a total income of AUD100m or more in 2013/14. In future, the ATO will release data relating to both Australian-owned resident private companies and public and foreign-owned corporate tax entities concurrently.

US Pass-Throughs Set Out Tax Reform Wish List

The Parity for Main Street Employers business coalition has issued a new letter that calls on the US Congress to enact tax reform "that is comprehensive, restores tax rate parity for all businesses, and reduces or eliminates the double tax on corporate income by integrating the corporate and individual tax codes."

The March 17 letter, signed by more than 110 business associations and addressed to the Chairmen and Ranking Members of the House of Representatives Ways and Means Committee and the Senate Finance Committee, noted that tax reform needs to be comprehensive, so as to encompass both C corporations and pass-through entities, including partnerships, sole proprietorships, and S corporations.

Pointing out that, with nearly 70m workers employed at pass-through entities, whose profits are passed directly to their owners and are taxed on their individual tax returns, tax reform should "ensure that we avoid harming these critical employers, [and therefore] needs to be comprehensive and improve the tax code for corporations and pass-through businesses alike."

The letter also urged that Congress should "restore rate parity by reducing the tax rates paid by pass-through businesses and corporations to similar, low levels. The 2012 fiscal cliff negotiations resulted in pass-through businesses paying, for the first time in a decade, a significantly higher top marginal tax rate than C corporations."

"Taxing business income at different rates penalizes pass-through businesses and encourages planning to circumvent the higher rates," it added, "ultimately resulting in wasted resources and lower growth."

Finally, it recommended that "Congress should eliminate the double tax on corporate income [at both the corporate and the shareholder levels] by integrating the corporate and individual tax codes. … A key goal of tax reform should be to continue to reduce or eliminate the incidence of the double tax and move towards taxing all business income once."

US Senate Finance Committee Chairman Orrin Hatch (R – Utah) has recently confirmed that he is working on a proposal for corporate tax integration. However, this year's tax reform efforts in the House of Representatives are being concentrated on international tax reform, with indications that it could include a corporate rate cut (which would increase the disparity with individual tax rates).

ICC Urges Limited EU Action On BEPS

The International Chamber of Commerce (ICC) has cautioned the European Commission against implementing rules on the exchange – and possible public disclosure – of multinational company tax information that go beyond international guidelines set out in the OECD's base erosion profit shifting (BEPS) project.

On March 8, 2016, the EU Economic and Financial Affairs Council reached political agreement on new rules enabling automatic exchange of country-by-country (CbC) reports between EU member states, subject to UK parliamentary scrutiny. The new rules are a key part of the Anti Tax Avoidance Package, which was adopted by the European Commission on January 28, 2016.

The ICC said in a March 15 release: "ICC fully acknowledges the importance of ensuring adequate access to information for tax authorities to determine the correct amount of tax for businesses. However, [CbC] reports should not be made public and that disclosure would be counterproductive to efficient tax administration. It would furthermore be harmful to the relationship between taxpayers and tax authorities. ICC therefore urges the [Commission] to implement measures that are consistent with international guidelines that support the confidentiality of commercially sensitive information."

The ICC pointed out that some of the provisions included in the Commission's package "have been extracted from the common consolidated corporate tax base (CCCTB) proposal. They were part of a broader, consolidated regime across countries aimed at creating a strong and dynamic internal market, able to compete with other major economies and better facilitate cross-border trade, enhance growth, employment, and investment in the EU."

"ICC is concerned that these new [Commission] measures, which significantly diverge from the BEPS project, will reduce rather than stimulate trade in the EU and negatively impact international trade by creating new tax barriers. The [Commission] should restrict itself to the implementation of the BEPS Action Plan and follow the initial path of a competitive CCCTB."

The body called for a coordinated implementation of the combined BEPS deliverables on a multilateral basis with a consensus approach in order for the solutions to be consistent and uniformly applied at the international level.

Christian Kaeser, Global Head of Tax at Siemens and Chairman of the ICC Commission on Taxation, commented: "Business fears that in deviating from international tax guidelines, the [Commission] risks setting a precedent that could potentially undermine global efforts to establish a consistent international tax landscape. We caution against implementation of domestic or regional tax legislation that could lead to disparate rules, increased complexity, and double taxation. By implementing a directive that goes beyond internationally agreed guidelines, the [Commission] will introduce double or multiple standards undermining the consistency of the international tax system. In addition to this, the proposed measures could put the EU at a competitive disadvantage in attracting global investment."

BEPS Infringing US National Sovereignty, Report Says

The OECD's Base Erosion and Profit Shifting (BEPS) project is undermining national sovereignty, according to a report from the Mercatus Center, a research center based at George Mason University in the US.

The report, entitled *The OECD's Conquest of the United States: Understanding the Costs and Consequences of the BEPS Project and Tax Harmonization*, noted that the project "attempts to change the international tax system by transferring control of corporate taxation from individual nations to an international body." It continued: "This shift favors consolidated and uniform tax rules but sacrifices compliance efficiency, taxpayer rights, and the ability of nations to set the tax policies best suited to their populations."

The report, which was authored by Jason Fichtner and Adam Michel, also disputed the OECD's claim that the BEPS project will increase corporate tax revenue.

The report said that the US should scrap the corporate tax completely, instead of trying to eliminate BEPS. It said that "the tax is inefficient because it double-taxes income, penalizes business activity, and requires onerous and costly regulations."

However, since repealing the corporate tax would not be politically viable in the short term, the report offered alternatives for the US, including ending the taxation of worldwide income, and lowering the corporate tax rate, which is currently the highest in the OECD.

MNEs Respond To TAXE Committee Criticism

Google, Apple, Inter-IKEA Group, and McDonald's told an EU Committee that they would welcome more clarity and certainty about their tax liabilities in the EU, but are concerned about rising compliance costs and tax data being made public.

Representatives from the companies met the European Parliament's Special Committee on Tax Rulings (the TAXE2 Committee) on March 15 to share their views on recent developments in the field of corporate taxation in the EU and on the OECD's base erosion and profit shifting recommendations. In the EU, these developments have included probes into the tax ruling practices of member states and of specific tax rulings, the relaunch of the proposal for a common consolidated corporate tax base (CCCTB), and the release of the Commission's Anti Tax Avoidance Directive.

According to a post-event statement from the European Parliament, MEPs were keen to hear the multinational companies' views on the proposed directive against base erosion and profit shifting (anti-BEPS). They specifically asked about the proposed requirement for country-by-country reporting of profits, taxes, and subsidies and whether such information should be made public. However, the anticipated CCCTB and company specific tax structures – such as Google's "Bermuda" structure, IKEA's "royalties" structure, Apple's tax arrangements in Ireland, and McDonalds' franchises – were said to be subject to intense debate.

