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a closer look

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

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

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GLOBAL TAX WEEKLY
a closer look

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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Reshaping Our Thinking: The New EU After Brexit

by Withers

The effect of the UK's referendum on membership of the EU has been felt around the world and has generally been met with caution, as individuals and businesses wait to see how the negotiation process will take shape. While we understand the motivations for this careful approach to the wide range of uncertainties in the international markets, we also perceive many short- and longer-term opportunities to capitalize on the dramatic impact of Brexit and aim to help you understand the related risks and prospects, especially following the delivery by Prime Minister Theresa May on January 17 of a somewhat more detailed outline of the Government's plans in this area.[1]

Corporate Tax Issues

Customs Duties

On Brexit, the UK will stand outside the existing EU customs union with all the other EU member states. Unless an alternative arrangement is negotiated, exports of goods to EU countries will become liable to EU customs duties and import VAT in the destination state. Imports of goods from the EU to the UK would likewise become liable to VAT and duties. Also, the UK would have no access to any preferential terms of export existing between the EU and third countries outside the EU.

VAT

While the UK as a non-EU member state has no obligation to maintain a VAT system, its abolition is impossible to envisage as it is responsible for 18 percent of all UK tax revenue. However, future decisions on VAT by the European courts would cease to be binding on the UK interpretation of VAT. There would be more flexibility in applying zero-rates and exemptions. The minimum rate of 15 percent under EU law is currently fixed at 15 percent, which restriction would no longer apply after Brexit.

As a practical matter, VAT compliance obligations for many businesses would be increased. Supplies across Europe would be more complex as the current "one stop shop" arrangements would end and a business would need to register in every member state in which it did business rather than in a just a single member state.

Corporation Tax

While direct taxes are within the competence of each member state, direct tax rules are still required to comply with EU legal principles such as freedom of establishment. UK direct tax rules on group relief and transfer pricing have been changed to fit in with these principles. Further such changes will now be unnecessary. Also, pressure by the EU to move towards a common consolidated corporate tax basis on which corporate profits would be assessed will no longer be relevant to the UK.

In practice, many of the amendments made to the UK tax code resulting from EU membership have been measures that are positive for business and supported the objective of making the UK an attractive place to do business in the G20. It seems unlikely that any government would wish to do anything that made significant changes to the UK's business-friendly image combined with a low corporation tax rate (20 percent, to become 17 percent by April 1, 2020).

Withholding Taxes

The EU Parent/Subsidiary Directive and the Interest and Royalties Directive will cease to apply on exit. This has potentially serious implications because it could make the UK a far less attractive holding company location. Dividends, interest and royalties paid up to the UK by an associated company in another member state (or Switzerland) may now be subject to withholding tax in the source state.

In many cases it will be possible to rely on a double taxation agreement between the source state and the UK to eliminate or reduce any withholding taxes, but this will not always be the case. For example, dividends paid by a wholly owned German subsidiary to a UK parent company could currently be paid without withholding tax using the Parent/Subsidiary Directive. However, on Brexit such dividends will be liable to withholding tax of 5 percent.

The UK itself does not under its domestic law impose withholding taxes on outbound dividends, so in this context Brexit is irrelevant. However, a 20 percent withholding tax does apply to interest and to some royalties. Again a double taxation agreement (of which the UK has a large

network) may help the position, but in some cases there will be real negative consequences. For example, a UK subsidiary paying interest to a Cypriot parent company will be required to withhold tax from interest at the rate of 10 percent, as the interest article in the agreement between the UK and Cyprus only reduces withholding tax from 20 percent to 10 percent.

Transfer Taxes

The UK would be free to impose capital duty in new share issues and increase stamp duty charges in the issue of shares to depositaries. However, such changes seem in practice very unlikely to occur.

State Aid

This relates not only to tax. However, in the tax sphere, the state aid rules have prevented the UK providing benefits that give an advantage to UK residents over non-residents, which in turn has prevented giving a competitive advantage to UK residents over residents of other EU member states.

Merger Directive

This Directive allows cross-border reorganizations for companies operating in the EU, enabling taxes to be deferred. The Directive is already enshrined in UK law and is unlikely to be changed immediately. However, there would be nothing to stop the UK making changes in the future.

Social Security Contributions

Under existing rules, UK workers employed to work in another EU member state are only required to pay contributions in one member state. Following Brexit, these rules will not apply, thereby potentially generating a double charge to contributions which in practice would be passed back to employers to satisfy.

Brexit Myth-Busting: Other Issues

The lead up to the UK's referendum on EU membership was characterized by contradictory claims and resulted in widespread confusion among businesses. This has continued post-vote, which is frustrating for businesses trying to process the results of the referendum and to formulate strategies to move forward.

There is simply no precedent for this situation, and we cannot claim to know what will happen in the months ahead. However, we can offer clear guidance on some of the most unhelpful

misconceptions that have been circulating about Brexit. With a firmer grasp of the facts in the current environment, we hope that you will be able to do business with more confidence. As with any market volatility, we believe that every crisis creates risks and opportunities, and we aim to provide pragmatic advice to navigate such situations.

Corporate Operations And M&A

- The UK will remain a top place to do business for UK and European companies who wish to invest in the US, Asia, the Middle East, and Russia.
- Bilateral treaties between the UK and each of the EU member states will remain in place and are likely to be reinforced.
- A number of countries – including the US under President Trump, if recent reports are to be believed – have stated that they will seek to conclude trade treaties with the UK, especially in the agricultural sector where the UK's existing EU treaty commitments currently restrict trading opportunities for non-EU countries. Some businesses will be preparing to take advantage of the increased opportunities for trade on offer.
- Companies are expected to push ahead with M&A activity if there is a good investment or strategic rationale, especially if the transaction is largely UK focused.
- Some foreign businesses will consider whether to invest (including on large cap-ex projects) in the UK until the terms of Brexit become clearer.
- There will also be other opportunities. For example, the short-term fall in sterling has seen some foreign businesses take advantage of what might be a brief investment window to acquire or establish businesses in the UK.
- The current uncertainty may help businesses negotiate more favorable terms with their counterparts, especially if the relevant transaction has not yet completed. Businesses should review their contracts and consider whether Brexit might trigger a material adverse change or *force majeure* and the contract's continued effectiveness.

Immigration

- Freedom of movement within the UK and EU remains the same until the former leaves, and further border controls will not be imposed until this time.
- We expect that transitional provisions will be introduced for European Economic Area (EEA) nationals and their family members already in the UK who have not yet been here long enough to have acquired the right of permanent residence. These transitional provisions will be for two years after the UK gives formal notice to the EU or longer by mutual agreement.

Banking And Finance

- The Bank of England has confirmed it will take appropriate measures to underpin market confidence and demand in the real economy and provide cheap funding to banks.
- Banks will need to lend despite the uncertainty and will continue to do so, albeit loan-to-cost ratios may be lower in the short term.
- Market volatility could affect the value of collateral supporting margin loans and other similar facilities. Consideration should be given to hedging arrangements to mitigate volatility.
- International banks currently see no change in their lending profiles.

Financial Services Regulation

- Until Article 50 is triggered and the two-year negotiation period expires, it is business as usual for compliance. Firms will continue to be subject to Single Market regulations and should continue to work on MiFID II implementation at the beginning of 2018.
- The Alternative Investment Fund Managers Directive (AIFMD) creates a Single Market for the management and marketing of hedge, private equity, venture capital and other unregulated funds. This is one piece of EU legislation that extends the availability of the "passport" to managers established in non-EEA countries. The granting of this passport depends largely on equivalence, and, as the UK has fully implemented AIFMD, there is no reason to think that the UK would not be granted prompt access to the EU market for unregulated funds.
- From 2018, MiFID II will expressly permit non-EEA, third country firms to provide investment services or perform investment activities on behalf of EEA professional and institutional customers on a branch or cross-border services basis.
- While it is business as usual for now, it may be prudent to consider the timing of any prospectus, public offering of debt or equity securities to take advantage of the favorable passporting arrangements that currently apply within the EU.
- Public companies may need to consider whether to make additional risk factor or other disclosures as to the likely impact of Brexit on their operations and financial statements.
- Given the globalization of the capital markets, if the center of influence shifts from London as a key financial center to Germany, for instance, it may give European companies trying to access public capital further cause to look to their local stock exchanges.

Data Protection

- UK Data Protection Act and Privacy & Electronic Communications Regulations (which implement and reflect the EU Data Protection and ePrivacy Directives) remain fully in place for at least another two to three years.
- It is extremely unlikely that we will see a departure from EU-style data protection laws, as this would be a pre-requisite to any form of trading relationship with the EU/EEA.

Intellectual Property

- The EU has attempted to harmonize certain IP laws through various Directives and Regulations, but we expect existing English laws regarding copyright, trademarks, designs rights and database laws that implement EU Directives to remain unaffected. However, when the terms of Brexit are finalized, the potential changes to pan-EU IP rights and enforcement need to be considered as part of any IP portfolio strategy.
- Many international conventions that affect IP law are not EU derived (*e.g.*, the Berne Convention; the World Trade Organization "TRIPS" agreement; the Madrid System in respect of "international trademarks"; and the "European Patent" and Patent Co-operation Treaty).
- Five key areas that need to be addressed in any Brexit negotiations and monitored by companies are:
  - **Current EU Registered Rights:** The EU Trade Mark and EU Registered Designs system administered by the EU IPO provides a single registration covering all 28 EU member states. If this no longer extends to the UK, then UK national registration and continuing protection for the "UK rights" element should be considered at the appropriate time. If the UK exits the EU IPO regime, some form of transitional relief for existing EU registrations where the owner wishes to still protect their UK rights would be a reasonable likelihood (*e.g.*, the option to "grandfather" an EU registration into both an EU and UK registration).
  - **The new EU Unitary Patent:** Brexit will probably not affect the current UK patent system. However, the proposed agreement for an EU Unitary Patent and Unitary Patent Court (UPC) which was due to be ratified by the UK this year to take effect, will almost certainly be delayed.
  - **Unregistered Community Designs (UCDs):** UCD rights are a product of EU Regulation creating a right that covers all of the EU. Post-Brexit, this may no longer apply in the UK. The UK has an unregistered UK design right, although this is different in scope and length of protection so we are likely to see amendments to the UK designs regime as a response at some point.
  - **IP Enforcement:** Depending on the type of Brexit arrangements, the UK may no longer be a party to the Brussels Regulation (as recently recast), which deals with allocation of

jurisdiction and the enforcement and reciprocity of judgments across the EU member states, which may make questions of this nature more complicated. It also remains to be seen how Brexit affects IP enforcement strategy and the use of English governing law or jurisdiction in contracts. Longer term, we could gradually see rulings from the EU courts no longer influencing English court decisions on IP issues. "Exhaustion of rights" rules may also be impacted.

- **Licensing and Other IP Agreements:** Any licenses or other agreements covering "EU" rights or that grant rights on an EU wide basis (*e.g.*, taking IP as security) which are intended to include the UK will need to be revisited and amended.

Disputes And Contractual Relations

- There will be no changes to existing dispute resolution procedures until the UK officially exits the EU. At that point, many procedures that have been applied throughout the EU may need to be replaced with domestic rules.
- Some of the current benefits of cross-border judicial cooperation may be preserved if a position in relation to the EU akin to that of Norway, Switzerland and Iceland can be secured.
- Those trading or dealing with counterparties in the EU should review their existing contracts to ensure that the dispute provisions still continue to be effective.
- Those negotiating contracts over the next few months should consider preferring arbitration to resolve any disputes to ensure a more certain enforcement route. The benefits of international enforcement of arbitration awards under the New York Convention are unaffected by Brexit.
- Parties should assess whether their existing choice of jurisdiction and law to govern their contractual disputes is recognized by EU member states. UK parties may no longer have any protection against parallel court proceedings being started against them elsewhere in the EU.
- The extent of cooperation with other member states in the liquidation of multinational companies and in cross-border bankruptcies will change.

Financial Services – Cross-Border Operations

Impact For Single Market Firms

A significant proportion of institutions regulated by the UK Financial Conduct Authority enjoy "passport" rights under one of the EU single-market financial services directives, allowing them to provide services or establish a branch on a cross-border basis in other EEA member states, without having to obtain fresh licenses in those "host" states.

The decision to leave the EU now poses a major question for these firms, which is whether their passport rights will be maintained and how they might provide services to clients or operate in the rest of the EU.

The current passport rights include:

- The Markets in Financial Instruments Directive ("MiFID"), in respect of investment managers;
- The Undertakings in Collective Investments in Transferable Securities ("UCITS") and Alternative Investment Fund Managers ("AIFMD") Directives, for fund managers;
- The Capital Requirements Directive ("CRD") and Regulation ("CRR"), for banks;
- The Solvency Directives, in respect of insurers.

Consumer credit providers are not entitled to a passport, so a lender from another EU member state who currently wants to offer loans to borrowers in the UK would need to set up a UK establishment and apply for authorization from the FCA.

Endnotes

1 https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech

2017 Tax Changes In Russia

by Anna Strelnichenko, Yulia Kolesnikova and Dmitry Nikolaev, EY, Russia

Main Changes In Tax Law Effective From 2017

This article presents an overview of the main changes in tax law that are to take effect in 2017.

The main tax law amendments adopted in 2016 included changes in the VAT treatment of electronic services, new requirements for confirming the status of the actual recipient of income for the purposes of applying tax treaty benefits, and substantial changes to the tax treatment of oil and gas companies. The year was rounded off by a series of Tax Code amendments adopted at the end of November. Below is a summary of the most significant corporate tax changes due to take effect in 2017.

Key Profits Tax Changes

The Federal Law "Concerning the Introduction of Amendments to Parts One and Two of the Tax Code of the Russian Federation and Certain Legislative Acts of the Russian Federation" [1] ("the Law"), which we discussed in detail in November 2016,[2] was signed and published on November 30, 2016. The main changes laid down in that Law include the following:

Limitation Of The Carry-forward Of Prior Year Losses

The Law limits the carry-forward of losses made in past periods to no more than 50 percent [3] of the tax base for the current accounting (tax) period calculated net of prior year losses. This measure will have an adverse impact on taxpayers, as it means losses being recognized at a slower rate than under the current rules. To compensate for this negative effect, the existing ten-year time limit on loss recognition is to be abolished. The carry-forward limitation also applies to losses made on transactions involving non-negotiable securities and non-negotiable derivatives.

The limitation came into effect from January 1, 2017 to December 31, 2020 in relation to losses made from January 1, 2007 onwards.

Limitation Of Loss Recognition Within A Consolidated Group Of Taxpayers (CGT)

The Law limits the amount by which the consolidated tax base of a CGT may be reduced by losses of loss-making members of the CGT to no more than 50 percent of the sum of the profits of profit-making members. The purpose of introducing this limitation is to help support and replenish regional budgets.

Change In The Correlation Of Profits Tax Rates Between The Federal And Regional Budgets

The correlation of profits tax rates between the federal budget and regional budgets have changed from 2017, with the previous proportions of 2 percent payable to the federal budget and 18 percent to a regional budget becoming 3 percent and 17 percent respectively. The new correlation will be in effect from 2017 to 2020. According to comments made by the Finance Ministry, the measure is aimed at providing support to the least wealthy regions.

At the same time, the measure will cause the minimum rate of profits tax which regions may set for payment to the regional budget to be reduced from 13.5 percent to 12.5 percent.

Penalties

With effect from January 1, 2017, a progressive scale of penalty rates has been introduced, which effectively involves the doubling of the rate to 1/150 of the CBR refinancing rate (which has been aligned with the CBR key rate since January 1, 2016) in the event that taxes are paid more than 30 days late. Penalties will be calculated at 1/300 of the CBR refinancing rate effective in the first 30 calendar days of the delay in payment, and at 1/150 of the CBR refinancing rate effective from the 31 calendar day of the delay onwards.

This increase is aimed at eliminating situations whereby it is cheaper for companies to "borrow" from the state by not paying taxes on time than to borrow from banks.

The rule will apply to arrears arising after October 1, 2017.

Changes To Transfer Pricing Rules

Certain transactions are no longer considered as controlled for transfer pricing purposes as from January 1, 2017. These include transactions involving the provision of surety bonds (guarantees) where all the parties to the transaction are Russian companies and are not banks, and interest-free loan transactions between Russian related entities.

Items Excluded From The Tax Base For Profits Tax

Under the Law, as from 2017 income in the form of services relating to transactions involving the provision of surety bonds (guarantees) will not be taxable if all the parties to the transaction concerned are Russian companies and are not banks.

Other Provisions

- The special provisions of Federal Law No. 32-FZ of March 8, 2015 concerning the application of the thin capitalization rules have been extended until December 31, 2019. The special provisions apply subject to the time limits for the fulfillment of debt obligations remaining unchanged for the entire effective period of the provisions, *i.e.,* until December 31, 2019;
- Provisions have been introduced allowing for taxes to be paid by third parties.

Key VAT Changes

Change In The VAT Rules For Electronic Services Provided By Foreign Companies

The VAT treatment of electronic services provided by foreign companies is changed from January 1, 2017.

According to Federal Law No. 244-FZ of July 3, 2016, sales of electronic services are taxable at the location of the purchaser. The Law establishes a list of operations that are/are not classed as electronic services and rules governing the application and payment of VAT in relation to electronic services provided to companies and individuals.

The VAT exemption for the provision of rights to use software and databases on the basis of a license agreement remains in force.

Termination Of Effect Of A Number Of Classifications

A number of classifications are abolished with effect from January 1, 2017:

- The All-Russian Classification of Economic Activities (OKVED) OK 029-2001 (NACE Rev. 1);
- The All-Russian Classification of Economic Activities (OKVED) OK 029-2007 (NACE Rev. 1.1);
- The All-Russian Classification of Economic Activities, Products and Services (OKDP) OK 004-93;
- The All-Russian Classification of Products by Economic Activity (OKPD) OK 034-2007 (CPA 2002);
- The All-Russian Classification of Products (OKP) OK 005-03.

As from January 1, 2017, companies must use the following classifications: the All-Russian Classification of Economic Activities (OKVED2) OK 029-2014 (NACE Rev. 2) and the All-Russian Classification of Products by Economic Activity (OKPD2) OK 034-2014 (CPA 2008). The classifications of economic activities and products by economic activity which were previously used alongside the above-mentioned classifications ceased to have force from January 1, 2017.

The abolition of multiple classifications brought changes to the lists of goods subject to 10 percent VAT and goods exempt from VAT. Specifically new lists of goods for children subject to 10 percent VAT and goods exempt from VAT were introduced last week, while a new list of medical goods/equipment subject to 10 percent VAT is expected to be introduced shortly.

Change In The Limit On The Volume Of Advertising In Print Publications For The Purposes Of Applying The 10 Percent VAT Rate

The maximum volume of advertising which an issue of a printed periodical may contain while qualifying for the 10 percent rate of VAT on sales will change from 40 percent to 45 percent from January 1, 2017.

Changes Relating To The Conduct Of An In-House Tax Audit Of A VAT Declaration

Taxpayers that file a VAT declaration in electronic form must present explanations in electronic form during the course of an in-house tax audit of that declaration.

VAT Offsets Must Be Reversed Upon Receipt Of Subsidies From All Budgets

Taxpayers will be obliged to reverse VAT offsets upon receiving subsidies not only from the federal budget but from any budget within Russia's budget system.

Change In The VAT Rate For Long-Distance Rail Carriage Of Passengers And Baggage

As from January 1, 2017, services involving the long-distance carriage of passengers and baggage by public railway will be zero-rated for VAT purposes. This provision will have force until December 31, 2029.

Key International Tax Changes

A number of major changes in Russia's tax treaty system occurred in 2016. Below are comments on new and/or amended treaty provisions which have taken effect from January 1, 2017.

Kazakhstan: Abolition Of Apostille Requirement For Residence Certificates

An Agreement in the form of an exchange of notes on the recognition of official confirmations of residence issued by competent authorities of the Republic of Kazakhstan and the Russian Federation ("the Agreement") for the purposes of the Convention between the Government of the Republic of Kazakhstan and the Government of the Russian Federation for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital of October 18, 1998 ("the Convention") entered into force on November 29, 2016.

The Agreement abolishes the compulsory affixing of apostille certificates or consular legalization for residence certificates issued by the competent authorities of the parties. It should be pointed out that the rule applies retrospectively from January 1, 2011.

The retrospective application of the Agreement presents an opportunity for Russian residents whose certificates were not recognized by the Kazakh tax authorities owing to the absence of an apostille or legalization to seek a refund of excess income tax which was paid/withheld in Kazakhstan in past periods in violation of the Convention.

It will be recalled that the apostille/legalization requirement was unilaterally introduced by Kazakhstan in July 2011.[4]

Cyprus: Commencement Of The New Provisions On The Taxation Of Income From The Alienation Of Shares In Companies Deriving More Than 50 percent Of Their Value From Immovable Property

The amended version of Article 4, "Income from the Alienation of Property" of the tax treaty with Cyprus dated December 5, 1998 (as amended by the Protocol of October 7, 2010) was scheduled to take effect from January 1, 2017.

In particular, according to paragraph 4 of that Article, once the amendments take effect, Russia will have the right to tax income of residents of Cyprus from the alienation of shares in companies which derive more than 50 percent of their value from immovable property situated in Russia.

For the purposes of paragraph 4, income from the alienation of shares does not include income from the alienation of shares which is received in the course of the reorganization of a company or income from the alienation of shares quoted on a registered stock exchange.

Income from the alienation of shares is also excluded from the scope of paragraph 4 where it is received by a pension fund, a provident fund, or the Government of a Contracting State.

However, on December 29, 2016, the Cypriot Finance Ministry published a statement to the effect that the competent authorities of Russia and Cyprus had agreed to postpone the application of the new version of the Article. It is also stated that an additional protocol is being finalized according to which the new wording will not apply until similar provisions have been made to other double tax treaties between Russia and European countries.

The Russian Finance Ministry has not commented on the Cypriot Ministry's announcement.

It should be pointed out that an international agreement of the Russian Federation cannot be amended, or its operation postponed, by an agreement between competent authorities, a memorandum of understanding, a Russian Government decree, a Presidential edict, or any other normative act. The postponement of the application of an international agreement and a related protocol can occur only after the conclusion, ratification (through the adoption of an appropriate federal law) and entry into force of a new international agreement or a protocol to an existing agreement. In Russia, those processes usually take between three and six months.

There is therefore uncertainty over what status the revised provisions of Article 4 of the Russia–Cyprus tax treaty will have from January 1, 2017 until the protocol in question has been signed, ratified and put into effect, given that it may have retroactive force, *i.e.*, from January 1, 2017.

China: New Double Taxation Treaty

The new tax treaty with China dated October 13, 2014 (as amended by the Protocol of May 8, 2015) is applied from January 1, 2017.[5]

Hong Kong: New Double Taxation Treaty

The tax treaty with Hong Kong dated January 18, 2016 is applied from January 1, 2017. [6]

Singapore: New Protocol To The Double Taxation Treaty

The provisions of the Protocol of November 17, 2015 amending the tax treaty with Singapore dated September 9, 2002 are applied from January 1, 2017.[7]

Endnotes

1 Federal Law No. 401-FZ of November 30, 2016 "Concerning the Introduction of Amendments to Parts One and Two of the Tax Code of the Russian Federation and Certain Legislative Acts of the Russian Federation."

2 http://www.ey.com/Publication/vwLUAssets/EY-Tax-Alert-17-November-2016-Eng/$File/EY-Tax-Alert-17-November-2016-Eng.pdf

[3] In the original version of the Bill, the limit was 30 percent.

[4] Law No. 467-IV of the Republic of Kazakhstan of July 21, 2011.

[5] More details of the provisions of the new treaty can be found at http://www.ey.com/Publication/vwLUAssets/EY-rtb-january-february-2016-eng/$FILE/EY-rtb-january-february-2016-eng.pdf

[6] *Id*.

[7] More details on the content of the Protocol can be found at http://www.ey.com/Publication/vwLUAssets/EY-RTB-November-2015-Eng/$FILE/EY-RTB-November-2015-Eng.pdf

Switzerland's Corporate Tax Reform III

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New international standards on corporate taxation are changing the face of taxation irrevocably in many parts of the world. Few jurisdictions are experiencing change to such an extent as Switzerland, as it prepares to undergo the largest shake-up of its corporate tax laws for many decades.

Existing System

Due to the federal structure of Switzerland, there is no centralized tax system, with some taxes being levied exclusively by federal authorities whereas other taxes are concurrently levied at cantonal, communal and federal levels. Although the rate of tax imposed at a federal level is consistent, that levied at a cantonal level varies from canton to canton. Because significant differences presently exist in the rates of taxes levied at cantonal level, the choice of canton is an important element in all tax planning.

For corporate income tax purposes, a company is deemed to be resident in Switzerland if it is either incorporated in Switzerland or effectively managed from there. Thus a UK-registered company whose effective seat of management is in Switzerland is a Swiss resident company for corporate income tax purposes.

The General Assessment Rule is that resident companies are assessed on their worldwide income except for profits generated by enterprises, permanent establishments and real estate situated abroad, whereas non-resident companies are only assessed on profit generated by enterprises, real estate and permanent establishments situated in Switzerland, as well as interest on loans secured on Swiss real estate.

Corporate income tax is levied at a federal, cantonal and communal level. The level of corporate income tax payable, as before, varies among the cantons.

The federal corporate income tax rate is 8.5 percent flat. Since income and capital taxes are deductible in determining taxable income, the effective tax rate that a company pays on its profits before deduction of tax is 7.8 percent.

Cantonal tax rates can be levied at rates of up to 24 percent, and like the federal tax are progressive, using a scale based on the relationship of profits to net worth.

Municipal tax on corporate income is calculated as a small proportion of cantonal tax.

The Swiss branch of a foreign company pays the same rates of corporate income tax on profits, income and capital gains as would be paid by a Swiss-resident corporate entity. Profits remitted abroad by the branch are not subject to any tax in Switzerland.

Cantonal Statuses

Tax-privileged operations may take place within the following forms, all of which are variants of the basic stock corporation.

Holding Company

The "holding company" is a stock corporation with a particular tax status. Holding companies benefit from reductions in corporate income tax and capital gains tax at federal and cantonal levels, and from a reduction in net worth tax at cantonal level.

For federal tax purposes, a company is defined as a holding company if it holds either a minimum of 10 percent of the share capital of another corporate entity, or if the value of its shareholding in the other corporate entity has a market value of at least CHF1m (USD1m) (known as a "participating shareholding").

Although the definition of a holding company varies among cantons, broadly speaking a corporate entity is a holding company for cantonal corporate income tax purposes so long as it either:

- Derives at least two-thirds of its income from dividends remitted by the subsidiary; or
- Holds at least two-thirds of the subsidiary's shares.

Generally speaking, foreign dividends remitted to a Swiss company and any capital gains realized by a Swiss company on the sale of shares in a foreign entity in which it holds a stake are taxable in Switzerland unless they are remitted to a company that, under Swiss fiscal law, is defined as a Swiss holding company.

At federal level, a holding company pays a reduced level of corporate income tax on any dividend income received from the subsidiary or the company in which it holds a "participating shareholding." The reduction in the level of corporate income tax payable depends on the ratio of earnings from the "participating shareholding" to total profit generated.

At cantonal or municipal level, no corporate income tax is payable on income represented by dividends so long as the corporate entity meets the cantonal definition of a holding company.

Domiciliary Company

Domiciliary companies are stock corporations that are both foreign-controlled and managed from abroad, have a registered office in Switzerland (*i.e.*, at a lawyer's premises), but have neither a physical presence nor staff in Switzerland. They must carry out most if not all of their business abroad and receive only foreign-source income. The use of domiciliary companies can result in savings in corporate income tax levied on income and capital gains, and in net worth tax liability.

At federal level, there are no tax advantages for a domiciliary company in terms of corporate income tax payable on income and gains. However, at cantonal and municipal level, the corporate income tax rate may be substantially reduced or even reduced to zero; taxes levied by the cantons are calculated according to a formula that relates to the company's paid-up share capital and reserves to profit.

Mixed Company

Mixed companies are stock corporations that have the characteristics of both domiciliary companies and holding companies, but which do not qualify as either. There is no benefit at federal level, but at cantonal and municipal levels there are corporate income tax benefits if the mixed company meets the following conditions:

- The company is foreign controlled;
- A minimum of 80 percent of its total income comes from foreign sources;
- The company has close relationships to foreign entities.

No tax relief is granted to a mixed company at federal level. However, at cantonal and municipal levels, a mixed company may pay reduced tax or be totally exempt if the above conditions are met.

Reasons For Change

According to the Swiss Government, the corporate tax reform is intended to ensure that Switzerland remains a competitive domicile in which to locate certain company activities. However,

to a large extent, the Swiss have been pressured into the changes, first by the EU under its Code of Conduct for Business Taxation, and then by the OECD as it progressed its base erosion and profit shifting (BEPS) work.

As the Swiss Federal Tax Administration observed in its recent statement on the matter: "The aim of the corporate tax reform is to consolidate international acceptance of Switzerland as a business location and secure the legal framework." [1]

Until recently, Switzerland and the EU were in fact at loggerheads on the issue of corporate tax for several years. However, attitudes to tax avoidance and secrecy laws have hardened since the financial crisis, and a series of tax evasion scandals involving wealthy foreign clients of Swiss banks in recent years has turned the focus on Switzerland and its tax laws like never before.

A critical juncture in the history of Swiss tax reform came in June 2014, when the Swiss accepted the EU Code of Conduct on Business Taxation. Jurisdictions recognizing the Code must, among other things, roll back tax measures deemed "harmful" and commit to not introducing new ones. This represented a major coup for the EU in its fight against tax avoidance.

Confirming the agreement, the Swiss Government announced at the time that, "during its meeting [on June 20, 2014], the Federal Council gave the go-ahead for the initialing of a mutual understanding between Switzerland and the EU on business taxation. On the EU side, the Economic and Financial Affairs Council [has also] approved this understanding. The business taxation dialogue between Switzerland and the EU is thus nearing completion."

While this "understanding" contains no state treaty obligations and is limited to the listing of principles and "mutual intentions," the Federal Council as a consequence affirmed its intention to abolish certain tax regimes, namely holding, domiciliary, and mixed companies within the framework of Corporate Tax Reform III (CTR III), particularly with reference to the different treatment of domestic and foreign revenue (so-called "ring-fencing").

A joint statement reaffirming Switzerland's commitments was initialed by Switzerland and EU member states in July 2014, and signed in October 2014.

Corporate Tax Reform III

The package of measures known as CTR III was approved by the Swiss Federal Council, the seven-member executive council that constitutes the federal government of Switzerland, on April 2, 2014, and by parliament in June 2016.

As highlighted in the preceding section, the reform package is an attempt to ensure that Switzerland's corporate tax regime falls into line with new international standards designed to prevent base erosion and profit shifting. To this end, CTR III will abolish corporate tax arrangements that are no longer considered in keeping with international standards, *i.e.*, the cantonal tax statuses for holding, domiciliary, and mixed companies outlined above.

However, the Government is also mindful that cantonal status companies employ around 150,000 people, and contribute about 20 percent to total cantonal and communal revenues. Therefore, the reforms are intended to ensure that Switzerland remains a competitive domicile in which to locate certain company activities, and there is a heavy emphasis on encouraging investment in new technologies and innovation. The main points of the reform are summarized below.

Patent Box

The reforms introduce a patent box at cantonal level (but not at federal level). The regime would offer preferential treatment for revenue from patents and similar rights associated with research and development (R&D) in Switzerland.

The qualifying patent income would be calculated based on a "residual method." This means that all income is considered patent income except the following items:

(i) Financing income;
(ii) Income from manufacturing, trading and other services if not relying upon patents;
(iii) Income from routine functions; and
(iv) Income from trademarks.

An uplift of up to 30 percent of qualifying Swiss costs would be permitted for related foreign R&D expenses (*e.g.*, outsourcing and acquisition costs).

The cantons would be able to exempt up to 90 percent of the patent income from taxation for cantonal/communal tax purposes, potentially giving an effective tax rate on such income of 10 percent.

It is intended that the Swiss patent box regime will follow the modified nexus approach set out by the OECD under Action 5 of the BEPS recommendations and agreed to by numerous countries.

R&D Deduction

The reforms give the cantons the option of introducing a 'super deduction' of up to 150 percent of qualifying R&D expenditure incurred in Switzerland. Expenses related to R&D activities

performed abroad are excluded from the increased tax deduction. This measure will not be applied at federal level.

Notional Interest Deduction

The final version of the CTR III includes the introduction of a notional interest deduction on "surplus equity." This measure is intended to align the tax treatment of debt and equity financing, and replaces proposals in a previous version of the reforms for an interest-adjusted corporate income tax.

The measure will allow a taxpayer to deduct deemed interest from a defined equity basis. The amount of the deduction will depend on asset class, and the notional interest rate will be based on the yield of Swiss ten-year federal bonds. However, deductions will not be permitted on qualifying participations, assets not commercially required, patents qualifying for the patent box, released untaxed hidden reserves, and assets connected to an "unjustified tax benefit."

The introduction of this measure will be mandatory at federal level, and optional for the cantons. Those cantons adopting this measure would ensure that at least 60 percent of dividends received by individuals from qualifying participations of at least 10 percent is subject to income tax. At present, the majority of cantons tax only 50 percent or less of individuals' dividend income.

Cantonal Corporate Tax Rates

The reform affords cantons the flexibility to adjust their own corporate income tax rates. Indeed, some cantons are already considering corporate tax cuts to ensure that they remain competitive when special tax statuses are phased out. These include Geneva, which has announced plans to gradually reduce its headline corporate tax rate from 24.2 percent to 13.49 percent; Vaud, which passed a resolution in March 2016 to reduce its corporate tax rate to 13.78 percent; and Zug, which has proposed cutting corporate tax from 14.6 percent to 12 percent.