At the meeting, several MEPs criticized Google for paying too little tax in the EU. They said that the deal between the UK's HM Revenue & Customs to pay GBP130m in back taxes, along with higher ones in the future, showed that Google was ethically off track. In response, Google's Head of Economic Policy, Adam Cohen, said that HMRC had looked into its transfer pricing arrangements and concluded that certain benchmarks needed to be adjusted. "That is normal for multinational companies," he underlined, adding that Google pays a global effective tax rate of 19 percent and that the EU's overall rate is around 20 percent.

He said that Google has reservations about the CCCTB plans, stating that it would increase costs for Google as it would require an establishment in every EU country. "This would be contrary to the principle of the internal market," he said.

Apple's representative pointed out that "Apple is the largest taxpayer in the world. In 2015 we paid USD13.2bn in taxes worldwide, which is an effective tax rate of 26.4 percent." Asked to disclose specific tax figures about its tax payments in the EU and in Ireland, the representative stated: "Those are confidential. When country-by-country reporting will become mandatory, we will of course follow." They stated that Apple, like Google, pays most of its taxes in the US, where most of its employees are based and its research is done.

Meanwhile, the Vice President for Corporate Tax for McDonald's, Irene Yates, welcomed the anti-BEPS proposal, saying it would create a "clearer, simpler, and more consistent international tax regime." She added: "We are concerned about unilateral approaches [that will result] if the BEPS directives are not harmonized in a holistic manner. The idea should be to remove barriers to trade, not create new ones," she continued, adding that McDonald's is not in favor of public reporting by country. "Information should be kept confidential between tax authorities and not be made public. That could harm competition," she concluded.

Finally, Inter-IKEA Group CEO Soren Hansen came under fire from the Green Party. It has presented research that accuses the company of dodging tax by using structures in the Netherlands and Liechtenstein. In response, Hansen said that some of the assumptions upon which the report was based were false, but said he would reply with a written assessment of the research. He also said that the anti-BEPS proposal should be aligned inside and outside the EU, that bureaucracy must be avoided, and that a mechanism for rapid dispute settlement would be highly welcome.

TEI Cautious On US CbC Reporting Regulations

The Tax Executives Institute (TEI) has offered a guarded welcome to the draft regulations recently released by the US Treasury Department concerning country-by-country (CbC) reporting requirements.

In its comments submitted to the US Internal Revenue Service (IRS) on March 21, 2016, the TEI stressed the need for the final regulations to be consistent with the final report on Action 13 of the OECD's base erosion and profit shifting (BEPS) project to minimize the administrative burden on businesses and permit flexibility in information reporting.

The TEI pointed out that "while the proposed regulations generally follow the OECD guidance for CbC reporting, there are significant differences between the proposed regulations and the final OECD report on BEPS Action 13. This is regrettable because one of the objectives of the BEPS project was to develop a common approach to address the perceived problems of BEPS and prevent 'global tax chaos' from arising if countries took unilateral measures to address BEPS."

The Institute urged the IRS and the Treasury to strive for consistency with the OECD's final BEPS Action 13 guidance regarding filing CbC reports when promulgating the final CbC regulations. It particularly recommended "a filing deadline consistent with the OECD standard – one year after the end of the relevant taxable year – even if it necessitates a separate filing with the IRS to preserve the flexibility provided to taxpayers by the regulations when choosing the data to populate the CbC report."

The TEI recommended against inclusion of CbC reports in information shared by the IRS with state and local jurisdictions in the US. It further recommended that the IRS publish a list of countries with which it is exchanging the reports to enable taxpayers to properly anticipate and react to direct requests for the CbC report in foreign jurisdictions.

IoM, UK Agree New VAT Sharing Arrangement

The Isle of Man and the UK have agreed a revision of the formula that governs the sharing of joint indirect tax revenues under the 1979 Customs & Excise Agreement.

The new arrangement was signed in London on March 2, 2016, by the Isle of Man's Minister for the Treasury, Eddie Teare, and the UK's Financial Secretary to the Treasury, David Gauke.

Teare said: "The new formula, which is largely based around final expenditure by households, is intended to give the Isle of Man the revenue due to it from the consumption of goods and services in the island whether purchased on or off the island, including via the internet."

He said that both the Isle of Man and the UK governments believe that the new formula provides a stable and secure basis for the long-term future of the Customs & Excise Agreement between the UK and the Isle of Man.

A separate standalone document describing how the new Final Expenditure Revenue Sharing Arrangement (FERSA) will work in practice is to be produced by the Isle of Man Treasury, which, once agreed with HM Treasury, will be made public.

Major EU VAT Reform Plan Expected

The EU intends to release an Action Plan to comprehensively reform value-added tax (VAT) rules in the EU on March 23, an EU official has confirmed.

The official said the plan will review current VAT rules to put in place "a single fraud-proof EU VAT area with simpler and more modern rules." It will also modernize the framework for VAT rates and give member states greater freedom to set their own reduced rates, the official said.

According to the official, the Plan will include measures to tackle VAT fraud, in particular by addressing fraud that manipulates the VAT-free treatment of intra-EU trade; simplification measures for businesses, to ease the burden and complexity of complying with EU rules; and new rules for the digital era.

IMF Puts VAT Introduction As Priority For San Marino

The International Monetary Fund (IMF) has released its 2016 Article IV consultation report for San Marino and recommended that the territory should start to reduce its fiscal deficit, with the introduction of the proposed value-added tax (VAT) being a policy priority.

The IMF noted that San Marino's economy "is bottoming out after six years of recession," and suggested a target for an overall fiscal adjustment of 1 percent of gross domestic product (GDP) over the four-year 2017–2020 period. While public spending is also being cut, it proposed that, beginning in 2017, government policy should also be looking "to modestly increase revenue."

It concluded that "the scheduled introduction of the VAT in 2017 remains a priority," and should "aim to increase revenues by 0.5–1 percent of GDP by setting the VAT rate a bit higher than the revenue-neutral rate."

The IMF welcomed San Marino's commitment to "rationalize and modestly reduce expenditure on public pensions and publicly financed health care benefits." However, it also noted that financial sector issues, such as the unfinished restructuring of Cassa di Risparmio della Repubblica di San Marino and a reduction in non-performing loans in the banking system, needed to be resolved quickly "to minimize contingent fiscal liabilities."

US Retail Groups Press For Online Sales Tax Legislation

On March 15, more than 20 business associations in the US sent a letter to Robert Goodlatte (R – Virginia), the Chairman of the House of Representatives Committee on the Judiciary, urging that he should markup legislation to give states the option of levying sales taxes on internet transactions.

In the letter, the associations – including many retail groups such as the International Council of Shopping Centers, National Retail Federation, and Retail Industry Leaders Association – pointed out that "because the Congress has not passed remote sales tax legislation, numerous states have enacted or are considering varied approaches to collecting these current tax obligations. In some cases, states may also be pursuing back-taxes."

They added that "the lack of movement from Congress on the issue of remote sales tax collection has left states, local governments, and our merchants with no choice but to seek disjointed and confusing remedies through individual state activity. … This state-by-state approach prevents businesses from benefiting from simplification measures such as uniform definitions or free tax software that could be achieved by federal legislation."

"We do not believe that the state-by-state approach is the best solution, which is why we are hopeful the House of Representatives will vote on a federal legislative solution this year to move this issue toward a final resolution," they concluded.

The House Judiciary Committee has responsibility in developing online sales tax legislation because of the interstate commerce nexus it would involve. Currently, retailers are only required to collect sales tax in US states where they also have brick-and-mortar stores (*i.e.*, a physical nexus).

A previous legislative attempt to change the position, the Marketplace Fairness Act (MFA), was approved by the then Democrat-led Senate in May 2013. The MFA would have given states the option to require online retailers with national annual sales greater than USD1m to collect the tax, even if their websites lacked a physical nexus in the state.

The MFA was then sent for approval to the Republican-led House where it encountered substantial opposition, particularly on the grounds that it was considered to create new taxation and onerous compliance requirements. Early last year, Goodlatte proposed an alternative system of taxing "remote sales" based on where the retailer – not the customer – is located, but that proposal also encountered criticism.

In their letter, the associations confirmed that they would be able to support the Remote Transactions Parity Act (RTPA), which was introduced in the House in June last year and includes several modifications over the MFA.

Instead of USD1m, the RTPA exempts small business under USD10m in the first year. This would be lowered to USD5m in the second year and to USD1m in the third.

It would also exempt businesses with under USD5m in gross receipts from audits in states where they do not have a physical nexus. States would be called on to give remote sellers the software needed to collect and remit the taxes due, and to pay for its setup, installation, and maintenance costs.

Liechtenstein, Switzerland Tax Treaty To Enter Into Force

A double tax agreement (DTA) between Switzerland and Liechtenstein has been approved by the parties' respective authorities and is expected to enter into force on January 1, 2017.

The DTA has been approved by the Swiss National Council and the Liechtenstein Government. Under the agreement, the withholding tax rate on interest payments will be set at zero. The rate for dividends will be set at a maximum 15 percent, with exemptions for pension funds and beneficial owners with significant holdings in the company paying the dividends.

The wages and pensions of cross-border workers will be taxed in the state of residence. Individuals who do not return to their place of residence for more than 45 working days in a year for professional reasons will not be classified as a cross-border commuter.

UK, Crown Dependencies Revise Double Tax Pacts

Guernsey, Jersey, and the Isle of Man – collectively, the UK's Crown Dependencies – have agreed to revise their bilateral double tax agreements (DTAs) with the UK to close a potential tax loophole for property developers.

Jersey and Guernsey said the revisions remove a potential loophole that may have allowed non-UK resident property developers to avoid income tax or corporation tax in the UK in certain circumstances. They are effective from March 16, 2016.

The Guernsey and Jersey governments said the agreement of these protocols demonstrates the UK's and the respective islands' joint commitment to working together to counter tax avoidance and evasion.

Guernsey's Treasury & Resources Minister, Gavin St. Pier, said: "We have always maintained that it is for the UK to make its own tax system as robust as possible – but where it falls to us to assist them in that, then we will."

"In agreeing to this amendment to the existing DTA with the UK, we have done so in accord with our longstanding policy of partnership with the HM Treasury and HM Revenue & Customs to prevent the use of Guernsey for aggressive tax avoidance, tax fraud, and tax evasion."

"The amendment incorporates into the existing DTA wording that is in the OECD's Model DTA, and which we would expect to be in any new DTA that emerges from the renegotiation of our existing DTA, shortly to commence."

"This step is also consistent with the OECD BEPS principles, to which Guernsey has previously indicated that it is generally committed."

Jersey's Minister for External Relations, Philip Bailhache, said: "In agreeing to this amendment to the existing [DTA] with the UK, we have done so in accord with our longstanding policy of cooperating with the UK to limit the use of Jersey to evade UK tax or engage in abusive tax avoidance."

The Minister added: "The need for the amendment in respect of a tax measure in the UK Budget, which has general application to non-UK property developers, arose because of the historic wording of the existing Arrangement which was entered into in 1952."

Singapore–UAE Tax Treaty Improved

The second Protocol to the double tax agreement between Singapore and the United Arab Emirates entered into force March 16, 2016, and will become effective from January 1, 2017, lowering withholding tax rates and amending permanent establishment (PE) rules.

The Protocol, which was signed in October 2014, revises the terms to include longer threshold periods to ascertain the presence of a PE. For instance, the Protocol states that a PE arises where a building site; a construction, assembly, or installation project; or supervisory activities in connection therewith continue for a period of more than 12 months, as opposed to the current nine-month threshold. Moreover, under the revised Protocol, furnishing of services, including consultancy services, would only constitute a PE if such activities continue for a period aggregating 300 days within any 12 months, up from six months. It is hoped that the revisions will enhance trade and investment flows. The agreement also modernizes tax information exchange provisions.

The Protocol removes withholding tax on interest at source, by providing that interest income may be taxed only in the country of the recipient. Provisions setting a 5 percent rate of withholding tax on income from dividends have been replaced with taxation solely in the country of the recipient on certain conditions. However, this does not affect the taxation of a company in respect of the profits out of which the dividends are paid. With respect to royalties, income from "the use of, or the right to use, industrial, commercial, or scientific equipment" has been removed from the scope of the double tax agreement and therefore the concessionary 5 percent withholding tax rate at source, which remains.

BELARUS - KAZAKHSTAN

Signature

Belarus and Kazakhstan signed a DTA Protocol on March 16, 2016.

BOTSWANA - MALAWI

Signature

Botswana and Malawi signed a DTA on March 16, 2016.

EUROPEAN UNION - MONACO

Initialed

The European Union and Monaco have initialed an automatic information exchange agreement.

FINLAND - UZBEKISTAN

Signature

Finland and Uzbekistan signed a DTA Protocol on March 8, 2016.