Overall Limitation At Cantonal Level

Under the reforms, no canton will be permitted to use the patent box, R&D super deduction or notional interest deduction to reduce a company's taxable income by more than 80 percent. Cantons are, however, free to set a reduced level of maximum deductions (and thereby increase the minimum amount of income subject to tax).

Transition/Step-up

"Step-up" measures will be mandatory at cantonal level to ease the transition from tax-privileged regimes which are being abolished to ordinary cantonal taxation. These would allow

taxpayers to release hidden reserves at lower rates for cantonal/communal tax purposes within a period of five years.

Similarly, a step-up rule will be introduced for companies migrating to Switzerland, allowing for a tax neutral declaration of hidden reserves.

Additional Measures

In other measures, the issue tax on equity capital will be abolished, and the cantons will be given the option to introduce targeted capital tax deductions.

Fiscal Equalization

The tax reforms will, however, result in an adjustment to the "fiscal equalization mechanism," which governs the distribution of revenues between the federal and cantonal governments. As a result, the cantons' share of direct federal tax is to be increased from 17 percent at present to 21.2 percent. The Federal Council estimates that the impact of the reforms on the federal finances will be approximately CHF1.1bn a year.

Introduction

It is expected that the CTR III measures will be introduced in January 2019. However, the legislation must first be validated by a referendum, which is due to be staged on February 21, 2017.

Evaluating The Reforms

The Federal Government is of the belief that the reforms strike the appropriate balance between international acceptance, competitiveness, and fiscal flexibility for the cantons. However, it is emphasizing the tax benefits for companies prepared to innovate, as reiterated by the Federal Department of Finance in an October 2016 media release: [2]

> "Regarding the tax law measures which are being introduced with the CTR III, the focus is on promoting innovation. The aim of the patent box is to tax patent revenue at a lower level. For [R&D] expenditure, the reform makes provision for a deduction to be made which goes beyond the actual costs. This will create an incentive for high value-added jobs which are associated with these activities to be retained in Switzerland or relocated here. …
>
> Overall, the reform will lead to Switzerland remaining an attractive location for companies and to each canton being able to tailor its tax policy to its economic and

> financial situation. The reform will prevent the exodus of the existing status companies and thus potential tax losses of over CHF5bn for the Confederation, the cantons, and the communes."

In evaluating the reforms in its latest Article IV Mission, the International Monetary Fund (IMF) largely concurred with the Government's view,[3] noting that: "These efforts to increase transparency in the financial sector help to level the playing field across participating countries while also protecting the integrity of Switzerland as an international financial center."

The IMF added that tax reforms will "help realign the corporate tax code with ongoing international initiatives to counter base erosion and profit shifting while preserving [the] competitiveness of [Switzerland's] corporate tax regime."

What's more, harmonizing the taxation of domestic and foreign firms under CTR III "will reduce disincentives that may have discouraged smaller firms from investing and growing their business," it suggested.

The IMF also agrees that the reforms could boost investment by small and medium-sized firms in particular. However, there could be negatives for both the Government and foreign companies, with the former likely to experience "some revenue loss," and the latter expected to see a slight increase in their tax burden.[4]

To buoy the nation's finances, in early 2017, Switzerland is expected to agree an increase to the VAT rate of around 1 to 1.5 percent, alongside a higher retirement age for women under plans to bolster pension provisions. However, the report concluded that the country's medium-term fiscal goals can be met without "an undue increase in taxes."

Nevertheless, many multinational corporations (MNCs) are concerned that the key benefits of operating in Switzerland are at risk, according to a survey carried out by KPMG last year.[5] In reaching its conclusions, KPMG surveyed more than 850 foreign-owned MNCs with operations in Switzerland, working with the IMD World Competitiveness Center, Switzerland Global Enterprise, and the Swiss-American Chamber of Commerce.

According to KPMG, MNCs' "decision to locate their key value drivers in Switzerland is inextricably linked to their tax planning." Of the respondents, 68 percent said that Switzerland's attractive tax system was a factor in their decision making, with a majority of participants benefiting

from a privileged tax status. In addition, 40 percent of MNCs located in Switzerland are subject to the standard tax rate for at least part of their income.

KPMG said that while MNCs generally approve of the CTR III program, some doubt that the package will be implemented effectively. Only 42 percent of respondents to the KPMG survey believed that a competitive tax system will be one of Switzerland's main advantages over the medium term. Fifty-eight percent said they expect Switzerland will be forced to adopt increasingly restrictive international tax standards as developed by the EU and the OECD.

Conclusion

From recent polling data, it seems likely that CTR III will be approved by voters. But given that the reform has been described as the largest shake-up of corporate taxation in Switzerland for half-a-century, what impact will it have when it is fully in place?

From a fiscal point of view, the tax changes are forecast to reduce tax revenue at the federal level, and there are worries that the shortfall could lead to increases in taxation elsewhere. If the IMF's analysis is correct, the revenue impact of CTR III in the medium-term will be minor. But from the perspective of companies operating in Switzerland, it would appear that CTR III is a mixed blessing.

Small companies carrying out extensive R&D and investment are expected to benefit overall, thanks to the incoming cantonal patent boxes and the R&D super deduction. The reforms also allow the cantons room to adjust corporate taxes, and it is anticipated that others will follow the lead of Geneva, Vaud, and Zug and cut corporate tax rates as they compete for investment.

For foreign companies in Switzerland on the other hand, the loss of special cantonal tax statuses is expected to lead to an increase in taxation. Although, as the IMF predicted, the additional tax burden on foreign companies is likely to be relatively small.

KPMG's survey suggests that a significant proportion of MNCs believe that, on balance, CTR III will contribute to a loss in Swiss competitiveness going forward as the country further aligns with international standards under the BEPS banner. This may well turn out to be true. But Switzerland's competitor jurisdictions are also implementing measures designed to thwart profit shifting, so perhaps its corporate tax reforms will merely narrow the competitive gap, rather than eliminate it. What's more, as the IMF also pointed out, other non-tax factors attracting foreign companies to Switzerland remain in place.

Time will tell how MNCs respond to the changes.

Endnotes

[1] https://www.estv.admin.ch/estv/en/home/die-estv/medien/nsb-news_list.msg-id-56784.html

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[5] https://home.kpmg.com/ch/en/home/media/press-releases/2016/11/key-swiss-location-factors.html

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Understanding Apple's Global Tax Strategy In Ireland

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1. Introduction

Apple, Inc. (Apple) is a US-registered domestic corporation in the United States. However, it owns a subsidiary corporation in Ireland and many retail chain stores in Europe. Apple takes advantage of many differences in tax laws between the United States and Ireland, such as tax rates, tax policies and deferral tax. Apple further entered into agreement with the Irish Government for the tax status of its subsidiary corporation and profit allocation scheme, among other entities. As a result, Apple's tax liability in Ireland is reduced to an unusually low level.

On August 30, 2016, the European Commission (the Commission) charged the Irish Government with granting preferential tax treatment and illegal tax subsidies to Apple. It also charged Apple with unreasonable business practice. As a consequence, the Commission ordered Apple to repay USD14.5bn to the Irish Government.[1] This article investigates what is wrong with the Irish government's tax policy and Apple's tax strategies. It further points out Apple's defense.

2. Apple's Tax Problem In Ireland

In 1980, Apple went to Ireland to set up Apple Operations International as a controlled foreign corporation (CFC). It was registered in Ireland as an Irish corporation. Apple Operations International in turn established Apple Sales International as its subsidiary corporation, also in Ireland. Subsequently, Apple Sales International operated eight retail sales stores in several European countries.

In a series of tax maneuvers, Apple entered into an agreement with the Irish Government that treated the Apple Operations International profits in Ireland as foreign-sourced income. The agreement further permitted Apple to use a set of ratios to allocate a subsidiary's profit to its parent company. As a benefit of this agreement, Apple's tax liability in Ireland was substantially reduced – to a bare minimum, in fact.

The Commission charged that the agreement was tantamount to Ireland granting illegal tax subsidies to Apple, distorted competition among all enterprises, constituted discrimination, and was a violation of the European State Aid Rule and the principle of a single European market. Further, the Commission accused Apple of unfair business practice in its allocation of profits among subsidiary corporations, leading to the hefty penalty.

It would be interesting to know why Apple chose to relocate its business to Ireland, as opposed to other countries. What were Apple's global tax strategies? What motivated Apple to seek agreement with the Irish Government? What were the details and consequences of the agreement? Is the agreement actually illegal? What are Apple's operation strategies in Europe? Are these strategies indeed unreasonable as an ordinary business practice? These questions point to Apple's tax problems in Ireland, as will be investigated below.

3. Tax Loopholes In International Taxation

In order to answer the question of why Apple moved to Ireland, it is necessary to compare international tax law in the United States with its counterpart in Ireland. Any differences may point

out the reason for the move. The differences could relate to tax rate, tax policy and tax deferral, as explained below.

3.1. Tax Rate

The current maximum US corporate tax rate is 35 percent, and it has not been reduced since 1993.[2] By comparison, the Irish tax rate has been steadily decreasing, from its high of 36 percent in 1997 to 12.5 percent today.[3] Note that many tax-shelter countries, such as Bermuda and the Cayman Islands, are tax-free.

For example, if Apple sells an iPhone to a customer in Ireland, its profit on the sale is subject to the 35 percent US tax rate because it is a US corporation. Alternatively, if Apple relocated itself to Ireland and sold the same iPhone to the same customer in Ireland, the profit on the phone would be subject to the much lower 12.5 percent Irish tax rate because Apple would then be an Irish corporation. This example shows that, instead of producing the iPhone in the United States and then selling it to a customer in Ireland, it would be more profitable to perform the same duty in Ireland. That is why the attraction to Ireland is simply irresistible. (Many US companies have moved to lower-tax domiciles recently; the phenomenon, called "corporate inversion," is beyond the scope of this article.)

In fact, the 35 percent US corporate tax rate is the highest in the world other than the 37 percent rate in Japan. The next is France with 34 percent, China 25 percent, Great Britain 20 percent, and Canada 15 percent. The 12.5 percent rate in Ireland is the lowest among industrialized countries.[4] Given the massive difference in the tax rates of the United States and Ireland, it should not be a surprise that Apple moved to the latter.

3.2. Tax Policy

How should the income that Apple in the United States derives from other countries be taxed? Likewise, if Apple moves to Ireland as an Irish corporation, how should income that it earns from other countries be taxed? There is a big difference between the United States and Ireland in this respect.

In the United States, both domestic-sourced income and foreign-sourced income are taxable. This is known as a "worldwide income tax policy." In other words, the United States imposes income tax on the entity that earns the income, regardless of where the income is earned. Any taxpayer in the United States is subject to US taxation on all sources of income.

In Ireland, on the other hand, only income from Ireland is taxable, while income from other countries is tax-free. This is called a "territorial income tax policy."

Therefore, from a taxpayer's point of view, a territorial income tax policy creates more profits than does a worldwide income tax policy. Throughout the world, only the United States and China have the latter, while the rest of the world employs the former.[5] Irish tax policy offered a great incentive for Apple to move to Ireland, so Apple took advantage of it.

If Apple in the United States sells an iPhone to a US customer and another iPhone to a customer in China, the profits on both are taxable in the United States at 35 percent because the United States employs the worldwide income tax policy. The profits on the iPhone sold to the customer in China are also subject to taxation in China at 25 percent, although the Chinese tax can be claimed as a tax credit against Apple's tax liability in the United States. Since the US tax rate is greater than its Chinese counterpart, this iPhone is actually taxed at 35 percent.

If Apple moves to Ireland and sells an iPhone to a customer in Ireland and another iPhone to a customer in China, what is taxable in Ireland? Only the iPhone sold to the customer in Ireland is taxable in Ireland, and at only 12.5 percent, while the iPhone sold in China is not taxed because Ireland employs the territorial income tax policy. The iPhone sold to the customer in China is still subject to taxation in China at 25 percent, although the Chinese tax can be claimed as a tax credit against Apple's tax liability in Ireland. Since the Irish tax rate is now zero, this iPhone is eventually taxed at 25 percent.

This situation can be depicted clearer in Table 1:

TABLE 1. TAX ON FOREIGN-SOURCED INCOME

	iPhone to U.S.	iPhone to Ireland	iPhone to China
As a U.S. corporation	35%	—	35%
As a Irish corporation	—	12.5%	25%

In comparison between these two corporations, the difference in tax amounts is the tax liability for the iPhone sold to the customer in the United States and the iPhone sold to the customer in Ireland, *i.e.*, 22.5 percent (35 percent – 12.5 percent), plus the iPhone sold to the customer in China, *i.e.*, 10 percent (35 percent – 25 percent), in favor of Apple had it moved to Ireland.

This example shows that it is more profitable to engage in sale of an iPhone to Ireland than that to the United States. It is also more valuable to sell the iPhone to China from Ireland than that from the United States. This scenario is far more complicated than the previous one because it involves profits from other countries. It shows that the amount of tax savings depends on the differences in tax rates among these three countries.

3.3. Tax Deferral

There is another difference in tax policies between the United States and Ireland. Under the worldwide income tax policy in the former, foreign-sourced income is taxable in the United States. Fortunately, it is not duly taxed until the cash dividends are received from a foreign country. In other words, the tax liability is not payable immediately; instead, it can be deferred. As a consequence, if no cash dividends were ever distributed from a foreign country back to the United States, the worldwide income tax policy would be virtually the same as the territorial income tax policy. A great number of US multinational corporations have taken advantage of the tax deferral policy, and Apple is no exception.

In fact, the amount of untaxed earnings still sitting in foreign countries is not small. To date, it amounts to about USD2 trillion.[6] Apple alone has accumulated USD91.5bn of untaxed foreign earnings.[7] Pfizer has USD74bn,[8] General Electric USD108bn, Microsoft USD60.8bn, Merck USD51.4bn, Johnson & Johnson USD49bn, Medtronic USD18bn, *etc*.[9] These figures demonstrate the magnitude of the benefits from a tax deferral strategy. Apple has certainly employed it.

It should be noted that although the tax liability on the foreign-sourced income can be deferred, it is not exempt. On the other hand, the domestic-sourced income is taxable and taxed immediately when the profits are earned. There is no ability to defer the tax payment. That is why Apple set up many foreign corporations in many other countries. The purpose is to avoid US taxation.

For example, Apple owns a subsidiary corporation in Ireland which distributes all of its profits as dividends to Apple. Apple also owns a subsidiary corporation in Canada, but it never distributes dividends to Apple. What is taxed in the United States? The former is, but not the latter. Both are examples of foreign-sourced income, but they entail different tax payments. Again, this points to the benefit of a tax-avoidance strategy.

In order to maximize the overall benefits, the above three tax loopholes need to be coordinated with one another. The optimal strategy is to relocate the business to a country with a low tax rate

and a territorial income tax policy with respect to foreign-sourced income. How Apple did it will be discussed immediately below.

4. Apple's Global Tax Strategies

Apple set up a subsidiary in Cork, Ireland in 1980. In subsequent years, the company developed a number of new product lines, from Macintosh to iPod to iPhone. During this long period of time, Apple developed three components of its Ireland tax strategy: tax status of its income in Ireland, profit allocation ratios among its subsidiaries, and tax status as a foreign corporation in the United States. They are described below.

4.1. Foreign-Sourced Income In Ireland

In 1984, Apple started producing Macintosh computers. It set up a CFC in Ireland known as Apple Operations International. It is a duly registered corporation in Ireland. It is simply an Irish corporation. The status of the entity cannot be changed, but the nature of its income in Ireland can. Now, Apple takes advantage of Ireland's territorial income tax policy. Any Irish corporation's "foreign-sourced income" is tax-free. Hence, its income from the United States and other foreign countries is completely tax-exempt in Ireland.

What is Apple Operations International's source of income? Apple's CFC in Ireland is nothing more than a sales station. It is true that iPhone is sold in Ireland, but the technology was completely developed in the United States. So where does the CFC derive its income: Ireland or the United States? If it is Ireland, it becomes domestic-sourced income and it is fully taxable in Ireland. If the income is from the United States, it becomes foreign-sourced income and is completely tax-free in Ireland.

In 1991, Apple entered into an agreement with the Irish Government providing that its income in Ireland would be treated as foreign-sourced rather than domestic-sourced.[10] That provision was based on Apple's argument that its computer technology was invented in the United States, not in Ireland. As a benefit, any income channeled from all subsidiary corporations in Ireland and in Europe to Apple Operations International would be completely tax-free. This is the starting point of Apple's tax strategy in Ireland, and Apple would take full advantage of it, as will be discussed in the next section. Is this tax treatment legal?

4.2. Profit Allocation Ratios Among Apple Subsidiaries

Apple launched the iPod in 2001. In order to maximize its tax benefits as a tax-free entity in Ireland, Apple Operations International set up several controlled subsidiary corporations:

Apple Sales International in Ireland, Apple Operations Europe, Apple Singapore, and Apple Asia in many Asian countries. Apple Sales International now operates a chain of eight retail stores in Europe:

> Apple Retail Belgium, Apple Retail France, Apple Retail Germany, Apple Retail Italy, Apple Retail Spain, Apple Retail Switzerland, and Apple Retail UK.[11]

The aim is to create a huge amount of foreign-sourced income.

Apple Sales International acted as the parent company of the eight retail chains, Apple Operations Europe, Apple Singapore, and Apple Asia. All customers of these subsidiaries purchase all Apple products from Apple Sales International in Ireland. In other words, Apple Sales International was the sole seller of all Apple products sold in Europe and many other countries. As a result, the profits belonged to Apple Sales International in Ireland. The local retail stores did not show any profit at all. The objective was to minimize tax liability in other countries and maximize tax savings in Ireland.

Since Apple Operations International was the parent corporation of all subsidiaries in Europe and in other foreign countries, Apple Sales International was required to allocate its profit to that entity. It should be noted again that Apple Operations International's income was tax-free in Ireland by agreement with the Irish Government. Moreover, it should also be noted that Apple Sales International is still an Irish corporation that is required to pay tax to the Irish Government. The profit allocation ratio from Apple Sales International to Apple Operations International was structured at such a high level that almost all profits were tax-free. The remaining amount of profit left with Apple Sales International was so small that it represents very little tax liability.

Apple launched the iPhone in 2007. It requested the Irish Government to renew their agreement and also to agree to the above profit allocation ratios. It was agreed by both sides.

However, in 2015, the above two agreements were abandoned due to too much an abuse.

What is the end result of the above tax strategies? Between 2009 and 2012, Apple Sales International generated gross sales revenue of USD74bn, earning USD22bn in profits, but it paid only USD10m in income tax to the Irish Government. The effective tax rate was reduced from the regular rate of 12.5 percent to 1 percent in 2003, to 0.05 percent in 2011, and to as low as 0.005 percent in 2014.[12] It is steadily decreasing. Is this tax rate fair?

4.3. Controlled Foreign Corporation In The United States

How is Apple's income from Ireland treated in the United States? Did Apple ever pay the IRS income tax on that revenue? It depends on the US Government's tax policy. The United States employs a worldwide income tax policy with a tax deferral option. Apple's income from Ireland is duly taxable in the United States, but the tax payment is not due to the IRS until cash dividends are received from Ireland. Apple takes full advantage of it. Apple claims that Apple Operations International is an Irish-registered corporation. It is an Irish domestic corporation. Hence, it is an Apple-CFC. Under the United States' worldwide income tax policy, Apple's income from Ireland is taxable in the United States. However, Apple Operations International never pays any cash dividends back to its parent corporation, Apple, Inc., in the United States. Therefore, no tax payment is due to the IRS at the present time. According to a US Congressional hearing, between 2009 and 2012, Apple underreported otherwise taxable income in the amount of USD44bn, resulting in a loss of USD10bn in tax revenue to the IRS.[13]

Thus, Apple paid a meager amount of tax to the Irish Government and no tax at all to the US Government on its income from Apple Operations International. In that sense, Apple takes advantage of both governments. Is this acceptable?

In 2014, the Commission launched an investigation raising questions on the legality of the above strategies. What are the accusations? What are the bases? How did Apple defend for itself? Read on.

5. European Commission's Accusations

Looking at the agreement between the Irish Government and Apple, the Commission points out three special tax treatments afforded to Apple. Apple earned income in Ireland. Why is it treated as foreign-sourced income? What is the purpose? Did the Irish Government intentionally grant tax subsidies to Apple? Apple's tax strategies involved a rather strange profit allocation ratio; what is its intention? Is this ratio reasonable? Why did the Irish Government agree to it? These questions are investigated next.

5.1. Preferential Tax Treatment For Apple

Ireland, as stated previously, has a territorial income tax policy. Irish-sourced income is taxable in Ireland, but the foreign-sourced income is completely tax-exempt. Under this policy, the source of income becomes critically important. It also opens up a tax loophole, and Apple takes advantage of it. Apple entered into an agreement with the Irish Government that would treat its business

income in Ireland as foreign-sourced income, so it is tax-free. It is based on the argument that its computer technology was completed and developed in the United States, not in Ireland. It is justifiable to attribute the profit to the source that created it, as mentioned previously.

However, the Commission pointed out that profits are earned by producing and selling activities, both of which must be accomplished at the same time. In fact, Apple outsourced the production of its computer products to China. The company might be justified in claiming that the computer products are indeed invented in the United States, but they are physically sold in Ireland and Europe. At most, the US side can claim only half of the profit, while the other half should belong to the Irish side. The Irish Government intentionally helps Apple escape the Irish tax, and so this is considered preferential treatment for Apple. It is a practice of favoritism. Therefore, the Commission challenges the validity of the Irish Government's tax policy.

5.2. Illegal Government Tax Subsidies

The Commission figured out how much tax Apple has actually paid to the Irish Government and pointed out Apple's two strategies. The Irish Government agreed to treat Apple Operations International's income in Ireland as "foreign-sourced income," which leads to a nontaxable status. Apple itself intentionally allocated an extremely large portion of its subsidiary corporations' profits to Apple Operations International. Combining these two strategies results in an extremely low tax liability in Ireland – for example, 1 percent in 2003, 0.05 percent in 2011, and 0.005 percent in 2014, as mentioned previously. Other corporations pay as much as 12.5 percent.

The Commission pointed out that these tax rates, coupled with Apple's tax strategies aiming at Ireland, show beyond any reasonable doubt that the Irish Government is providing illegal tax subsidies to Apple alone. Governments may offer a tax incentive program to a particular industry such as high technology, but it must be applied to all corporations on a fair and equitable basis. Evidently, Apple was singled out as a beneficiary. It obviously constitutes discrimination. The European Union State Aid rules prohibit such a discriminatory state action. It results in unfair competition among all corporations in Ireland.

The worst is yet to come. Apple now turns to the US IRS, claiming that Apple Operations International is a duly Irish-registered corporation and should be treated as a CFC in the United States. As such, its income is not taxable in the United States until the cash dividends are received. Apple Operations International purposefully never paid any dividends back to its parent company, Apple, Inc., in the United States. As a result, Apple never paid income tax to the IRS either.

In fact, Apple never paid tax to either government. Apple has exploited the discrepancy in tax laws between Ireland and the United States.

It is appalling that Apple Operations International's income is not taxed anywhere in the world. A corporation must have a tax domicile. Tax is paid to either its own home country or to a foreign country. Tax must be paid one way or the other. Apple Operations International ends up with no tax domicile at all. Apple's tax structure sounds illogical. The Commission disputes the legality of the Irish Government's tax incentive program.

The deficiency in tax payment amounted to USD14.5bn between 2003 and 2014. That is why the Commission now requires Apple to pay that amount to the Irish Government. This penalty is intended to restore fair competition among all enterprises in Ireland.

5.3. Misleading Measurement On Business Performance

The Commission further scrutinizes the impact of the profit allocation ratios among Apple's subsidiary corporations in Europe. Apple intentionally transfers all profits from its eight retail stores to Apple Sales International for the purpose of avoiding tax in Europe and taking advantage of the low tax rate in Ireland. As a consequence, these subsidiary corporations do not earn any profits at all. Is this a fair business practice when it comes to the measurement of business performance?

Profit is earned by selling a product. In truth, it is the retail stores in Europe that sell the iPhone, not Apple Sales International in Ireland. Profits should justifiably belong to the retail stores. Apple's profit allocation scheme does not reflect the "economic reality" of these retail stores. It does not represent the true profit in an "arm's length transaction." It is simply misleading and unjustifiable. It results in mismeasurement of the performance of the retail stores. Moreover, it leads to misinformation for investors and misallocation of resources.

Further, Apple Operations International is the parent company of Apple Sales International. Apple Sales International deliberately allocated an extremely high proportion of its profit to Apple Operations International only because it is a tax-free entity. In fact, Apple Operations International exists only on paper. It has no sales activities or any operations except a few meetings per year. It functions like a phantom entity. Thus, it does not deserve any profit at all. Its profit is simply fake. Thus, the Commission questions the fairness of Apple's business practices.

The above accusations reveal some dilemmas between Apple's desire for profit and the economic reality of its operations. For example, special treatment for Apple's subsidiary corporation in

Ireland defies the taxation principle. The Irish Government's tax subsidy may be illegal. The profit allocation scheme does not measure its operating efficiency. It would be rather curious to observe how Apple defends for itself, as will be elaborated on in the next section.

6. Apple's Defense

In response to the Commission's three accusations, Apple launched three counter-arguments:

(1) The charge on Apple's tax status in Ireland is based on an out-of-date concept;
(2) The accusation of an illegal tax subsidiary is an interference of a government's internal affairs;
(3) To blame Apple's profit allocation scheme is ignorance on the part of the Commission of a corporation's management privilege.[14]

These arguments are further described below.

6.1. New Concept On Source Of Income

Apple Operations International is indeed an Irish-registered corporation. The Irish Government did agree to treat it as a "non-resident corporation," *i.e.,* a foreign corporation in Ireland. This tax status does not necessarily mean that its Irish-sourced income is tax-free. Instead, it is the corporation's US-sourced income that is tax-exempt under the territorial income tax policy. The Irish Government did grant Apple Operations International such a special tax status, and Apple takes advantage of it. The Commission now charges that this tax treatment is not in conformity with the principle of international taxation.

Apple countered that the above principle stemmed from the old principle of "physical presence." It means that profit is earned where the product is sold. The physical presence of a product determines the source of income. The computer products are indeed sold in Ireland, not in the United States. It is otherwise Irish-sourced income and hence is taxable in Ireland.

Nowadays, in a high-tech industry, the product requires highly concentrated research activities with heavy expenditures. This effort accounts for almost all of the profits earned. The effort to sell the product accounts for only a very minute portion of the profit. Apple argues that the computer products were solely invented and developed in the United States, not in Ireland. The US side is justified to claim the entire profit. In other words, profit is earned where the product was developed, not where it is sold. Ireland is nothing more than a station to sell the computer products,

according to Apple. This is a new concept in determining the source of income in the high-tech environment. It is known as "economic nexus," as opposed to physical presence.

In fact, the principle of physical presence originated as early as 1944 in the case of *Sears & Roebuck, Inc.*, concerning a mail order business.[15] The case raised a question whether an out-of-state seller should be required to collect sales tax from an in-state buyer. Many court decisions were in favor of the principle that only when the seller has a physical presence in the state can it be required to do so. In other words, there is a connection between the seller and the state through a physical branch location.

In 2008, this principle evolved to the concept of "economic nexus" in the case of Amazon's New York State sales tax on its Internet commerce.[16] The case questioned the meaning of connection between the seller and the state. Should it mean that as long as a remote seller earns a profit in the state, there can be a connection between a seller and the state? In other words, the source of profit determines the connection, not a branch in a state. The New York state legislature enacted a law to adopt this concept, now termed "economic nexus."

In this tax dispute with the Commission, Apple simply applies the concept of economic nexus and claims that there is a close connection between its computer products sold in Ireland and the profit derived in the United States. In other words, the profit in Ireland is in substance earned in the United States, not in Ireland. This is a fact and a reality, according to Apple, claiming that it is a new concept in the high-tech industry and the Commission is simply not up-to-date. Therefore, Apple rejects the Commission's accusation.

Can Apple's argument stand up to a vigorous test in court? In fact, in 2003, the US Congress enacted the Marketplace Fairness Act of 2003.[17] It requires all remote sellers to collect sales tax from an in-state buyer regardless of the seller's physical presence in the state. Actually, it is based on the concept of "economic nexus." In this sense, Apple's argument is legally acceptable. If so, there will be far-reaching consequences in deciding where foreign-sourced income should come from. This is a new subject brewing up in regards to the principle of International taxation.

6.2. Intrusion On Government Tax Incentive Program

The Commission further investigated the tax that Apple has actually paid to the Irish Government. It discovered that the effective tax rate was as low as 0.005 percent in 2014 as opposed to the regular tax rate of 12.5 percent. The Commission has pointed at this absurdly low tax rate and accused the Irish Government of engaging in illegal tax subsidies solely to Apple.

Apple repudiates the accusation and points out that it came to Cork, Ireland in 1980. Its argument: At that time, the area was undeveloped. It desperately needed investment capital. The Irish Government offered many tax incentive programs so as to attract corporations to come. Apple did come, starting with only 60 employees. The Irish Government did grant Apple a special tax status and reduced its tax rate as an incentive. It would have been unwise for Apple not to accept the tax subsidies offered. Apple simply followed the law and has paid all taxes it owes. There is nothing illegal about this.

By 2016, Apple has expanded to approximately 6,000 employees in Ireland alone, plus an estimated 1.5m in Europe and other countries.[18] Apple says it has made tremendous contributions to the development of the Irish economy and should be rewarded instead of being penalized. Whether the Irish Government's tax incentive program is legal is just a matter of a government's policy and Apple should not be blamed, Apple asserts. Therefore, Apple rejects the Commission's charge in this respect.

Worse yet, Apple says, if the Commission can override the Irish Government's policy, it will cause confusion among corporations as to what order to follow. The Commission is acting like a government's government. Apple can enter an agreement with the Irish Government, but not with the Commission. The Commission's intervention in this situation has eroded the integrity of the Irish Government, Apple says.

Even more devastating is the fact that the USD14.5bn penalties are applied retroactively for the last ten years since 2003. Can a taxpayer be held responsible for such a long period of time? The statute of limitation is only three years. If there is any wrongful tax treatment on the part of the taxpayer, it is the Irish Government's duties to rectify the taxpayer's action, not the taxpayer's responsibilities. Therefore, now Apple, in turn, questions the legality and wisdom of the Commission's action.

6.3. Misunderstanding "Taxable Income" **Versus** *"Accounting Income"*

Apple's eight subsidiary corporations in Europe actually earn profits. However, all profits are shifted to Ireland for tax purposes. The Commission now charges Apple with misrepresentation of a corporation's performance. Apple argues that the Commission fails to understand the difference between a corporation's "taxable income" and "accounting income." The former is determined by tax law, while the latter by generally accepted accounting principles, and the amounts are not the same, Apple says.

More of Apple's rationale: the profit allocation scheme is structured for the purpose of minimizing the corporation's overall tax liability. However, its financial statements are designed to measure the performance of its operating efficiency. They belong to two different functions in two different systems. Evidently, the Commission is mixing them up. In other words, it mistakenly views the "taxable income" as "accounting income." This is incorrect and thus misleading.

Worse still, Apple says, the so-called measurement of business performance, as concerned by the Commission, is just a matter of a corporation's management prerogative. The management allocates its profit among its subsidiaries for different purposes, such as tax liability or resource allocation. If the profit allocation ratios are indeed unreasonable, management will never be misled by it. It is none of the Commission's business. In short, the Commission simply oversteps its authority. Therefore, Apple further rejects the Commission's accusation in this regard.

6.4. Final Judgment

Thus, finally, between the Commission's accusations and Apple's defense, what is the ultimate judgment? It is true that Apple did take advantage of its tax status as "US-sourced income." It indeed saves a great amount of tax. But it is the Irish Government's tax policy. Apple accepted the Government's offering. Apple did nothing wrong.

Apple did manipulate its profit allocation scheme among its retail stores in such a way as to minimize its tax liability. The allocation ratios are indeed quite unreasonable, but the Irish Government agreed to it for the purpose of attracting Apple's business to Ireland. The Government has done nothing wrong either.

Therefore, what merit is there to the Commission's charges? The Commission lodges its accusations on the basis of the Irish Government's policy for Apple as compared to other corporations in Ireland. The above two policies for Apple are very much custom-made and were specifically tailored for Apple's purpose only. They are not commonly applied to other corporations. Therefore, if there is any blame to be lodged, it is the Irish Government's peculiar tax treatments for Apple, not Apple itself.

7. Conclusion

On August 30, 2016, the European Commission ordered Apple to repay USD14.5bn to the Irish Government for allegedly illegal tax subsidies. This article discussed what went wrong with Apple, exactly what the charges are, and how Apple defends for itself.

First, this article attempted to find out why Apple moved its business to Ireland. It pointed out that there may be three major tax loopholes in US international tax law. They include a high tax rate, a worldwide income tax policy, and a tax deferral option. The article investigated some details relating to these loopholes.

Then, Apple entered into an agreement with the Irish Government that treated Apple's income in Ireland as US-sourced income. Apple operates many subsidiary corporations in Europe and Asia and manipulates a profit allocation scheme so as to minimize its overall tax liability. This article investigates some details of Apple's tax strategies.

Further, the Commission launched three charges against Apple: Apple receives special tax treatment and illegal tax subsidies from the Irish Government, and Apple misrepresents its business performance. This article elaborates on the details of these charges.

In addition, in its defense, Apple pointed out that there is a new development in the concept of source of income known as economic nexus. The Commission fails to recognize it. This article explained this new concept. Apple also pointed out that it simply followed the Irish law and there was nothing illegal about it. Therefore, Apple denied all of the charges.

Finally, this article offered an ultimate judgment as to whether the Commission's accusations were justified. It concludes that the answer is negative.

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Topical News Briefing: Brexit Bluster

by the Global Tax Weekly Editorial Team

The UK is leaving the Single Market, Prime Minister Theresa May stated in no uncertain terms at the end of last week.