GHANA - TURKEY

Negotiations

According to preliminary media reports, Ghana and Turkey completed a third round of DTA negotiations on February 19, 2016.

HONG KONG - VARIOUS

Effective

Hong Kong's new DTAs with South Africa, the United Arab Emirates, Vietnam, Japan, and Italy will be effective for Hong Kong taxes from April 1, 2016.

IRELAND - BOTSWANA

Effective

The DTA between Ireland and Botswana will become effective from January 1, 2017.

KENYA - ITALY

Signature

Kenya and Italy signed a DTA on March 3, 2016.

NEW ZEALAND - SAMOA

Effective

The DTA between New Zealand and Samoa will become fully effective from April 1, 2016.

NIGERIA - QATAR

Signature

Nigeria and Qatar signed a DTA On February 28, 2016.

PAKISTAN - CZECH REPUBLIC

Effective

The DTA between Pakistan and the Czech Republic will become effective on July 1, 2016.

PORTUGAL - SENEGAL

Into Force

According to preliminary media reports, the DTA between Portugal and Senegal will enter into force on March 20, 2016.

UNITED ARAB EMIRATES - SINGAPORE

Into Force

The second Protocol to the DTA between the UAE and Singapore entered into force on March 16, 2016.

UNITED KINGDOM - URUGUAY

Signature

The United Kingdom and Uruguay signed a DTA on March 4, 2016.

UNITED KINGDOM - VARIOUS

Forwarded

The United Kingdom and the Crown Dependencies — Jersey, Guernsey, and the Isle of Man — have agreed to revise their DTAs, according to statements from Jersey and Guernsey on March 16, 2016.

VIETNAM - VARIOUS

Forwarded

On March 1, 2016, the Vietnamese tax authority confirmed that the country's recent DTAs with Mozambique, Kazakhstan, San Marino, Serbia, Uruguay, Turkey, Iran, Macedonia, Portugal, and the US are not yet effective.

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

THE AMERICAS

8th Regional Meeting of IFA Latin America

5/4/2016 - 5/6/2016

IBFD

Venue: JW Marriott Hotel Lima, Malecón de la Reserva 615, Lima, Peru

Key speakers: TBC

http://www.ibfd.org/IBFD-Tax-Portal/Events/8th-Regional-Meeting-IFA-Latin-America

STEP International Tax and Estate Planning Forum: Around the Globe in 2016

5/5/2016 - 5/6/2016

STEP

Venue: Surf & Sand Resort, 1555 South Coast Hwy, Laguna, California, USA

Chairs: M. Katharine Davidson (Henderson, Caverly, Pum & Charney LLP), Lawrence H. Heller (Greenberg Traurig)

http://www.step.org/sites/default/files/STEP_LA_2016_Forum_Formal_Brochure.pdf

The 7th Annual Private Investment Funds Tax Master Class

5/25/2016 - 5/26/2016

Financial Research Associates

Venue: The Princeton Club of NY, 15 West 43rd St., New York, New York 10036, USA

Key Speakers:TBC

https://www.frallc.com/conference.aspx?ccode=B998

US International Tax Compliance Workshop – San Diego

6/20/2016 - 6/21/2016

Bloomberg BNA

Venue: Marriott San Diego Gaslamp, 660 K Street, San Diego, CA 92101, USA

Key speakers: TBC

http://www.bna.com/compliance_sandiego2016/

International Practice Units: The IRS Approach to Auditing International Tax Issues

6/21/2016 - 6/21/2016

CCH

Venue: Webinar

Chair: Robert J. Misey

http://www.cchgroup.com/media/wk/taa/pdfs/training-and-support/seminar/cch-seminars-calendar-fact-sheet.pdf

Athletes and Entertainers – US International Tax Issues

10/18/2016 - 10/18/2016

CCH

Venue: Webinar

Chair: Robert J. Misey

http://www.cchgroup.com/media/wk/taa/pdfs/training-and-support/seminar/cch-seminars-calendar-fact-sheet.pdf

International Tax Issues In The Manufacturing Industries

11/9/2016 - 11/9/2016

CCH

Venue: Webinar

Chair: Robert J. Misey

http://www.cchgroup.com/media/wk/taa/pdfs/training-and-support/seminar/cch-seminars-calendar-fact-sheet.pdf

Tax-Effective Global Value Chain – Post BEPS

11/23/2016 - 11/25/2016

IBFD

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

Key Speakers: Carlos Gutiérrez Puente (IBFD), Tamas Kulcsar (IBFD)

http://www.ibfd.org/Training/Tax-Effective-Global-Value-Chain-Post-BEPS

Fundamentals of US International Taxation

12/6/2016 - 12/6/2016

CCH

Venue: Webinar

Chair: Robert J. Misey

http://www.cchgroup.com/media/wk/taa/pdfs/training-and-support/seminar/cch-seminars-calendar-fact-sheet.pdf

ASIA PACIFIC

The 7th Offshore Investment Conference Hong Kong 2016

6/15/2016 - 6/16/2016

Offshore Investment

Venue: Conrad Hong Kong, One Pacific Place, 88 Queensway, Admiralty, Hong Kong

Chair: Michael Olesnicky (KPMG)

http://www.offshoreinvestment.com/pages/index.asp?title=The_7th_Offshore_Investment_Conference%2C_Hong_Kong_2016&catID=12842

International Corporate Tax Planning Aspects

7/27/2016 - 7/29/2016

IBFD

Venue: InterContinental Kuala Lumpur, 165 Jalan Ampang, 50450 Kuala Lumpur, Malaysia

Key Speakers: Shee Boon Law (IBFD), Chris Finnerty (Ernst & Young LLP) and Julian Wong (Ernst & Young)

http://www.ibfd.org/Training/International-Corporate-Tax-Planning-Aspects-1

CENTRAL AND EASTERN EUROPE

Wealth Management & Private Banking Summit – Russia & CIS

4/12/2016 - 4/14/2016

Informa

Venue: Radisson Royal Hotel, 2/1 bld.1 Kutuzovsky Prospekt, Moscow, 121248, Russia

Key Speakers: Dmitri Kushaev (Credit Suisse Russia), Anna Matveeva (Sberbank Private Banking), Dmitry Peshnev-Podolskiy (Gazprombank), Elena Lisitsyna (M2M Private Bank), among numerous others

http://www.russianwealthmanagement.com/

MIDDLE EAST AND AFRICA

International Tax Aspects of Corporate Tax Structures

4/13/2016 - 4/15/2016

IBFD

Venue: Radisson Blu Gautrain Hotel, Sandton Johannesburg, Cnr Rivonia Road and West Street, Postnet Suite 2010, Private Bag X9, Benmore 2010, Johannesburg, South Africa