The announced "hard Brexit" augurs massive changes for the UK and could result in an overhaul of the UK legal framework, the tax system, and immigration laws, among various other things. While the decision to leave the EU has angered many in Brussels, May argues that the UK can still be a key part of Europe and also seek stronger international ties. That is the official government line, at least. However, it's not clear that the EU agrees.

With a new ruling from the UK Supreme Court that Parliament must approve the Government's plans, the Government must also now deal with potential opposition on the home front. The Prime Minister faces the prospect of having to secure support from enough UK lawmakers for her plans for a hard Brexit – and there is still an outside chance that lawmakers (most likely those in opposition) may use this new bargaining chip to seek a second referendum on whether to proceed with what is proposed.

May, who assumed the role of Prime Minister after the resignation of David Cameron, came to the foreground as a known hardliner keen on obtaining a full split from the EU. Last week she said she is seeking "not partial membership of the European Union, associate membership of the European Union, or anything that leaves us half-in, half-out."

While that statement may appear dismissive of the EU, she is right that the UK cannot pick and choose what elements of the EU it wants to retain, change, and discard: if the UK wants to remain a part of the Single Union, it must also adopt harmonized policies and honor the "four freedoms" upon which the EU is built, including the free movement of people.

Departing from the Single Market could mean a return to zero; importantly, for businesses in both the EU and the UK, non-tax and tax barriers to trade and investment that have taken decades to break down could reappear at the end of a two-year negotiation period after the triggering of

Article 50 to leave the EU, expected in March – unless, as also mooted, the UK and EU enter a transitional period on completion of negotiations to avoid a "cliff-edge" scenario.

The EU has said negotiations cannot begin until Article 50 is triggered. Concerns have been raised over whether two years is enough to negotiate a new relationship and a comprehensive free trade agreement on cross-border goods and services; indeed, the former UK top diplomat in Brussels, Sir Ivan Rogers, who resigned recently called the feat unobtainable, saying those remaining had to tackle "ill-founded arguments and muddled thinking" from the top.

Though an EU–UK trade treaty might take more than two years to negotiate, the UK is looking at all short-term options. In fact, Australian and British negotiators met this week to chalk out what a free trade deal might look like, and according to May the UK has received interest from China, Brazil, and the Gulf states.

As far as the US goes, May says President Trump has reassured her the UK is not "at the back of the queue" for a trade deal with the US, but "front of the line," as reported in this week's edition of *Global Tax Weekly*. "The future's promising" is the message the UK Government would have business leaders believe.

The UK will also have to use those two years to make key decisions on tax. In particular, it will have to decide on how its value-added tax rules will change, if at all, given that VAT rules are heavily harmonized across the EU. Leaving the EU could bring much long-sought freedom, but businesses might suffer a heightened burden from any change to the *status quo*.

The upside of leaving the Single Market is that the UK should be free from EU restrictions on the design of its tax system – and in particular state aid rules. This could allow the UK to negotiate and agree tax rulings with key global industries, something the EU in recent judgments has been keen to slap down.

With talk of a potential (and perhaps intentional) go-slow on UK–EU trade negotiations – a situation described by May as potentially calamitous and mutually self-defeating for both sides – the UK has recoiled; Chancellor Philip Hammond hinted that if shut off from the EU, the UK could look to drastically cut its tax rates to boost its attraction to "overseas business."

He told German media that it would use all means necessary to respond to being isolated. And in response, according to a letter obtained by UK newspaper *The Guardian*, one senior Dutch

politician went so far as to say the UK should not be allowed to quit the EU without reassurances that it would not become a low-tax outlier in Europe.

Since then, there was a lull this week, with the UK again pausing to get its story straight on home shores. And if any venom was exchanged between the UK and the EU, it was mostly behind closed doors. Nonetheless, without doubt there's more bluster to come before March.

UK: When The Diverted Profits Tax And The Expanded Royalty Withholding Tax Rules Interact

by Jesse Dalton, DLA Piper

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Introduction

Two ways in which the UK Government has recently sought to increase the amount of tax payable in the UK by non-resident companies have been to impose a new Diverted Profits Tax (DPT) and to amend its existing 20 percent withholding tax (WHT) rules so that they apply to a wider range of royalties.

DPT and WHT are distinct regimes that operate independently. However, they can interact where DPT applies, because a non-resident company may be required to pay extra DPT if there are royalties connected with its avoided UK permanent establishment (PE) instead of having to deduct and pay royalty WHT. In that case, assuming the recipient then receives the royalty gross, the payer would have effectively borne the recipient's UK tax liability. While this may pose less of a problem where the royalties are intragroup (as the overall tax cost to the group is the same), the rules are not restricted to intragroup royalties, so this interaction mechanism could create another layer of taxation for affected companies (unless they can contractually pass the extra DPT cost back to the recipient).

In this article, we provide more background and context to the DPT and royalty WHT reforms and the interaction between them, and give a simple example.

Diverted Profits Tax

To understand the DPT, one must first understand how non-resident companies carrying on trades would otherwise fall into the charge to UK corporation tax, because it was the perception

that some multinational groups were putting in place arrangements to avoid that tax which led to the DPT.

Non-resident companies are only subject to UK corporation tax if they carry on a trade through a UK PE, which can arise from having either a fixed place of business in the UK or a UK dependent agent habitually concluding contracts in the UK on behalf of the non-residential company with UK customers. Where this is the case, the non-resident company would be liable for corporation tax at 20 percent on the profits attributable to that UK PE under transfer pricing principles. The UK's obligations under its treaty network with other countries would not typically override those taxing rights.

There are a number of techniques that non-resident companies could use to try to avoid creating a UK PE. HMRC's *DPT Guidance* offers the example of a non-resident company avoiding creating an agency PE by the "contrived separation of contract conclusion from the selling activity and process of agreeing terms and conditions." To address that concern (and others), the DPT was introduced with effect from April 1, 2015. A full discussion of the conditions to trigger DPT is beyond the scope of this article. However, suffice to say that where it applies due to an avoided PE, the non-resident company is liable to pay DPT at the rate of 25 percent (higher than 20 percent) on a notional profit equal to the amount of profit on which it would have had to pay corporation tax if it had a UK PE. That notional profit could include, for example, deductions for royalties that would have been allowed if the non-resident company had an actual UK PE.

Expanded Royalty WHT Rules

Where a non-resident company derives royalties or other payments in respect of intellectual property (IP) with a UK source, such payments are chargeable to income tax at 20 percent for the recipient; but, as a collection mechanism, the person making the payment is liable to pay this tax and is permitted to deduct this from the royalty (unless the recipient is entitled to relief under a treaty or under the EU Interest and Royalty Directive).

The concept of "source" for royalties is not statutorily defined, so will depend on case law. In HMRC's view, a royalty will have a UK source if the IP to which it relates is "exploited in the UK" regardless of the governing law of the contract. The UK Government expressed concern that it was not always clear if royalties paid by non-resident companies with UK PEs would have a UK source.

Accordingly, with effect from June 28, 2016, royalties that are made in connection with a UK PE of a non-resident company will be deemed to have a UK source. The phrase "in connection with" is very broad, so HMRC has produced guidance on how, in practice, it would determine the quantum of royalties connected with a UK trade. In particular, according to HMRC, this would normally be by reference to sales made by the non-resident company through the UK PE (unless the royalty is determined by reference to a factor other than sales) and that an apportionment would need to be made where the IP to which the royalty relates is not restricted to UK sales.

Interaction Mechanism

Non-resident companies within the scope of the DPT would not have an actual UK PE and therefore the deemed UK source royalty rule would not apply to them. The UK Government did not want such companies to be advantaged over companies with actual PEs. As a result, non-resident companies liable to DPT are required to include within the calculation of the notional profits of an avoided PE an amount equal to the royalties that would have had a UK source had the avoided PE been an actual PE.

It is interesting to note that it is not strictly necessary for a deemed UK source royalty to also be deductible from the profits of the avoided PE. The tests are not the same, and HMRC has specifically acknowledged this. However, where the royalty would also be deductible for the avoided PE, the extra DPT charge effectively cancels that deduction and it is this effect that led to many commentators calling this mechanism the "royalty add back rule".

As noted above, this interaction mechanism could result in a higher overall tax imposed for non-resident companies paying royalties outside the group. Having said that, HMRC acknowledges in its guidance that the rate of DPT was deliberately set higher than corporation tax to encourage businesses within DPT to change those arrangements (so as not to be liable for DPT) and to start paying corporation tax in line with economic activity. So it may be that the possibility of an extra layer of tax in this context is merely intended to add further incentive, and thus help achieve that aim.

Illustrative example: A Dutch BV that is non-resident for UK tax purposes contracts with customers in the UK for the sale of its products

In this example, the Dutch BV uses a related company in the UK to provide sales and marketing support. However, the related company stops short of concluding contracts on behalf of the Dutch BV and thus does not create an actual UK PE for the Dutch BV. Royalties are paid to an unconnected company (IP Co) for the right to use the brand. IP Co is based in a tax haven

jurisdiction that has no treaty with the UK that would afford relief from royalty WHT. Assume that the Dutch BV meets all of the conditions to be caught by the DPT. Assume that payment of the royalty enables the Dutch BV to make sales in both France and the UK, but that UK sales account for 50 percent of total sales.

Assume that the royalty for the relevant period was GBP2m, only GBP1m of which is deemed to have a UK source for royalty WHT purposes (given that the UK represents 50 percent of total sales). Assume the profits of the avoided PE would be GBP5m if it had a UK PE (taking into account a deduction of GBP1m for the royalty under transfer pricing principles).

The Dutch BV would be liable for DPT of GBP1.25m on its avoided PE profits (*i.e.*, 25 percent on profits of GBP5m) plus an extra GBP250,000 on the avoided deemed UK source royalties (*i.e.*, 25 percent on GBP1m). This extra DPT charge effectively offsets the benefit of the royalty deduction.

Assuming the Dutch BV cannot pass the extra DPT charge on to the unconnected tax haven company under the brand license agreement, that tax haven company would have effectively saved GBP200,000 of WHT on the GBP1m royalty as a result of this interaction mechanism.

Examining The 'Foreign' Tax Home Requirement

by Mike DeBlis, DeBlis Law

The concept of "tax home" is deceptively simple. According to recent statistics, it ranks among the most misunderstood terms in the Internal Revenue Code. The source of much of the confusion lies in the fact that there is a general rule with exceptions that all but swallow up the rule. This has led some tax professionals to label it "a riddle wrapped in a mystery inside an enigma."

However, it's an essential ingredient to determining whether a US person is eligible for the foreign earned income exclusion. Indeed, not having a non-US abode automatically disqualifies a US person from excluding their foreign earned income from their gross income for US tax purposes. Therefore, it is essential to know the IRS's black letter definition of "tax home" and how the courts have come to interpret the gray areas.

IRC Section 911 and its regulations are used to determine whether a taxpayer has a non-US abode.

For purposes of IRC section 911, "tax home" has the same definition as it does under IRC section 162(a)(2) (relating to traveling expenses while away from home). Under Treas. Reg. § 1.911-2(b), an individual's tax home is considered to be located either:

- At his regular or principal (if more than one regular) place of business, or
- If the individual has no regular or principal place of business due to the nature of the business, then at his regular place of abode in a real and substantial sense.

To throw in a "wrench," the Internal Revenue Code explicitly states that an individual cannot have a tax home in a foreign country during any period in which his abode is in the United States.[1]

How do we reconcile these requirements so that they make sense? First, it is necessary to determine whether the taxpayer has a US abode. If so, then he "flunks" the foreign tax home requirement.

If the taxpayer does not have a US abode, then one might assume the taxpayer's tax home to be his "regular or principal place of business." But this is not always the case. If no regular or principal place of business exists, then the taxpayer's tax home reverts back to his "regular place of abode."

As you can see, this reasoning is circular. Indeed, if one follows the steps in the order described above, then it would be blatantly obvious whether the taxpayer had a US abode from the very beginning.

What does this mean for taxpayers who don't have a US abode yet want to take advantage of the foreign earned income exclusion? In order to satisfy the section 911(d)(3) "foreign" tax home requirement, such taxpayers must establish that their regular or principal place of business is in a foreign country. Absent that, they must prove that their regular place of abode is in a foreign country – any foreign country – under Treas. Reg. § 1.911-2(b).

From this, we can construct a helpful rule: The limitation does not require that the taxpayer's abode be in a foreign country, so long as his regular or principal place of business is located there. It only requires that the taxpayer's abode not be in the United States.

Beware of a particular fact pattern that at first blush appears to impose a formidable barrier to a taxpayer satisfying the "foreign" tax home requirement. I'm referring to the situation where the taxpayer has both an abode and a principal place of business, the locations of which differ, but are nonetheless foreign.

For example, suppose that a US taxpayer's abode is located in Timbuktu but that his principal place of business is located in France. The rule explicitly states that when the taxpayer's regular or principal place of business is in a foreign country, the location of the taxpayer's abode is utterly meaningless. In other words, a taxpayer's "abode" need not be located in the same country as his "principal place of business" in order for the taxpayer to satisfy the "foreign" tax home requirement.

Instead, all that's required is for the abode not to be located in the United States. In the example above, the taxpayer still satisfies the tax home requirement, despite the fact that his abode and principal place of business are located half-a-world apart. At the end of the day, all that matters is that the taxpayer's abode – here, Timbuktu – is not the United States.

Recall that an individual cannot have a tax home in a foreign country during any period in which his abode is in the United States.[2] However, Treas. Reg. section 1.911-2(b) blunts the harshness of this rigid rule:

- "Temporary presence of the individual in the United States does not necessarily mean that the individual's abode is in the United States during that time"; and
- "Maintenance of a dwelling in the United States by an individual whether or not that dwelling is used by the individual's spouse and dependents, does not necessarily mean that the individual's abode is in the United States." In other words, the Code recognizes that an individual's abode may not necessarily be located in the United States even though the individual maintains a home for his or her family in the United States.

Both the US Tax Court and US Circuit Courts have weighed in on the "tax home" requirement of section 911 in a number of decisions. The leading court decisions are *Bujol v. Commissioner*,[3] and *Lemay v. Commissioner*.[4]

In *Bujol* and *Lemay*, the taxpayers alternated blocks of time working abroad with blocks of time at home in the United States where their families lived. Specifically, in *Bujol*, the taxpayer alternated working 28 days abroad and returning home to the United States for 28 days. Similarly, in *Lemay*, the taxpayer spent approximately half of his time with his family in Louisiana.

With respect to the tax home requirement, these courts focused on the requirement that the taxpayer's abode not be in the United States. For this purpose, the tax court and appellate courts have applied the following definition of "abode":

> "Abode" has been variously defined as one's home, habitation, residence, domicile, or place of dwelling. Black's Law Dictionary 7 (5th ed. 1979). While an exact definition of "abode" depends upon the context in which the word is used, it clearly does not mean one's principal place of business. Thus, "abode" has a domestic rather than vocational meaning, and stands in contrast to "tax home" as defined for purposes of section 162(a)(2).[5]

Applying the above definition of "abode", most courts have held that the taxpayer had a US abode. As a result, the taxpayers could not exclude their foreign earned income from gross income for US tax purposes.[6]

Below are a few of the more salient points that were instrumental in these courts' decisions:

- Possession of a US bank account and US driver's license;
- A US voter's registration;
- Existence of strong familial, economic and personal ties in the United States and only transitory

ties in the foreign country where the taxpayer worked (conversely, IRC section 911 contemplates that transitory presence in the United States would not constitute a US abode).

As a result of determining that the taxpayers in the cases above had US abodes, these courts dispensed with analyzing the location of the taxpayers' regular or principal places of business since that issue was now moot.

Endnotes

1 *See* IRC section 911(d)(3).

2 IRC section 911(d)(3).

3 53 TCM (CCH) 762 (1987), *affd.* without published opinion 842 F.2d 328 (5th Cir. 1988).

4 53 TCM (CCH) 862 (1987), *affd.* 837 F.2d 681 (5th Cir. 1988).

5 *Bujol*, 53 TCM at 763.

6 *See Harrington v. Commissioner*, 93 TC 297 (1989); *Doyle v. Commissioner*, 57 TCM (CCH) 1436 (1989); *Lemay v. Commissioner*, *supra*, note 4; and *Bujol v. Commissioner*, *supra*, note 3.

Topical News Briefing: TPPing Point

by the Global Tax Weekly Editorial Team

In quick succession following his inauguration on January 20, Donald Trump, the United States' 45th President – and certainly one of its most controversial in recent memory – wasted no time in making clear his agenda for the next four years on a number of fronts, including notably on international trade.

The President's decision to pull the country out of the Trans-Pacific Partnership (TPP), as reported in this week's edition of *Global Tax Weekly*, coupled with a threatened NAFTA withdrawal, will not have come as much of a shock to observers, given his previous pronouncements on international trade. The move has been welcomed by former Democratic presidential nominee Bernie Sanders and by House Speaker Paul Ryan (R – Wisconsin), who was previously a strong advocate of the agreement.

For the other eleven participants in the TPP, a way forward must now be found, given the significant amounts of political capital that most have staked on its success. Japanese Prime Minister Shinzo Abe said in November last year that the trade pact would be "meaningless" without the US on board, but the mood this week appeared to be one of pragmatic resignation. Australian Trade Minister Steven Ciobo expressed disappointment but stressed that the will remains strong among the countries still involved to keep discussions moving.

Indeed, both Australia and New Zealand have stated their hope that the remaining members can press ahead with the partnership, with the former suggesting the agreement could be renamed the "TPP 12 minus one". According to Ciobo, "Indonesia has expressed a possible interest and there would be scope for China if we were able to reformulate it to be a TPP 12 minus one for countries like Indonesia or China or indeed other countries to consider joining …"

As also reported in this week's *Global Tax Weekly*, a progress report on the US–EU Transatlantic Trade and Investment Partnership (TTIP), published on January 17, said "considerable progress" has been made in negotiations. But with a new US Administration now in place, Trump's scrubbing of any mention of the agreement from the Presidential website – when taken in the context of his vocal criticism of the agreement in the past – will have raised concerns in Brussels that the TTIP may be the next domino to fall.

UK To Leave EU Single Market, Says May

Prime Minister Theresa May has ruled out the possibility of the UK remaining part of the EU Single Market, in a speech that gave more detail on her Brexit strategy.

In outlining plans for Britain to secure full control of its affairs, including on legal matters and immigration, she said this "cannot mean membership of the Single Market."

May said she would instead seek to gain "the greatest possible access" to the European market "through a new, comprehensive, bold, and ambitious free trade agreement."

"That agreement may take in elements of current single market arrangements in certain areas – on the export of cars and lorries for example, or the freedom to provide financial services across national borders – as it makes no sense to start again from scratch when Britain and the remaining member states have adhered to the same rules for so many years."

She added that a "punitive" deal would be "an act of calamitous self-harm" for the EU.

May said while she wants the UK to remain part of the EU's Customs Union as an "associate member," the UK would seek concessions to enable it to engage with other territories towards its own free trade agreements and not be bound by the Common External Tariff.

"Countries including China, Brazil, and the Gulf states have already expressed their interest in striking trade deals with us," she said. "We have started discussions on future trade ties with countries like Australia, New Zealand, and India. And [President] Trump has said Britain is not 'at the back of the queue' for a trade deal with the United States, the world's biggest economy, but front of the line."

"I know my emphasis on striking trade agreements with countries outside Europe has led to questions about whether Britain seeks to remain a member of the EU's Customs Union. And it is true that full Customs Union membership prevents us from negotiating our own comprehensive trade deals. Now I want Britain to be able to negotiate its own trade agreements. But I also want tariff-free trade with Europe and cross-border trade there to be as frictionless as possible."

An Isolated UK Could Adopt Aggressive Tax Policies Post-Brexit

UK Chancellor of the Exchequer Philip Hammond has threatened to reduce taxes to attract overseas businesses post-Brexit if the UK is not granted sufficient access to the EU market.

Asked by German newspaper *Welt am Sonntag* whether the UK could lower its corporation tax further, Hammond said if the country was closed off from the EU market, "we will have to change our model to regain competitiveness" and "do whatever we have to do."

Opposition Labour leader Jeremy Corbyn told the BBC's Andrew Marr Show that such a "risky strategy" would be "a recipe for some kind of trade war with Europe."

He was speaking ahead of the announcement from Prime Minister Theresa May that the UK would leave the EU Single Market.

Irish Economy Vulnerable To US Tax Changes, Brexit

A lower corporate tax rate and additional trade disputes in the US, and the UK leaving the EU, will impact Irish economic growth in 2017, according to a report from financial services provider Merrion Capital.

In its latest Irish Quarterly Economic Outlook, Merrion said that US President Donald Trump's planned tax cuts and public spending measures could "fire up the American economy, which in turn should be positive for the Irish economy." However, Merrion did warn that "the possibility of lower US corporate tax rates and talk of trade tariffs being imposed by the Trump Administration could potentially outweigh any positives."

Merrion added that it is possible to only speculate how the UK's withdrawal from the EU will impact Ireland in the coming months and years. It noted that 30 percent of all Irish employment is from sectors that are heavily reliant on UK exports. It expects SMEs, particularly in the agri-food and tourism sectors, to be harder hit than larger companies by the introduction of any tariffs or barriers to trade.

According to Merrion, the Irish economy "appears to be holding up very well, even though export growth has slowed." It does nevertheless expect Brexit worries to intensify in 2017, leading to lower overall GDP growth this year. It anticipates GDP growth to fall below 4 percent in 2017.

Merrion warned the Irish Government against bowing to pressure to increase public sector pay, "which, if granted, will have to be taken out of money that could have been spent on crucial services." In turn, it cautioned, the Government would have to raise taxes, which would damage the economy.

"The last thing the Irish economy needs now against the uncertain Brexit backdrop and the Trump Presidency is to become uncompetitive again," Merrion said.

UK Government Not Considering Levy On EU Workers

The UK Government has distanced itself from a levy on skilled EU citizens working in the UK.

Immigration Minister Robert Goodwill had said a levy of GBP1,000 (USD1,217) a year could be levied on skilled EU workers. The UK Government has underscored it has no plans to proceed with such a tax, saying the move was "not on the government's agenda."

Responding to the suggestion, the Director General of the British Chambers of Commerce, Adam Marshall, said: "Implementing this measure would be harmful to individual firms and overall growth, as it would make the UK less attractive to both investment and talent."

He said the unnecessary expense and bureaucratic obstacles linked to such a levy would impact UK companies' recruitment and expansion plans, damaging small businesses in particular.

Trump's First Executive Order Pulls US Out Of TPP

President Donald Trump has followed through on his previous policy statements by signing an executive order to pull the US out of the Trans-Pacific Partnership (TPP).

In the past, the President had said that TPP was one of the worst deals he had ever seen, and earlier this year he described the treaty as "the greatest danger yet" to the US economy. There has also been opposition to the TPP in both the Democrat and Republican parties, with many believing its terms would actually harm, rather than grow, the US economy.

The TPP was signed in February last year by Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. It would therefore have encompassed a huge marketplace, with 800m people and about 40 percent of global gross domestic product.

Approximately 86 percent of tariffs on industrial goods would have been eliminated by the agreement. Last year, the Asian Trade Centre noted in a paper that, while it is unlikely it will have the same level of market access benefits as TPP, for many non-US TPP countries "the default Plan B option will be the Regional Comprehensive Economic Partnership (RCEP) negotiations."

In fact, seven TPP countries (Australia, Brunei, Japan, Malaysia, New Zealand, Singapore, and Vietnam) are already involved in ongoing talks on the Chinese-led RCEP between the ten-member Association of Southeast Asian Nations and its six trade agreement partners (South Korea, Australia, New Zealand, China, India, and Japan).

However, the prospect of the US now being shut out from closer trade relations in the region has prompted US lawmakers to request an alternative strategy from the President. House of Representatives Ways and Means Committee Chairman Kevin Brady (R – Texas) stated that "it's important that America not abandon the Asia-Pacific region because American companies and workers will lose out. … We have to reach new customers around the world through strong enforceable trade agreements."

Ways and Means Committee Ranking Member Richard Neal (D – Massachusetts) added that "the TPP agreement was flawed in many respects, as all of the major presidential candidates recognized last year. But withdrawing from the TPP must be a first step, not a last one. We need new rules and better enforcement to make trade a two-way street, particularly in the Asia-Pacific region."

White House Confirms US Could Withdraw From NAFTA

The White House website has indicated that the Trump Administration will renegotiate, and could withdraw from, the North American Free Trade Agreement (NAFTA) with Mexico and Canada, according to a list of six "issues" the new Administration has released that it intends to address.

It is said that President Donald Trump "understands how critical it is to negotiate the best possible trade deals for the United States. By renegotiating existing trade deals, and taking a tough stance on future ones, [he] will ensure that trade agreements bring good-paying jobs to [US] shores and support American manufacturing."

"This strategy starts by withdrawing from the Trans-Pacific Partnership and making certain that any new trade deals are in the interests of American workers," the White House website states. This includes a firm commitment "to renegotiating NAFTA." However, "if our partners refuse a renegotiation that gives American workers a fair deal, then the President will give notice of the United States' intent to withdraw from NAFTA."

The President has already confirmed immediate action on NAFTA. In the White House on January 22, he stated the renegotiation will begin when he meets Canadian Prime Minister Justin Trudeau and Mexican President Enrique Peña Nieto shortly. It has been reported that the meeting with the latter will be on January 31.

The note reaffirms Trump's "plans to show America's trading partners that we mean business by ensuring consequences for countries that engage in illegal or unfair trade practices that hurt American workers. … The President will direct the Commerce Secretary to identify all trade violations and to use every tool at the federal government's disposal to end these abuses."

On taxation, as part of "pro-growth tax reform … [the] President's plan will lower rates for Americans in every tax bracket, simplify the tax code, and reduce the US corporate tax rate, which is one of the highest in the world. Fixing a tax code that is outdated, overly complex, and too onerous will unleash America's economy, creating millions of new jobs and boosting economic growth."

Trump Promises US Corporate Tax Cuts

President Donald Trump invited the leaders of several US multinational companies to the White House on January 23 to reiterate his two-pronged plans for corporate tax rate cuts and import tariffs to convince them to boost their investment in productive facilities in the US.

While also asking the leaders of such companies as Dow Chemical, Ford Motor Company, Dell Technologies, Lockheed Martin, US Steel, and Johnson & Johnson to advise him on how to encourage the establishment of new manufacturing plants in the US, he confirmed that there would be "massive" tax cuts for companies.

Trump foresaw that the current US headline corporate tax rate would be reduced to 15 percent, as he has suggested, or to 20 percent, as suggested in the Republican party tax reform framework. He also promised to reduce and improve the efficiency of regulations on business investments.

However, he also emphasized his other commitment to impose tariffs of up to 35 percent on imports from US multinational companies that move their production facilities out of the US at the cost of American jobs and then sell the products back into the country.

EU, US Take Stock Of TTIP Negotiations

The EU and US have published a joint assessment of the progress made in the negotiations for a Transatlantic Trade and Investment Partnership (TTIP).

Between July 2013 and October 2016, 15 negotiating rounds were held. The report, released on January 17, said: "TTIP has the potential to turn the already immensely successful US and EU economic relationship into an even stronger driver of mutual prosperity for decades to come."

According to the assessment, the EU and the US had made "considerable progress." It explained that negotiators had exchanged offers to eliminate duties on 97 percent of tariff lines, with a large majority to be phased out upon entry into force or phased out quickly.

The document added that negotiators had identified steps to reduce burdensome requirements and delays at borders, and agreed that TTIP must include obligations to protect the environment and fundamental labor rights. Finally, negotiators had agreed on the importance of transparency and due process in trade remedy procedures and competition policy, and drawn up a dedicated chapter on SMEs.

The assessment did however note that significant work must still be done to resolve differences in key areas, including how to treat the most sensitive tariff lines on both sides.

EU Trade Commissioner Cecilia Malmström said: "The EU has left no stone unturned in trying to achieve a balanced, ambitious, and high-standard TTIP agreement with clear benefits for citizens, local communities, and companies. We have made considerable, tangible

progress, as this summary demonstrates. I look forward to engaging with the incoming US administration on the future of transatlantic trade relations."

Such engagement with the new Administration under President Donald Trump looks to be hanging in the balance, however, following his actions on January 23 to pull the US out of the Trans-Pacific Partnership. During his election campaign, Trump repeatedly voiced his concerns over future US engagement in international trade agreements.

IRS Issues Procedures For Early US CbC Reporting

The Internal Revenue Service (IRS) has issued a Revenue Procedure (RP) providing for US multinational enterprise (MNE) groups to file a Form 8975, Country-by-Country (CbC) Report, for periods that are earlier than the applicability date of its previous regulations.

In June 2016, as part of its efforts to implement the OECD's base erosion and profit shifting (BEPS) project in respect of US taxpayers, the IRS issued final regulations requiring CbC reporting on Form 8975 by US persons that are the ultimate parent entity of an MNE group with revenue of USD850m or more in the preceding accounting year.

While the US reporting requirements apply to all parent entities with taxable years beginning on or after June 30, 2016, the IRS has recognized that, in accordance with OECD recommendations, local CbC reporting from foreign subsidiaries of US MNE groups may be required by other jurisdictions for earlier reporting periods that begin on or after January 1, 2016.

RP 2017-23 discusses the timing and manner of these early filings. It has been decided that, beginning on September 1, 2017, Form 8975 may be filed for an early reporting period at the same time as the income tax return for the taxable year of the US MNE group's ultimate parent entity within which the early reporting period ends.

In order to ensure timely automatic exchange of the information with another jurisdiction for an early reporting period, ultimate parent entities are encouraged to file their Forms 8975 electronically. The IRS intends to provide specific electronic filing information on Form 8975 to the software industry in early 2017.

EU Tells Italy To Reduce Budget Deficit

On January 17, the Italian Minister of the Economy and Finance, Pier Carlo Padoan, received a letter from the European Commission's Vice-President, Valdis Dombrovskis, and Tax Commissioner Pierre Moscovici, in which they said Italy will need to introduce additional budgetary measures for 2017.

They indicated that there is a "significant" risk that Italy will breach its "required adjustment path" under the EU's medium-term budgetary objectives. The letter added that additional budgetary measures "representing at least 0.2 percent" of Italy's gross domestic product, or EUR3.2bn (USD3.4bn), will be required to reduce the fiscal deficit "to broad compliance."

According to the Commission, the Italian Government will need to provide its reply, "with a sufficiently detailed set of specific commitments," by February 1.

While the Government is officially studying its options, Padoan has pointed out that the reasons for the slower-than-expected reduction in Italy's fiscal deficit – global uncertainty and slow economic growth rates – still persist. The Government, he said, is balancing the need for fiscal consolidation with measures to launch an economic recovery.

The Government will be keen to protect the tax cuts contained in its 2017 Budget, which has already received parliamentary approval. For example, a significant corporate tax rate reduction next year, from 27.5 percent to 24 percent, has been part of the Government's tax reform plans for some time.

A reduced business tax rate is also being provided for small businesses, including sole traders and artisans, who are currently taxed under the Italian individual income tax code, while there are increases in the research and development tax credit and the tax deduction for investors in start-ups.

Use Taxes To Redistribute Wealth, Urges Oxfam Report

Governments across the world should make their tax systems "fairer" by tackling tax avoidance and hiking taxes on the wealthy, according to a report by Oxfam.

The charity claimed that eight men now own the same wealth as the poorest half of the world. It also pointed to research by economist Thomas Piketty showing that, over the last 30 years, the incomes of the bottom half of income distribution have remained flat, while the incomes of the top 1 percent have grown 300 percent.

The paper calls for governments to cater for the needs of all of their citizens, rather than the wealthy minority, and for women to be empowered to play a greater role in the global economy.

"We must end the era of tax havens once and for all," Oxfam said. "Countries must cooperate, on an equal basis, to build a new global consensus and a virtuous cycle to ensure corporations and rich people pay fair taxes, the environment is protected, and workers are paid well."

Mark Littlewood, the Director General of the Institute of Economic Affairs in the UK, said the report "demonizes capitalism" and fails to note "the fact that free markets have helped over 100 million people rise out of poverty in the last year alone."

"Their claim that eight people own the same wealth as half the world is as spurious as their methodology – adding assets and subtracting wealth to make 'net wealth' – implies that some of the 'poorest' in the world are those with high debts."

"It is misleading at best to label the average university graduate who has accumulated GBP50,000 (USD61,500) of debt among the world's poorest, without any consideration of their future earning potential," he noted.

"Aggregating net wealth figures is largely meaningless headline fodder. Unfortunately there are some corrupt countries where wealth is accumulated at the expense of the poor but this is a case for tackling big government, not bashing free markets."

Macau Hints At Gaming Tax Reform

Following representations from the gaming industry, Macau's Director of the Gaming Inspection and Coordination Bureau, Paulo Martins Chan, has disclosed the Government is open to reviewing tax on gaming.

Under the specific taxation regime regarding their income from gaming activities, gaming concessionaires are currently subject to a 35 percent tax, calculated on their gross gaming revenue (all revenue derived from casino or gaming areas), and an additional 4 percent in levies for a range of educational and development programs. On average, these taxes account for more than 75 percent of Macau's total annual revenue.

Some stakeholders have suggested that the specific tax should be reduced, so as to remain competitive with other Asian countries, where lower tax regimes are being introduced to attract gamblers. Others recommend a tax differential between high-stakes (so-called VIP) gamblers and the mass market.

Chan said the Government does not, as yet, have any particular plans to change the sector's tax rates, but would consult widely. He added that, in any case, there is plenty of time to reach a decision before the present casino licenses are due for renewal between 2020 and 2022.

South Africa Should Review Sectoral Tax Breaks: World Bank

Reorienting investment tax incentives towards sectors of the South African economy that have high productivity and a comparative advantage would stimulate growth and create additional jobs, according to a recently issued World Bank report.

According to the World Bank, the South African economy is growing modestly. Growth is estimated at 0.4 percent for 2016, and is projected at 1.1 percent and 1.8 percent, respectively, for 2017 and 2018.