Key speakers: Shee Boon Law (IBFD), Boyke Baldewsing (IBFD) http://www.ibfd.org/Training/International-Tax-Aspects-Corporate-Tax-Structures

Treaty Aspects of International Tax Planning

5/22/2016 - 5/24/2016

IBFD

Venue: Hilton Dubai Jumeirah Hotel, Jumeirah Beach Road, Dubai Marina, Dubai

Key speakers: Bart Kosters (IBFD), Ridha Hamzaoui (IBFD)

http://www.ibfd.org/Training/Treaty-Aspects-International-Tax-Planning-1

Substance in International Tax Planning

11/13/2016 - 11/15/2016

IBFD

Venue: Hilton Dubai Jumeirah Hotel, Jumeirah Beach Road, Dubai Marina, Dubai

Key speakers: Boyke Baldewsing (IBFD), Ridha Hamzaoui (IBFD)

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

WESTERN EUROPE

International Tax Aspects of Permanent Establishments

4/19/2016 - 4/22/2016

IBFD

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

Key speakers: João Félix Pinto Nogueira (IBFD), Carlos Gutiérrez P. (IBFD), Bart Kosters (IBFD), Tamas Kulcsar (IBFD).

http://www.ibfd.org/Training/International-Tax-Aspects-Permanent-Establishments

International Cross Border Estate Planning

4/20/2016 - 4/20/2016

Informa

Venue: London, TBC

Key speakers: Richard Frimston (Russell Cooke), Brad Westerfield (Butler Snow), Jim Edmondson (Mourant Ozannes), Richard Dew (10 Old Square), Michael Parkinson (Macfarlanes), Patrick Harney (Forsters), Freddie Bjorn (Payne Hicks Beach).

http://www.iiribcfinance.com/event/International-Cross-Border-Estate-Planning-conference

STEP Tax, Trusts & Estates Conference Exeter 2016

4/21/2016 - 4/21/2016

STEP Worldwide

Venue: Sandy Park Conference Centre, Sandy Park Way, Exeter, EX2 7NN, UK

Key Speakers: TBC

http://www.step.org/events/step-tax-trusts-estates-conference-exeter-2016

VAT and Financial Services 2016

4/27/2016 - 4/27/2016

IIR & IBC Financial Events

Venue: London, TBC

Key Speakers: Bruno Giordan (HMRC), Reshma Sharma (Barclays), Timothy Lyons QC (39 Essex Chambers), Peter Mason (Rosetta Tax), Michael Barnard (Blackrock), among numerous others

http://www.iiribcfinance.com/event/VAT-and-Financial-Services-Conference-2016

STEP Tax, Trusts & Estates Conference Leeds 2016

4/28/2016 - 4/28/2016

STEP Worldwide

Venue: Hilton, Neville Street, Leeds, LS1 4BX, UK

Key Speakers: TBC

http://www.step.org/events/step-tax-trusts-estates-conference-leeds-2016

STEP Tax, Trusts & Estates Conference London 2016

5/13/2016 - 5/13/2016

STEP Worldwide

Venue: Park Plazza, 200 Westminster Bridge Rd, London, SE1 7UT, UK

Key Speakers: TBC

http://www.step.org/events/step-tax-trusts-estates-conference-london-2016

STEP Tax, Trusts & Estates Conference Birmingham 2016

5/19/2016 - 5/19/2016

STEP Worldwide

Venue: Crowne Plaza Birmingham City, Central Square, Birmingham, B1 1HH, UK

Key Speakers: TBC

http://www.step.org/events/step-tax-trusts-estates-conference-birmingham-2016

Tax Planning for Non-Domiciliaries

5/25/2016 - 5/25/2016

Informa

Venue: London, TBC

Key speakers: John Barnett (Burges Salmon), Emma Chamberlain (Pump Court Tax Chambers), Mark Davies (Mark Davies & Associates Ltd), Dominic Lawrence (Charles Russell Speechlys), among numerous others

http://www.iiribcfinance.com/event/tax-planning-for-non-domiciliaries-conference

Tackling Tax Avoidance in Practice

6/2/2016 - 6/3/2016

European Acadamy

Venue: Ramada Hotel Berlin-Alexanderplatz, Karl-Liebknecht-Strasse 32, D-10178 Berlin, Germany

Key Speakers: TBC

http://www.euroacad.eu/events/event/tackling-tax-avoidance-in-practice.html

International Tax Congress 2016

6/21/2016 - 6/22/2016

IIR & IBC Financial Events

Venue: London, TBC

Key Speakers: Ian Brimicombe (Astrazeneca), Kristoffer Knutsen (Nestle Waters), Alain Berlier (Louis Dreyfus Commodities), David Campkin (BBC), among numerous others

http://www.iiribcfinance.com/event/International-Tax-Congress-Conference/key-speakers

Current Issues in International Tax Planning

6/29/2016 - 7/1/2016

IBFD

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

Key Speakers: Tigran Mkrtchyan

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

The 2nd Planning for the Super-Rich, An Offshore Investment Event London 2016

7/6/2016 - 7/7/2016

Offshore Investment

Venue: Royal Thames Yacht Club, 60 Knightsbridge, London, SW1X 7LF, UK

Chair: Paul Stibbard (Rothschild)

http://www.offshoreinvestment.com/pages/index.asp?title=The_2nd_Planning_for_the_Super-Rich%2C_an_Offshore_Investment_Event_London&catID=12851

Global VAT

7/6/2016 - 7/8/2016

IBFD

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

Key Speakers: Jordi Sol (IBFD), Fabiola Annacondia (IBFD), Christine Peacock (IBFD), Wilbert Nieuwenhuizen (University of Amsterdam), Laura Mattes (IBFD), among numerous others.

http://www.ibfd.org/Training/Global-VAT

International Taxation of Banks and Financial Institutions

8/31/2016 - 9/2/2016

IBFD

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

Key Speakers: Francesco Mantegazza (Pirola Pennuto Zei & Associati), Carola Maggiulli (DG TAXUD), Omar Moerer (Baker & McKenzie), Ingrid Rensema (ABN AMRO), Peter Drijkoningen (BNP Paribas).

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

Trusts and Estate – International Tax Planning

10/12/2016 - 10/14/2016

IBFD

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

Key speakers: Joanna C. Wheeler (IBFD), Bart Kosters (IBFD), Jonathan Schwarz (Temple Tax Chambers), Alessandro Bavila (Maisto e Associati)

http://www.ibfd.org/Training/Trusts-and-Estate-International-Tax-Planning

THE AMERICAS

A listing of recent key international tax cases.

United States

Two Cayman financial institutions have pleaded guilty in Manhattan Federal Court to conspiring to hide more than USD130m in Cayman bank accounts and have agreed to produce the account files of non-compliant US taxpayers, in the first conviction of a non-Swiss financial institution for tax evasion conspiracy.

The US Department of Justice on March 9, 2016, announced the two institutions are Cayman National Securities Ltd. and Cayman National Trust Co. Ltd., two Cayman Island affiliates of Cayman National Corporation, which provided investment brokerage and trust management services to individuals and entities within and outside the Cayman Islands, including US taxpayers.

The two entities admitted that they had helped their US taxpayer clients to hide more than USD130m from the US Internal Revenue Service, as part of plea agreements requiring them to, among other things, produce through the treaty process account files of non-compliant US taxpayers who maintained accounts with them and pay a total of USD6m in penalties.

US Attorney for the Southern District of New York, Preet Bharara, revealed:

> "The guilty pleas of these two Cayman Island companies today represent the first convictions of financial institutions outside Switzerland for conspiring with US taxpayers to evade their lawful and legitimate taxes. The plea agreements require these Cayman entities to provide this office with the client files, because we are committed to finding and prosecuting not only banks that help US taxpayers evade taxes, but also individual taxpayers who find criminal ways not to pay their fair share. We will follow them no matter how far they go to hide their accounts, whether it is Switzerland, the Cayman Islands, or some other tax haven."

Acting Deputy Assistant Attorney General Stuart Goldberg of the Justice Department's Tax Division added: "Today's convictions make clear that our focus is not on any one bank, insurance company, or asset management firm, or even any one country."

https://www.justice.gov/opa/pr/two-cayman-island-financial-institutions-plead-guilty-manhattan-federal-court-conspiring-hide

Manhattan Federal Court: *US DoJ v. Cayman National Securities Ltd and Cayman National Trust Co. Ltd.*

United States

A judge from the US District Court of the Southern District of Florida (Miami) has called on UBS to appear on March 31 to defend its decision not to provide the Internal Revenue Service (IRS) with the bank details of a taxpayer resident in China who is the subject of an ongoing IRS audit.

In a client brief on the matter, law firm Caplin and Drysdale said the US is seeking to enforce a "Bank of Nova Scotia" summons – named after an 1982 appellate decision in which the court compelled the Miami branch of Scotiabank to produce records from the its Cayman branch despite Cayman secrecy laws. In that case, the bank complied; had it failed to do so, the court could have imposed substantial fines on the Miami branch until the Cayman records were delivered to the IRS.

Commenting on the summons, Caplin and Drysdale stated in its client brief:

> "In late February 2016, the Justice Department filed an action in federal court to compel UBS's branch in Miami to produce bank records of a Singapore account purportedly owned by a taxpayer who lives in China and is under IRS audit. With a tactic not used in several years, this heralds the opening of a new front in the US enforcement effort against unreported foreign assets. Much of the activity in the last eight years has been aimed at Switzerland, where the US can declare victory. The Miami summons action reflects that the government will pursue money transferred out of Switzerland, particularly into Singapore, and that the IRS and [Department of Justice (DOJ)] have additional ways to overcome foreign bank secrecy laws, whether or not the taxpayer under scrutiny lives in the US. …
>
> During the past eight years of aggressive US enforcement in the foreign account area, the Justice Department has not resorted to this method of obtaining foreign bank records. Instead,

> the IRS/DOJ issued 'John Doe' summonses, treaty requests, and 'required record' summonses to taxpayers under audit or criminal investigation, among other tactics. Now, the DOJ and IRS want records from Singapore, a bank secrecy jurisdiction long thought to have attracted money flowing out of Switzerland once the US crackdown began. Because the taxpayer lives in China, the IRS cannot serve a summons directly on him, and as the US and Singapore have no tax treaty, the Government issued a 'Bank of Nova Scotia' summons. The IRS is demanding that the Miami branch of UBS retrieve from Singapore the sought-after bank statements, irrespective of Singapore law."

US District Court S.D. Fl (Miami): *United States of America v. UBS AG (1:16-mc-20653)*

United States

The US Tax Court has ruled in favor of the Internal Revenue Service (IRS) in an appeal brought by Guidant LLC against determined federal income tax deficiencies and an accuracy-related penalty in relation to its transfer pricing affairs.

Guidant's transactions with its foreign affiliates included the licensing of intangibles, the purchase and sale of manufactured property, and services. For many products, the flow involved a "round trip" from the US to Ireland or to Puerto Rico and back. The deficiencies and the accuracy-related penalty arise from the IRS's transfer pricing adjustments, which increased the income of Guidant Corp. and its US subsidiaries (sometimes collectively, Guidant group) by approximately USD3.5bn. The Guidant group filed consolidated federal income tax returns, and the IRS's adjustments stemmed from transactions that the Guidant group engaged in with the group's affiliated foreign entities.

During an audit, the IRS determined that the group's transfer prices were not at arm's length. The IRS, relying on Section 482, adjusted the reported prices at which items were transferred between the group and its foreign affiliates. It then determined the group's true consolidated taxable income (CTI) by posting all of the adjustments to the separate taxable income of the group's parent (which increased *pro tanto* the group's CTI) and without making any specific adjustment to any subsidiary's separate taxable income (STI). The IRS also did not determine any portion of the adjustments that related solely to tangibles, to intangibles, or to services.

The US Tax Court noted that it is the IRS's practice to compute member-specific adjustments when the taxpayer and the audit team can agree on such adjustments or when the audit team has sufficient information to make them. The IRS's practice is to defer making member-specific adjustments in other circumstances until a final resolution has been reached because these determinations often involve complex calculations, as well as extensive and collaborative discussions with the taxpayer. Because the parties did not reach a resolution of the Section 482 issue, the IRS did not expend time or resources to determine member-specific adjustments for each Guidant group-controlled taxpayer.

The IRS said that, due to lacking documentation, it did not believe that it could independently make reliable member-specific adjustments on the basis of the information available to it. The IRS considered the complexity of the activities of each member of the Guidant group and its relationship with the activities of other members of the Guidant group and/or of their foreign affiliates. It also concluded that it could not independently make reliable member-specific adjustments for each of the Guidant group members after considering the flow of products among Guidant group entities, involving multiple steps and multiple transfer pricing transactions.