The World Bank suggests that encouraging private investment is one area where policy can help to turn around the South African economy and enhance growth. In particular, the report examines the effectiveness, cost, and impact of the investment tax incentives (ITIs) that reduce the tax burden on businesses and are being granted to various economic sectors in the country to encourage additional investment and job creation.

"The current set of ITIs, which the Government has deployed among other policy instruments aimed at promoting industrial development, have not yielded a significant reallocation of private capital toward industrial sectors, nor produced higher industrial employment as expected," the report states. "Instead, private investment has in recent years increasingly gone to less productive sectors, generating negative total factor productivity growth."

World Bank Program Leader Sebastien Dessus said: "What we observe is a negative composition effect since 2012 in which capital went to sectors such as mining, electricity, transport, and other services that recorded a decline in their capital productivity, and away from sectors recording increases in capital productivity, such as agriculture, manufacturing, construction, trade, and finance, thus reducing average capital productivity."

The report argues that reorienting investment tax incentives more in favor of agriculture, manufacturing, construction, trade, and other services would increase job creation at no additional fiscal cost, as, overall, tax incentives have generated additional private investment which has served to at least offset tax revenues foregone.

Egypt Confirms VAT Hike This Year

Egypt's Government has confirmed a plan to increase the value-added tax (VAT) rate later this year under a series of revenue-raising measures.

Finance Minister Amr El-Garhy announced that the rate would increase by 1 percent to 14 percent in July 2017, as the Government seeks additional revenue to cover a large budget deficit. Previously, the Government had indicated the rate would rise from October 1, 2017.

The VAT replaced the 10 percent goods and services tax on September 8, 2016, under a program with the International Monetary Fund that included a lending facility worth USD12bn.

The VAT rate increase forms part of a plan to boost tax revenues and lift Egypt's tax-to-gross domestic product level to 15 percent. Other measures include a planned overhaul of the customs system and income tax increases.

Digital Services Sales Tax Floated In Canada

Canada's ruling Liberal party is reportedly considering levying a consumption tax on digital services purchased from overseas firms.

Broadcasting company CBC said it had obtained via an Access to Information request a briefing note prepared for Heritage Minister Mélanie Joly. Joly last year launched a consultation on "Canadian content in a digital world."

According to CBC, the briefing warned that the lack of tax collection by such companies "not only represents a significant loss of potential tax revenue for government, but it can also place domestic digital suppliers at an unfair competitive disadvantage."

The briefing added: "Specifically, the requirement to charge customers sales tax can make the goods and services of domestic digital businesses more expensive than those of offshore businesses that do not comply with the appropriate sales tax regime."

The briefing did nevertheless warn that, "beyond voluntary compliance, little can be done to enforce a sales tax regime, even when a foreign-based company has registered with the relevant authority." It cautioned that tax authorities have "little recourse where a foreign-based supplier does not remit any sales tax or where there is a dispute over the amount of tax remitted."

The proposals outlined in the briefing note are separate from those to impose a tax on overseas suppliers to fund Canadian content. The Government has repeatedly rejected the latter policy. A spokeswoman told CBC, "Our Government has said there will be no Canadian-content levy on Netflix."

Stamp Duty Hike Cooled Hong Kong Property Market

At a media session on January 16, Hong Kong's Secretary for Financial Services and the Treasury, K. C. Chan, said that the further stamp duty increase introduced in November 2016 has achieved its objective of cooling the city's property market.

"We think the latest round of stamp duty increase has really introduced a period of cooling in the market," he confirmed. "At this point in time, we believe that the latest round of stamp duty has done the job as we intended."

Chargeable on transactions for residential property signed on or after November 5, 2016, a new flat rate of 15 percent was substituted for the 8.5 percent ad valorem stamp duty. On its introduction, it was stated that the stamp duty hike was intended "to address the overheated residential property market and to guard against a further increase in the risks of a housing bubble" in Hong Kong.

Hong Kong Eyeing Policies To Boost Growth

Hong Kong's Chief Executive, C. Y. Leung, has explained how the territory aims to boost growth opportunities, including through the use of tax breaks.

Leung outlined plans to strengthen collaboration with Mainland China in his 2017 Policy Address delivered on January 18. With "China playing an increasingly prominent and leading role in the global economy," he said, "Hong Kong's dual advantages of 'one country' and 'two systems' and its role as the 'super-connector' are becoming more apparent. Leveraging the National 13th Five-Year Plan and the Belt and Road Initiative, Hong Kong enjoys endless opportunities" in new markets.

He said Hong Kong intends to further expand and enhance the Closer Economic Partnership Arrangement (CEPA) trade treaty with the Mainland. The liberalization of trade in services was achieved last year, and it is planned that, this year, the CEPA will be extended into the areas of investment, and economic and technical cooperation.

In addition, he said developments in China's free trade zones, particularly in Qianhai and Hengqin in Guangdong province (the closest to Hong Kong), are of particular interest and may open up opportunities for collaboration.

Leung also singled out the work being done by the Financial Services Development Council (FSDC), which has, over the past four years, released 26 reports that have put forward an array of recommendations on the sustainable

development of Hong Kong's financial market and financial services sector. He confirmed that "the Government will actively consider the recommendations on taxation, laws and regulations, nurturing talent, *etc.*, and implement the feasible measures."

The FSDC's most recent report looked at the tax changes the Government could introduce so as to promote Hong Kong as a preferred location for international financial product origination and trading centers. It suggested amending the city's interest deductibility rules so that interest expense paid by a company licensed by Hong Kong's Securities and Futures Commission should also qualify for a tax deduction in the same way as a bank.

Leung noted that such enterprises "create new impetus for economic and social development. Hong Kong's application of innovation and technology notably trails the Mainland in various aspects. Facing competitors, Hong Kong must consider how to enhance its overall competitiveness, including offering tax and financial concessions, to attract enterprises from Hong Kong, the Mainland, and overseas."

India Releases Final Guidance On POEM

India's Central Board of Direct Taxes (CBDT) has published final guidelines on determining whether a company is tax resident in India through the "place of effective management" (POEM) test.

In the 2015 Finance Act, India amended Section 6(3) of its Income-tax Act to provide that a company will be tax resident in India in any previous year if it is an Indian company; or its POEM in that year is in India. POEM is defined to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance, made.

The amendment is aimed at preventing companies from artificially escaping tax resident status in India. Prior to its amendment, Section 6 provided that a company is resident in India in any previous year if it is an Indian company or if during that year, the control and management of its affairs is situated wholly in India.

In December 2015, the CBDT issued for stakeholders comments draft guidelines on POEM to clarify the meaning of several terms connected with determining POEM.

The final guidelines, which were released on January 24, 2017, incorporates the views put forward by stakeholders during the consultation process and is said to contain some unique features. The final guidelines provide for an "active business outside India" test, which waives the POEM test if passed. According to the CBDT, the intent of POEM is not to target Indian multinationals engaged in business activity outside India; rather, it is to target shell companies and other companies that are created for retaining income outside India even though real control and management of affairs are located in India.

The CBDT said: "It is emphasized that these guidelines are not intended to cover foreign companies or to tax their global income, merely on the ground of presence of Permanent Establishment or business connection in India."

The CBDT said adequate administrative safeguards have been incorporated into the guidelines, to ensure that a proposed change to a company's POEM is first signed off by upper management.

Last, it has been clarified that the POEM test will not apply to companies having turnover or gross receipts of INR500m (USD7.3m) or less in a given financial year. The guidelines contain illustrations to explain situations where POEM will or will not apply.

The law providing for the POEM test became effective on April 1, 2016, and will apply from the 2017/18 assessment year.

IRS Issues Final Regulations On REIT Spin-Offs

On January 18, the US Internal Revenue Service (IRS) issued its final regulations regarding the measures included in the Protecting Americans from Tax Hikes (PATH) Act to restrict tax-free spin-offs involving publicly traded real estate investment trusts (REITs).

US REITs do not pay corporate tax so long as at least 75 percent of their total assets are real estate assets and/or cash; at least 75 percent of gross income comes from real estate-related sources; and at least 90 percent of their taxable income is distributed to shareholders annually in the form of dividends.

Prior to the PATH Act, more American corporations were encouraged to consider spinning-off assets into REITs, when the IRS began to accept that non-traditional real estate assets (such as warehouses, shopping centers, health care facilities, and telecommunication assets) could be held in a REIT.

Such spin-offs are capital gains tax-free for both the distributing corporations and their shareholders, and enable them to limit their exposure to the US's 35 percent corporate tax rate. Subsequently, REITs normally lease the property back to the distributing corporations, to be utilized in the latter's operations.

However, the PATH Act laid down that a spin-off involving a REIT will qualify as tax-free only if, immediately after the distribution, both the distributing and controlled corporations are REITs.

The only change that the IRS made in its final regulations was to reduce the "recognition period" – the length of time during which a REIT could still be subject to capital gains and corporate income taxes on certain dispositions of property – to five years from the ten years it had originally imposed.

On October 18, 2016, the Chairmen and Ranking Members of the House of Representatives Ways and Means Committee and the Senate Finance Committee had written to the Treasury Secretary that the ten-year recognition period introduced unilaterally by the IRS in its temporary regulations "was inconsistent with congressional intent and the longstanding practice of treating REITs as having the same built-in gain recognition period as S corporations, currently five years."

Report On BEPS Project's Impact On Real Estate Firms

The UK-based Royal Institution of Chartered Surveyors has released a paper on how

the OECD's base erosion and profit shifting (BEPS) recommendations will impact the real estate sector.

While referring specifically to legislative changes in the UK, the paper also recognizes the wider global effects of the BEPS recommendations in this sector, such as through tax treaties.

The paper claims that the recommendations were not designed with the property industry in mind. Discussing the proposals on interest deductions, it states: "When computing the taxable profits of an enterprise, interest costs are generally deductible for tax purposes. However, revised interest deductibility rules suggest limiting interest deductions to no more than 30 percent of earnings before interest, tax, depreciation, and amortization (EBITDA) (with potential carve outs if overall external leverage for the group is higher). This is clearly well below the interest payable on the level of gearing that a typical investor could hope to obtain from a bank when the loan is secured against real estate."

The paper notes that under revised rules on preventing treaty abuse, "claimants will be asked to demonstrate that they are conducting an active business or to establish that none of the reasons (not necessarily the dominant one) for creating the structure was to obtain treaty benefits [with the condition, in OECD guidance, that such can be prevented only when granting the treaty advantages 'would be contrary to the object and purpose of the relevant clauses of the tax convention']. The OECD has recognized that investment funds may create special cases, but unless any specific treaty exemptions are widely drawn this could mean that the tax costs of many real estate funds could rise significantly over the coming years, having a significant impact on returns."

The paper stresses that hybrid instruments are used quite widely in the context of real estate funds, and in some cases the proposed introduction of hybrid mismatch rules will likely lead to higher levels of tax and lower returns.

The paper also recommends actions from professionals whose area of practice may be affected as a result of BEPS-related changes. It states: "Real estate fund managers and investors should review their current structures to identify any hybrid instruments or entities that are currently in place, and consider risk areas in light of these proposals. They should then monitor the implementation of these proposals across all relevant countries. Fund managers should be sure they understand their potential exposures, and what alternatives may be available to mitigate the impacts of the changes. As the proposals have yet to be finalized, they should also be making sure that their views are heard during consultations to ensure that the final rules are fair and workable for all parties."

AUSTRALIA - GERMANY

Effective

The provisions of the new DTA between Australia and Germany became effective on January 1, 2017.

BELARUS - HONG KONG

Signature

Belarus and Hong Kong signed a new DTA on January 16, 2017.

CANADA - ISRAEL

Effective

The new DTA between Canada and Israel became effective on January 1, 2017.

CANADA - SWITZERLAND

Effective

A TIEA between Canada and Switzerland for the automatic exchange of information in tax matters came into effect on January 1, 2017.

CYPRUS - RUSSIA

Negotiations

During recent negotiations, Cyprus and Russia agreed to postpone the implementation of a Protocol to their DTA.

CZECH REPUBLIC - CHILE

Into Force

The DTA between the Czech Republic and Chile entered into force on December 21, 2016, the Czech Ministry of Finance announced on December 27, 2016.

GUERNSEY - UNITED KINGDOM

Into Force

A Protocol to Guernsey and the UK's DTA entered into force on December 6, 2016, the UK Government confirmed on January 4, 2017.

INDIA - CYPRUS

Effective

The revised DTA between India and Cyprus will take effect from April 1, 2017.

INDIA - KAZAKHSTAN

Signature

India and Kazakhstan signed a DTA Protocol on January 6, 2017.

INDIA - SINGAPORE

Signature

India and Singapore signed a DTA Protocol on December 30, 2016.

INDIA - TAJIKISTAN

Forwarded

India's Cabinet on December 14, 2016, approved a DTA Protocol with Tajikistan.

JERSEY - UNITED KINGDOM

Into Force

The DTA Protocol between Jersey and the UK entered into force on December 2, 2016, the UK Government announced on January 5, 2017.

KAZAKHSTAN - SLOVENIA

Ratified

Kazakhstan's Senate on December 29, 2016, ratified the new DTA with Slovenia.

KUWAIT - INDIA

Signature

According to preliminary media reports, Kuwait and India signed a DTA Protocol on January 14, 2017.

SWITZERLAND - VARIOUS

Effective

Switzerland's revised DTAs with Albania and Norway became effective on January 1, 2016.

SWITZERLAND - VARIOUS

Effective

Switzerland's TIEAs with Belize and Grenada became effective from January 1, 2017.

TAIWAN - POLAND

Effective

A DTA and Protocol between Taiwan and Poland became effective on January 1, 2017.

UNITED KINGDOM - ISLE OF MAN

Into Force

The DTA Protocol between the UK and the Isle of Man entered into force on November 29, 2016, the UK Government announced on January 5, 2017.

UNITED KINGDOM - URUGUAY

Effective

The UK Government on January 12, 2017, confirmed that the new DTA with Uruguay became effective on that date.

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

THE AMERICAS

International Tax Issues 2017

2/7/2017 - 2/7/2017

PLI

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

Chair: Michael A. DiFronzo (PwC)

http://www.pli.edu/Content/Seminar/International_Tax_Issues_2017/_/N-4kZ1z10p5l?ID=288687

Consolidated Tax Return Regulations 2017

2/13/2017 - 2/14/2017

Practising Law Institute

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

Chair: Mark J. Silverman (Steptoe & Johnson LLP)

http://www.pli.edu/Content/Seminar/Consolidated_Tax_Return_Regulations_2017/_/N-4kZ1z10p5i?ID=288681

The Leading Forum For Transfer Pricing Professionals in the US and Beyond

2/21/2017 - 2/22/2017

Informa

Venue: The Biltmore Hotel, Miami, 1200 Anastasia Ave, Coral Gables, FL 33134, USA

Key speakers: Matthew Frank (General Electric), Brandon de la Houssaye (Walmart), Brian Trauman (KPMG), Katherine Amos (Johnson & Johnson), Michael Cartusciello (JP Morgan), among numerous others

https://finance.knect365.com/tp-minds-americas-conference/

IFA USA 45th Annual Conference

2/22/2017 - 2/23/2017

IFA

Venue: Waldorf Astoria, 301 Park Ave, New York, NY 10022, USA

Key speakers: TBC

http://www.ibfd.org/IBFD-Tax-Portal/Events/IFA-USA-45th-Annual-Conference#tab_program

The 6th Offshore Investment Conference Panama

3/8/2017 - 3/9/2017

Offshore Investment

Venue: Hilton Panama, Esquina de Avenida Balboa y Aquilino de la Guardia, Av Balboa, Panama

Key speakers: TBC

http://www.offshoreinvestment.com/pages/index.asp?title=The_6th_Offshore_Investment_Conference_Panama_2017&catID=14286

Hot Issues in International Taxation

3/29/2017 - 3/30/2017

Bloomberg BNA

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

Key Speakers: TBC

https://www.bna.com/hot-issues_arlington2017/

International Tax and Estate Planning Forum: Around the Globe in 2017

5/4/2017 - 5/5/2017

STEP

Venue: Surf & Sand Resort, 1555 South Coast Highway, Laguna Beach, CA, USA

Key speakers: TBC

http://www.step.org/events/international-tax-and-estate-planning-forum-around-globe-2017

Transcontinental Trusts: International Forum 2017

5/4/2017 - 5/5/2017

Informa

Venue: The Fairmont Southampton, 101 South Shore Road, Southampton, SN02, Bermuda

Key speakers: TBC

http://www.iiribcfinance.com/event/transcontinental-trusts-bermuda

STEP Miami 8th Annual Summit

5/19/2017 - 5/19/2017

STEP

Venue: Conrad Miami Hotel, 1395 Brickell Avenue, Miami, 33131, USA

Key Speakers: TBC

http://www.step.org/events/step-miami-8th-annual-summit-19-may-2017

16th Annual International Mergers & Acquisitions Conference

6/6/2017 - 6/7/2017

International Bar Association

Venue: Plaza Hotel, 768 5th Ave, New York, NY 10019, USA

Key Speakers: TBC

http://www.ibanet.org/Conferences/conf774.aspx

10th Annual US–Latin America Tax Planning Strategies

6/14/2017 - 6/16/2017

American Bar Association

Venue: Mandarin Oriental Miami, 500 Brickell Key Dr Miami, FL 33131-2605, USA

Key speakers: TBC

http://shop.americanbar.org/ebus/ABAEventsCalendar/EventDetails.aspx?productId=264529724