The IRS submitted that each Guidant group member's available financial statements encompassed all activities the entity performed and all products produced and sold, including those not at issue in these cases. The IRS said it was unable to extract the information necessary to ascertain the income reported by each Guidant group member with respect to the products and transactions at issue and to determine the STI of each Guidant group member for the products and transactions at issue.

The Tax Court noted that Guidant did not maintain its financial records in a manner that allowed the IRS to readily track income and expenses by place of manufacture, and that Guidant could not tie the income and expenses in the business unit financial statements to particular product lines, or to products manufactured in the United States, in Ireland, or in Puerto Rico.

Under Section 482, the Commissioner may "distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among … [controlled enterprises], if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such [enterprises]."

Considering Guidant's motion for a partial summary judgment, the US Tax Court noted that to counter the adjustments, the petitioner must first establish that the Commissioner abused his discretion by making allocations that are arbitrary, capricious, and unreasonable. Second, a taxpayer must establish that arm's length consideration for the adjusted transactions is consistent with the taxpayer's allocations. Guidant sought to argue that the IRS's adjustments were inappropriately made through a combined group-wide analysis on the basis of multiple types of controlled transactions among multiple corporations.

However, in its ruling, the US Tax Court held that neither Section 482 nor the regulations thereunder require that the IRS, when exercising its authority under Section 482, always determine the true separate taxable income of each controlled taxpayer in a consolidated group contemporaneously with the making of the resulting adjustments. Further, it held that Section 482 and the regulations thereunder allow the IRS, when exercising its authority under Section 482, to aggregate one or more related transactions instead of making specific adjustments with respect to each type of transaction.

This judgment was released on February 29, 2016.

http://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=10712

United States Tax Court: *Guidant LLC, et al. v. Commissioner of Internal Revenue (146 T.C. No. 5)*

ASIA PACIFIC

Australia

The Australian Taxation Office (ATO) has issued a response to the Federal Court of Australia's ruling in *Orica Ltd v. Commissioner of Taxation* (2015 ATC 20-547), which concerned the application of Part IVA of the Income Tax Assessment Act 1936 to cross-border financing arrangements.

The ruling centers on an intragroup arrangement entered into by members of the Orica group, under which Australian-resident Orica Finance Ltd (OFL) lent Australian-resident Orica Explosives Holdings (OEH) USD590m; OEH used the loan proceeds to subscribe to redeemable preference securities issued by a US-resident subsidiary, Orica US Services Inc. (OUSSI); and OUSSI then placed USD517m on deposit at interest with OFL.

Under the arrangement, deductions were claimed under Section 25-90, or alternatively Section 8-1 of the Income Tax Assessment Act 1997 (ITAA 1997) for interest paid by an Australian-resident group company to a US-resident group company with significant carried-forward US tax losses. The funds deposited with the Australian company had originally been lent by the

Australian company itself to a third group entity, and then paid to the US company by way of subscription for redeemable preference shares in it.

OUSSI conducted Orica's North American explosives business. It had incurred significant operating losses and had consequently accumulated US tax losses in the years leading up to the scheme. The losses had initially been recognized in Orica's consolidated balance sheet as a Future Income Tax Benefit (FITB) asset for US purposes. However, under the Australian accounting standards, to maintain recognition of the value of the FITB in Orica Ltd's subsidiary, the FITB had to be "virtually certain" of being used in the future. Given OUSSI's protracted poor financial performance, the FITB asset was written off in 2001.

The scheme caused OUSSI to receive income that was assessable in the US. This enabled the re-recognition and use of the US tax losses. Orica re-recognized the losses over a period of three years. In 2006, when the US losses had been fully used, the arrangement was unwound.

The interest expenses of OFL were claimed as deductions in Australia under Section 25-90 of the ITAA 1997. In dispute were deductions claimed between 2004 and 2006 by Orica Ltd as head company of the consolidated group of which OFL was a member. Deductions for the years in dispute amounted to AUD88.65m.

With the exception of a USD48,999,338 dividend paid on the redemption of the Series B Redeemable Preference Shares, no dividends were paid to OEH on any of the preference shares issued by OUSSI under the scheme.

The expert evidence before the court was that the scheme improved the reported profits over the re-recognition period. The three consequences of the arrangement were:

- A cumulative reduction of AUD33.8m in the income tax expense recognized on the payment of interest by OFL to OUSSI,
- An increase of AUD45m in the income tax expense of OUSSI, and
- A cumulative reduction in the income tax expense of OUSSI, equal to the increased amount, by bringing into account the unbooked benefits of the tax losses.

The Commissioner submitted that the deduction under Section 25-90 for interest paid by OFL to OUSSI was a tax benefit to which Part IVA applied.

Part IVA contains anti-avoidance measures, intended to have been drafted widely to give a large degree of discretion to the Commissioner of Taxation to disregard an arrangement and either include an amount in a taxpayer's assessable income or disallow a deduction.

In *Orica Ltd*, the court ruled, on December 7, 2015, that the deduction claimed by Orica under Section 25-90 of the ITAA 1997 was a tax benefit to which the general anti-avoidance provisions contained in Part IVA of the 1936 Act applied.

In its statement released on March 17, 2016, the ATO explained: "The ATO considers the decision to be consistent with the established case law on Part IVA and the penalty provisions. The case shows that the anti-avoidance legislation is capable of defeating artificial or contrived arrangements that shift taxable profits out of the Australian tax base."

"The ATO will give close attention to schemes that exhibit similar features; namely schemes in which, in effect, entities inject capital into foreign subsidiaries and then borrow the funds back again at interest, where the interest is said to be deductible under Section 25-90 of the ITAA 1997. Typically in these schemes the corresponding income from the interest flows is for some reason not taxed anywhere at a comparable rate. We informally refer to these schemes as 'loan-ups'."

"As well as Part IVA, some 'loan-up' schemes currently under examination raise questions as to whether the conditions for deducibility in Section 25-90 of the ITAA 1997 are met. In particular, the ATO may question whether the requisite income-generating purpose is genuinely present, especially if the scheme seems incapable of generating a positive net return for the borrower. This issue was not raised in *Orica* but it might be in future cases."

The response to the December 7, 2015, judgment was released on March 17, 2016.

https://www.ato.gov.au/law/view/view.htm?docid=%22LIT%2FICD%2FVID43-48of2015%2F00001%22

Australian Federal Court: *Orica Ltd v. Commissioner of Taxation [2015] FCA 1399*

Sweden

Sweden's Administrative Court of Appeal has ruled in favor of NetEnt AB, a provider of software to the online gaming industry, in its dispute with the Swedish tax authority concerning certain transfer pricing arrangements.

The Swedish Tax Agency, Skatteverket, imposed additional tax of approximately SEK94.4m (USD11.3m) on NetEnt in January 2013 following an audit of the company's accounts for the tax years 2007–2010.

According to the firm, the assessment was based on an adjustment of transfer pricing arrangements between the group's Swedish parent company, Net Entertainment NE AB, and its Malta-based subsidiary, which is responsible for sales, marketing, customer support, and hosting.

Insisting that it "has followed applicable laws for taxation of its operations," the company appealed the assessment and a later ruling by the Administrative Court, which supported Skatteverket's conclusions. However, the ruling by the Administrative Court of Appeal on March 10 reversed the Administrative Court's decision.

Because it was confident in its legal position, the company said that it has not made any provision for additional taxes in its accounts, and therefore the ruling will not impact its reported earnings or financial position. However, NetEnt was awarded costs of SEK1.8m.

https://www.netent.com/en/administrative-court-of-appeal-rules-in-netents-favor-in-tax-dispute/

Sweden's Administrative Court Of Appeal: *NetEnt AB (publ) v. Skatteverket*

United Kingdom

HM Revenue & Customs (HMRC) has welcomed a court ruling against a major tax avoidance scheme used by banking giants UBS and Deutsche Bank. The agency successfully argued that the scheme had been designed to avoid around GBP135m (USD194.1m) in tax.

The scheme saw bankers receive their bonuses in the form of shares in specially created companies, rather than cash, in the hope that the initial award of the shares and their subsequent redemption would be exempt from Pay As You Earn (PAYE) tax and National Insurance Contributions

(NICs). HMRC challenged the arrangements on the basis that the shares were taxable as money's worth and not exempt from PAYE or NICs.

The Supreme Court ruled in HMRC's favor and HMRC has confirmed that it will now pursue a further GBP30m in tax from 27 other users of similar schemes.

The Financial Secretary to the Treasury, David Gauke, announced: "This is an important victory and confirmation from the UK's highest court that tax avoidance is simply unacceptable. The UK is home to some of the world's most successful banks and we have been clear we expect them and their employees to pay their fair share of tax."

Jennie Granger, Director General for Enforcement and Compliance, HMRC, said: "This is another important success for HMRC against an avoidance scheme with the top court in the country confirming our view this scheme did not work. This is the latest in a series of successful HMRC challenges to such schemes marketed at wealthy individuals to get out of paying tax. We will continue to challenge artificial arrangements such as these in the interests of the vast majority of businesses and people who choose to play by the rules."

This judgment was released on March 9, 2016.

https://www.supremecourt.uk/cases/uksc-2014-0151.html

UK Supreme Court: *UBS AG v. HM Revenue and Customs [2016] UKSC 13*

Dateline March 24, 2016

It's funny how when finance ministers miss their fiscal targets it's always somebody else's fault. According to Chancellor of the UK Exchequer George Osborne, global economic factors are to blame for his latest failure to bring down the **United Kingdom's** public borrowing requirement. And of course, as Prime Minister Cameron's frontbenchers are wont to point out on a regular basis, if the previous Labour government hadn't been so spectacularly incompetent, Britain wouldn't be in the fiscal hole that the Tories are currently trying to dig it out of.

For Labour's part, the ballooning of the UK budget deficit to double-digit figures in 2008/09 and the mushrooming of the country's public debt was all the bankers' fault. Nothing to do with a half-baked financial regulatory system. Oh, no, no. Gordon Brown was busy trying to "save the world" back in the dark days of '08 and '09, so perhaps history will forgive him for taking his eye off the ball at home. Then again, maybe not.

Anyway, as you've probably spotted, it was budget time in the UK last week. Or perhaps it passed you by. After all, they're becoming about as commonplace as red buses in Oxford Street nowadays.

After last December's "Autumn Statement" (to all intents and purposes, a mid-year Budget announced in the winter), last summer's post-election Budget, and the swansong Budget of the former Lib-Con coalition last spring, this is effectively the fourth Budget delivered by Osborne in the space of a year. He must be all budgeted-out by now. We certainly are. Not that the youthful Osborne is showing any signs of becoming jaded. You'd think he'd be running out of ideas at this point, but the rabbits continue to come thick and fast.

However, once again, Chancellor Osborne leaves me in a bit of a quandary. For while there's stuff in the 2016 Budget worthy of praise, as ever with George, it's a case of good and bad – and I dare say ugly as well. If you run a small business in the UK, or are planning to, you're probably quite happy. The additional corporate tax cut was also a surprise, as was the decision to slash capital gains tax. Then again, you can have too much change. A recent survey by KPMG concluded that the UK is now second only to Ireland in terms of tax competitiveness. But that same survey said that tax rates were fairly low on the list of things businesses consider when measuring up the merits of various jurisdictions. First was stability. Second was information about changes. Third was simplicity. Tax rates came in fourth.

There are also nagging doubts about the public finances. The budget deficit, at 4.4 percent in 2015, is higher than Greece's, and some analysts are skeptical of Osborne's claim that the books will be balanced by 2020.

All things considered, the Budget is just about worth praising, given the fact that the UK's attraction to foreign investors will probably be further enhanced. But it's qualified praise. Maybe it's time to leave the rabbits in the hat for a while, George, and take stock. And, really, when are you going to get the deficit down?

Another country that feels like it's often in a state of flux is **Ukraine**, although sometimes this is for much more sinister reasons than the mere tweaking of tax policy. However, just how this unfortunate country will emerge from its tug-of-war between East and West, between Moscow and Brussels, is difficult to foresee at this stage. At the moment, the country has a Western-facing Government that is trying to implement long-overdue economic reforms and which has long-term aspirations to become a member of the European Union. The conclusion of an Association Agreement with the EU, which includes the Deep and Comprehensive Free Trade Area, under which the country will align many of its regulations and standards with Europe, represents a major step towards Ukraine's modernization. A newly approved and comprehensive economic reform plan should also help Ukraine along this road.

However, the path is likely to be a long and tricky one. For the seventh year in a row, Ukraine registered Europe's lowest levels of economic freedom in 2016, according to the Heritage Foundation, which also found that corruption is still widespread, and the rule of law patchy to say the least. With the conflict unresolved in the east of the country, economic uncertainty persists, and the economy plunged by 11 percent last year. What's more, the continuing dominance of inefficient state industries hinders private sector growth. These are hardly prime conditions to nurture an economic renaissance, although you can't knock the Government for trying. The key question is: how long will Vladimir tolerate Ukraine's dalliance with the West?

The Jester