ASIA PACIFIC

The 5th Offshore Investment Conference

2/8/2017 - 2/9/2017

Offshore Investment

Venue: Fairmont, 80 Bras Basah Rd, 189560, Singapore

Key Speakers: TBC

http://www.offshoreinvestment.com/pages/index.asp?title=The_5th_Offshore_Investment_Conference_Singapore_2017&catID=13805

International Taxation of Expatriates

4/3/2017 - 4/5/2017

IBFD

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

Key Speakers: TBC

http://www.ibfd.org/Training/International-Taxation-Expatriates-2

MIDDLE EAST AND AFRICA

3rd IBFD Africa Tax Symposium

5/10/2017 - 5/12/2017

IBFD

Venue: Labadi Beach Hotel, No. 1 La Bypass, Accra, Ghana

Key speakers: TBC

http://www.ibfd.org/IBFD-Tax-Portal/Events/3rd-IBFD-Africa-Tax-Symposium#tab_program

WESTERN EUROPE

Private Client Property Tax 2017

1/26/2017 - 1/26/2017

Informa

Venue: TBC, London, UK

Chair: Robert Smeath (New Quadrant Partners)

https://finance.knect365.com/private-client-property-tax/agenda/1

6th Annual IBA Tax Conference

1/30/2017 - 1/31/2017

International Bar Association

Venue: TBC, London, UK

Key Speakers: TBC

http://www.ibanet.org/Conferences/conf779.aspx

Global Transfer Pricing Conference

2/22/2017 - 2/24/2017

WU Transfer Pricing Center at the Institute for Austrian and International Tax Law

Venue: WU (Vienna University of Economics and Business), Welthandelsplatz 1, 1020 Vienna, Austria

Key speakers: Krister Andersson (Lund University, Joe Andrus (OECD), Piero Bonarelli (UniCredit), Melinda Brown (OECD), among numerous others

https://www.wu.ac.at/fileadmin/wu/d/i/taxlaw/institute/transfer_pricing_center/TP_Conf/Global_TP_Conference_2017_-_Brochure_19.8..pdf

Tax Planning for Entertainers and Sports Stars 2017

2/23/2017 - 2/23/2017

Informa

Venue: TBC, London, UK

Chair: Patrick Way (Field Court Tax Chambers)

https://finance.knect365.com/tax-planning-for-entertainers-sports-stars/

Principles of International Taxation

2/27/2017 - 3/3/2017

IBFD

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

Key speakers: TBC

http://www.ibfd.org/Training/Principles-International-Taxation

Landed Estates 2017

2/28/2017 - 2/28/2017

Informa

Venue: TBC, London, UK

Chair: Rhoddy Voremberg (Farrer & Co)

https://finance.knect365.com/landed-estates/

The 15th Annual Definitive Permanent Establishment & BEPS Mastercourse

3/1/2017 - 3/1/2017

Informa

Venue: TBC, London, TBC

Chair: Jonathan Schwarz (Temple Tax Chambers)

https://finance.knect365.com/permanent-establishment-beps-masterclass/

BEPs Action 15 – Multilateral Convention

3/2/2017 - 3/2/2017

Informa

Venue: TBC, London, UK

Chair: Jonathan Schwarz (Temple Tax Chambers)

https://finance.knect365.com/multilateral-convention-beps-action-15/

22nd Annual International Wealth Transfer Practices Conference

3/6/2017 - 3/7/2017

International Bar Association

Venue: Claridge's, Brook Street, London, W1K 4HR, UK

Key speakers: TBC

http://www.ibanet.org/Conferences/conf771.aspx

TP Minds International

3/6/2017 - 3/9/2017

Informa

Venue: Hilton London Bankside, 2-8 Great Suffolk St, London, SE1 0UG, UK

Chair: Ruth Steedman (FTI Consulting)

https://finance.knect365.com/tp-minds-international-conference/agenda/1

2nd International Conference on Taxpayer Rights

3/13/2017 - 3/14/2017

The Institute for Austrian and International Tax Law

Venue: TBC, Vienna, Austria

Key Speakers: TBC

https://www.wu.ac.at/fileadmin/wu/d/i/taxlaw/eventsn/ITRC_RegistrationFlyer_101216.pdf

International Trust & Private Client Guernsey

3/21/2017 - 3/21/2017

Informa

Venue: TBC, Guernsey

Chair: Paul Hodgson (Butterfield Trust (Guernsey) Limited)

https://finance.knect365.com/international-trust-private-client-guernsey/

International Trust & Private Client Jersey

3/23/2017 - 3/23/2017

Informa

Venue: TBC, Jersey

Chair: Julian Washington (RBC Wealth Management)

https://finance.knect365.com/international-trust-private-client-jersey/

International Tax, Legal and Commercial Aspects of Mergers & Acquisitions

3/29/2017 - 3/31/2017

IBFD

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

Key Speakers: Frank de Beijer (Liberty Global Plc Amsterdam HQ), Hugo Feis (ABN AMRO), Bart Weijers (PwC), Rens Bondrager (Allen & Overy LLP), among numerous others

http://www.ibfd.org/Training/International-Tax-Legal-and-Commercial-Aspects-Mergers-Acquisitions

International Tax Aspects of Permanent Establishments

4/4/2017 - 4/7/2017

IBFD

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

Key Speakers: TBC

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

Global Tax Treaty Commentaries Conference

5/5/2017 - 5/5/2017

IBFD

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

Key speakers: Prof. John Avery Jones, Dr Philip Baker (QC Field Court Tax Chambers), Prof. Dr Michael Beusch (Federal Administrative Court), Prof. Mike Dolan (IRS Policies and Dispute Resolution and KPMG), among numerous others

http://www.ibfd.org/IBFD-Tax-Portal/Events/Global-Tax-Treaty-Commentaries-Conference#tab_program

WESTERN EUROPE

France

A listing of recent key international tax cases.

The European Court of Human Rights has endorsed the decision of French authorities to compel UBS to put up a EUR1.1bn (USD1.16bn) security in its case against the bank concerning alleged tax fraud.

In its January 12 decision, the Court declared UBS's application inadmissible. The decision is final.

The ruling concerns a sum of EUR1.1bn required by way of security in the context of the court supervision of the bank, which was placed under formal investigation for illegal direct selling of banking products and aggravated laundering of the proceeds of tax fraud.

The Court noted that the security was intended to ensure the presence of the party under investigation for all the steps of the proceedings and for execution of the judgment, as well as payment of the fines and reparation for the damage caused.

In its judgment in favor of the French authorities, the Court noted the "growing and legitimate concern both in Europe and internationally in relation to financial offences, which constituted socially unacceptable behavior, and the difficulty of combating such offences." It stressed that in the present case, firstly, the security constituted an interim measure which did not prejudge the outcome of the proceedings, as the sum paid would be returned at the end of the proceedings if the person concerned was not convicted.

Secondly, it explained that the amount of the security had been assessed by the investigating judges and by the Investigation Division, using particularly thorough reasoning, on the basis of the findings of the investigations, the alleged facts, the scale of the offenses and the potential harm, and the amount of the fine payable in the event of a conviction. The assessment had also been based explicitly on the applicant bank's resources.

Lastly, the Court found that the bank had been afforded adequate procedural safeguards, as it had been able to make use of the remedies provided for by domestic law in order to challenge the decision in question and to debate in adversarial proceedings the factors taken into consideration by the judges, first before the Court of Appeal and then before the Court of Cassation.

Accordingly, the Court found that the interference to UBS had not been disproportionate and that a fair balance had been struck. In addition, it stated that UBS had not exhausted potential domestic remedies to the dispute before bringing a case before the Court.

http://hudoc.echr.coe.int/eng-press#

European Court of Human Rights: *UBS AG v. France (application no. 29778/15)*

France

The French Constitutional Court has ruled that legislation for a UK-style diverted profits tax (DPT) in France is unconstitutional.

According to the ruling, released by the Court in French on December 29, the method by which the French tax authority would apply the DPT was insufficiently detailed in the legislation and therefore gave the tax authority too much discretion in a company tax audit.

As a result, the provision violated Article 34 of the French Constitution, which stipulates that statutes must determine "the base, rates, and methods of collection of all types of taxes."

The law formed part of the 2017 Finance Bill approved by parliament last month. Based partly on the UK DPT, it would have allowed the tax authority to impose corporate tax on profits deemed to have been artificially diverted from France with the intention of avoiding tax, irrespective of whether the company was established inside or outside France.

The tax was due to be introduced on January 1, 2018.

http://www.conseil-constitutionnel.fr/conseil-constitutionnel/francais/les-decisions/acces-par-date/decisions-depuis-1959/2016/2016-744-dc/decision-n-2016-744-dc-du-29-decembre-2016.148423.html (*in French*)

French Constitutional Court: *Decision No. 2016-744 DC*

Gibraltar

An EU Advocate General (AG) has opined that the UK and Gibraltar should be considered "one entity" in a case regarding the applicability of UK gambling duties.

The Gibraltar Betting and Gaming Association (GBGA) is challenging the gambling tax regime introduced by the UK Government in 2014. The UK requires gambling service providers to pay a gambling duty in respect of services provided to UK persons, regardless of whether the provider is located in the UK or another country. The GBGA claims that the tax is contrary to the freedom to provide services established in Article 56 of the Treaty on the Functioning of the European Union (TFEU).

AG Maciej Szpunar stated that the question of whether or not Article 56 can be invoked in this case hinges on whether Gibraltar and the UK are considered part of the same EU member state, and if the dispute is a "purely internal situation."

According to the AG, the European Court of Justice "should hold that, for the purposes of Article 56 TFEU, Gibraltar and the UK are to be treated as one entity." Should the Court find otherwise, AG Szpunar argued, "the provisions of the new tax regime which are contested … should not be regarded as a restriction on the freedom to provide services, given that they apply without distinction and on a non-discriminatory basis to gambling service providers located in the UK and elsewhere."

The opinion was issued on January 19, 2017.

http://curia.europa.eu/juris/document/document.jsf;jsessionid=9ea7d0f130d6608787cc6ce246e38919f5d89e906500.e34KaxiLc3eQc40LaxqMbN4PaheTe0?text=&docid=186974&pageIndex=0&doclang=en&mode=req&dir=&occ=first&part=1&cid=780080

European Court of Justice: *Gibraltar Betting and Gaming Association Ltd v. HMRC (Case C-591/15)*

European Union (EU)

According to an opinion delivered by Advocate General Campos Sánchez-Bordona on January 12 to the European Court of Justice (ECJ), Italy should not be precluded from taking both criminal and administrative action following a taxpayer's failure to pay value-added tax (VAT).

He noted a previous ECJ judgment which established a person's right not to be tried twice for a single breach of the obligation to pay VAT, and observed that this has created difficulties in the

courts of some member states, such as Italy, where the tax code provides for both administrative and criminal penalties regarding the same VAT non-payment.

However, in his opinion, AG Sánchez-Bordona argued that EU law does not preclude Italy from filing criminal charges against the individual representative of a company that is already subject to an administrative penalty for its failure to pay.

He proposed that the ECJ should indicate to the Italian courts that its previous judgment is not applicable "where there are two sets of proceedings in respect of the same offense and the [administrative] tax penalties are imposed on a legal person, such as a company, while the criminal proceedings are brought against a natural person, even if that person is the legal representative of the company."

http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62015CC0217

European Court of Justice: *Italian Tax Authorities v. Massimo Orsi et al. (C-217/15 and C-350/15)*

United Kingdom

The UK Supreme Court on January 24, 2017, ruled that Parliament must approve the Government's plan to trigger Article 50 to exit the EU.

It stated that Theresa May cannot use her executive powers as Prime Minister to automatically trigger Article 50 and launch the two-year separation process, upon which in-depth negotiations with the EU will begin.

The Supreme Court did not, however, require that lawmakers in Scotland, Northern Ireland, and Wales must also pass the necessary legislation, in a blow to those hoping that a Brexit could be avoided *via* that path.

The announcement could delay May's aim to trigger Article 50 by March, however. Opposition lawmakers may now seek to dictate to some extent the path the UK will take in the future, with May saying recently the UK would divorce itself from the Single Market, which is likely to have far-reaching consequences in a number of areas.

https://www.supremecourt.uk/cases/docs/uksc-2016-0196-judgment.pdf

UK Supreme Court: *Miller v. Secretary of State for Exiting the European Union ([2016] EWHC 2768 (Admin) and [2016] NIQB 85)*

Dateline January 26, 2017

For all the anticipation, last week's revelation by Prime Minister Theresa May that the **United Kingdom** is headed for a "hard Brexit" wasn't quite the seismic shock it perhaps should have been. People have had so long to ruminate on all the myriad possibilities for the UK's post-Brexit relations with the EU that most have concluded that if out is to truly mean out, then hard Brexit it has to be. But at least we know now.

As the **European Union**'s most influential figures have been insisting for the last six months, membership of the Single Market and the "four freedoms" that go with it are indivisible: you can't have one without the others. Otherwise, it would be a double market, or a triple, or a quadruple market, which defeats the whole purpose of the thing. It became fairly obvious early on that a "soft Brexit" (*i.e.*, the UK's continued membership of the Single Market) would necessarily entail continued interference – as Leave supporters perceive it – by the EU in the UK's political, economic, legislative, and social affairs. At the same time, the UK's influence in the EU would be substantially diminished, yet it would still have to stump up membership fees. In other words, the worst of all worlds if you are a Leaver, and certainly not what the (albeit slender) majority of voters wanted.

Hard Brexit means there are going to be advantages and disadvantages for UK taxation once the deal is done. On the one hand, the government of the day will have a lot more freedom over **tax policy**. There will be no more worrying about state aid or discriminating against taxpayers from EU countries (in theory). Therefore, the UK will have much more scope to offer tax incentives (as long as they're not "harmful").

But disentangling the UK tax system from the EU is going to be no easy task. Think about all the **EU legislation and regulations** that have been transposed into UK law over the past four decades, not to mention the thousands of pages of **case law** issued by the EU courts. How will these be dealt with in the negotiations? How long will EU case law continue to apply in the UK? And will the UK seek to repeal EU-related law wholesale, bit by bit, or, in the interests of stability, not at all? And we haven't even mentioned **value-added tax** yet, the only tax which is "harmonized" at EU level. For UK taxpayers, the future either looks very exciting, or really quite scary. I haven't quite made up my mind which.

Another predictable event occurred in **India** last week. Yes, you've guessed it, the routine delay to the incoming **goods and services tax**.

If India's GST reforms were a train, those on board could be forgiven for thinking that there is no destination, that the tracks must stretch on infinitely, and that they are destined never to leave their coach. However, there have been some encouraging sights sliding past the windows recently.

That the constitutional amendment bill, required to levy **GST on services**, was passed at all was a major milestone last year. And the GST Council appears to have made swift progress towards settling some of the most important rules, such as **GST rates** and **registration thresholds**.

But perhaps the Central Government created a rod for its own back by insisting that GST be ready in time for April 2017. To roll out such a vital reform the length and breadth of India is going to take time, so perhaps a more realistic deadline should have been set after the passage of the GST legislation of, say, two or three years. Taxpayers have got used to waiting after all, but the litany of broken deadlines hasn't exactly done wonders for the credibility of governments past and present. I hope, for India's sake, I am proven wrong, and we're not back here in June discussing yet another GST deferment.

Last, but certainly not least, is **President Donald Trump**'s policies on trade, which are – and I'm reaching for a diplomatic description here – shall we say, robust. Indeed, some commentators believe the world is on the brink of a **trade war**. And they would have been emboldened in their view by the news that **Mexico** would quickly retaliate against any tariffs applied to its exports by the US. Others, however, are less pessimistic. The International Monetary Fund, for one, believes that Trump would be unlikely to follow through with his border tax threat because much of the damage it could cause would be self-inflicted.

In another interesting development, **China** indicated that it would turn the other cheek against any form of border tax on its goods, even going so far as to say that it would be the world's leading example of a freely trading nation.

Trump's tariffs may also not materialize any time soon because of internal political wrangling within the Republican Party, with two rival **border tax** ideas on the table. The so-called border adjustment tax advocated in the tax reform blueprint signed off by House Speaker Paul Ryan last year is a markedly different approach to Trump's, and some say it would effectively usher in a form of **value-added taxation** into the United States for the first time. But Trump, who finally

broke his silence on the matter last week, is not a fan. He agrees with those observers who surmise that the border adjustment tax is an overly complicated way to achieve what are in effect the same goals as his proposed tariffs.

Judging by their recent comments, and notably those from House Ways and Means Committee Chairman Kevin Brady, the Republican leadership in the House sees the border adjustment tax as a cornerstone of comprehensive **business tax reform**. That Trump demonstrably doesn't share this view suggests that we could be in for a period of stalemate on tax reform. Another period of stalemate, that is.

The Jester